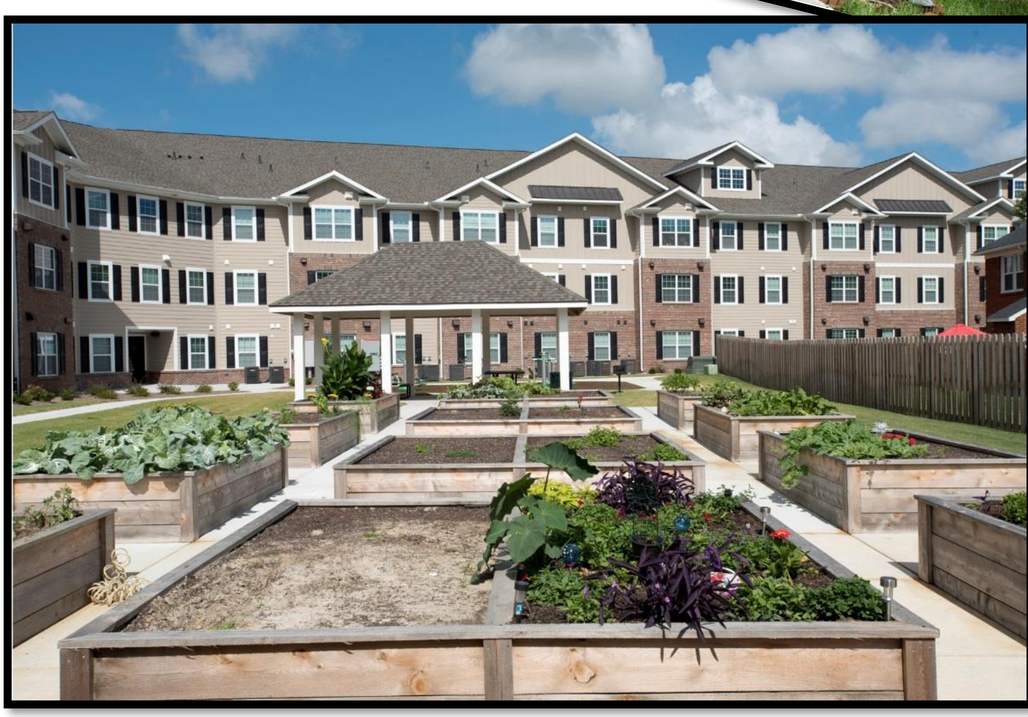
# Audited Financial Statements

June 30, 2017



# NORTH CAROLINA HOUSING FINANCE AGENCY
# FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
# FOR THE YEAR ENDED JUNE 30, 2017

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## FINANCIAL STATEMENTS



## SUPPLEMENTARY INFORMATION

**MANAGEMENT DISCUSSION AND ANALYSIS (*Unaudited*)**
**June 30, 2017**

The management discussion and analysis of the North Carolina Housing Finance Agency's financial performance provides an overview of its financial activities for the fiscal year ended June 30, 2017. The financial statements, accompanying notes, and supplementary information should be read in conjunction with the following discussion.

## Overview

The North Carolina Housing Finance Agency (Agency) was created in 1973 to provide financing for residential housing, both ownership and rental, to North Carolina households with low and moderate incomes. The Agency issues bonds and sells mortgage-backed securities (MBS) on the secondary market to finance housing throughout the State of North Carolina (State). In addition, the Agency administers the US Department of the Treasury's (Treasury) Hardest Hit Fund (HHF), the Section 8 program, the HOME Investment Partnerships Program (HOME), Low-Income Housing Tax Credits (LIHTC), the North Carolina Housing Trust Fund (HTF) and other federal and state programs. These programs provide different types of assistance such as down payment assistance, low-interest mortgage loans, foreclosure prevention mortgage assistance, foreclosure prevention counseling, rent subsidies, and various types of rehabilitation of both single and multifamily properties.

## Financial Highlights

The following information is an analysis of the Agency's performance for the year ended June 30, 2017, compared to the prior fiscal year's results and activities:

- *Total Assets* increased $318,023,000, or 23.0%
- *Deferred Outflows of Resources* decreased $49,000, or 0.8%
- *Total Liabilities* increased $280,404,000, or 39.9%
- *Deferred Inflows of Resources* decreased $1,504,000, or 25.3%
- *Total Net Position* increased $39,074,000, or 5.7%

The Agency issued tax-exempt bonds in November and June of fiscal year 2017 to finance a portion of NC Home Advantage (HomeAd) mortgage loans, which were securitized into MBS. These transactions caused an increase in *Investments* and *Bonds payable, net* as well as other related accounts. Proceeds from the bond series issued in June 2017 are primarily responsible for the increase in *Cash and cash equivalents.* Overall increases in HomeAd production caused an increase in *Nonfederal program expense*, which reflects down payment assistance expense and lender compensation. In addition, the Agency started a new arrangement with its master servicer to purchase a portion of the HomeAd loans to hold until the time of MBS securitization; these mortgage loans are reflected in a new account called *Mortgage loans held for resale*. These transactions are primarily responsible for the increases in the accounts below:

- *Cash and cash equivalents* increased $235,087,000, or 56.1%
- *Investments* increased $204,589,000, or 217.0%
- *Mortgage loans held for resale* increased $23,341,000, or 100.0%
- *Bonds payable, net* increased $241,446,000, or 37.8%
- *Interest on investments* increased $1,051,000, or 15.1%
- *Net increase in fair value of investments* increased $3,114,000, or 135.2%
- *Nonfederal program expense* increased $4,836,000, or 23.1%

*Program income/fees* increased $7,212,000, or 10.8%, for a variety of reasons including a $3.9 million increase in payoffs related to subordinate loans, a $1.4 million increase in tax credit application fees, and a $1.7 million increase in administrative fees primarily related to HOME, Section 8 and HHF.

While the production for HomeAd loans continues to increase, the Agency's balance of FirstHome mortgage loans continues to decrease as homeowners sell or refinance their homes. As a result, fiscal year 2017 continued to see a decrease in *Mortgage loans receivable, net* and related accounts. *Other expenses* decreased primarily as a result of decreases in foreclosures due to market improvement. The impact of these items is reflected below:

- *Mortgage loans receivable, net* decreased $112,484,000, or 13.7%
- *Accrued interest receivable on mortgage loans* decreased $1,359,000, or 22.2%
- *Interest on mortgage loans* decreased $5,548,000, or 12.9%
- *Mortgage servicing expense* decreased $281,000, or 11.6%
- *Other expenses* decreased $771,000, or 29.5%

Interest rates increased significantly and the Agency terminated one of its swaps in fiscal year 2017, the combined effect of which caused a decrease in the *Derivative instrument – interest rate swap* and *Accumulated decrease in fair value of hedging derivative*:

- *Accumulated decrease in fair value of hedging derivative* decreased $2,501,000, or 48.3%
- *Derivative instrument – interest rate swap* decreased $2,501,000, or 48.3%

*Unearned revenues* increased as a result of the timing of draws made on the HHF in fiscal year 2017. An $8.3 million increase in HOME spending and an $11.9 million increase in HHF spending during the fiscal year account for the majority of the increase in *Federal program awards received.* Of these amounts, $6.2 million was spent on amortizing mortgage loans, which accounts for the smaller increase in *Federal program expense* relative to *Federal program awards received*:

- *Unearned revenues* increased $35,448,000, or 96.3%
- *Federal program awards received* increased $19,299,000, or 8.2%
- *Federal program expense* increased $12,338,000, or 5.2%

The State Tax Credit (STC) expired on January 1, 2015, and was replaced by the Workforce Housing Loan Program (WHLP), resulting in a decrease to *State receivables*. *State program expense* experienced a net decrease, which is attributable to a $12 million decrease in remaining program disbursements for the STC, a $4 million increase in spending for WHLP and other programs, and a $4.7 million increase in spending on the Key Rental Assistance (Key) program. *State appropriations received* increased primarily due to the receipt of $20 million in disaster recovery funding after Hurricane Matthew and other natural disasters, as well as a $7.5 million increase in the WHLP appropriation over the prior year:

- *State receivables* decreased $30,715,000, or 99.6%
- *State appropriations received* increased $29,041,000, or 134.3%
- *State program expense* decreased $4,613,000, or 6.2%

*Deferred state grant* primarily represents funds transferred from the North Carolina Department of Health and Human Services (DHHS) related to the Community Living Housing Fund (CLHF), which must be appropriated by the North Carolina State General Assembly (General Assembly) for disbursement. As authorization occurs, the amounts are reclassed from *Deferred state grant* to *State grants received.* The impact of these transactions resulted in changes to the following items:

- *Deferred state grant* decreased $1,299,000, or 23.5%
- *State grants received* increased $3,381,000, or 34.5%

In fiscal year 2015, the Agency implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68). Under GASB 68, the Agency is allocated its proportionate share of the Teachers' and State

Employees' Retirement System of North Carolina's net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense. The fiscal year 2017 increase and decrease in *Deferred outflows for pensions* and *Deferred inflows for pensions*, respectively, reflect changes in the Agency's portion of the State's pension. Additionally, the increase in *Other liabilities* results from $2.8 million related to insurance claims reserved for Hurricane Matthew damage and a $2.7 million increase related to the Agency's net pension liability. The increase in *General and administrative expense* relates primarily to increases in contractor, salary, and pension costs associated with the Agency's various initiatives, including CLHF and HHF. The effect of these transactions is listed below:

- *Deferred outflows for pensions* increased $2,452,000, or 311.2%
- *Deferred inflows for pensions* decreased $205,000, or 48.5%
- *Other liabilities* increased $5,166,000, or 74.1%
- *General and administrative expense* increased $5,433,000, or 22.9%

The net effect of the transactions detailed above, along with regular operations of the Agency, resulted in an increase in *Total Net Position* of $39,074,000, or 5.7%. The primary driver of the change relates to the increase in state appropriations received for WHLP and the disaster recovery efforts. The Agency continues to proactively manage its programs to further its mission of creating affordable housing for North Carolinians with low and moderate incomes.

**Financial Analysis**

The following tables summarize the changes in net position between June 30, 2017 and June 30, 2016 (*in thousands)*:

| | 2017 | 2016 | Change | % |
|---|---|---|---|---|
| **Condensed Statement of Net Position** | | | | |
| **Assets*** | | | | |
| Cash and cash equivalents | $ 654,099 | $ 419,012 | $ 235,087 | 56.1 |
| Investments | 298,872 | 94,283 | 204,589 | 217.0 |
| Accrued interest receivable on investments | 1,423 | 1,949 | (526) | (27.0) |
| Mortgage loans receivable, net | 709,491 | 821,975 | (112,484) | (13.7) |
| Mortgage loans held for resale | 23,341 | - | 23,341 | 100.0 |
| Accrued interest receivable on mortgage loans | 4,775 | 6,134 | (1,359) | (22.2) |
| State receivables | 131 | 30,846 | (30,715) | (99.6) |
| Other assets, net | 11,017 | 10,927 | 90 | 0.8 |
| **Total Assets** | $ 1,703,149 | $ 1,385,126 | $ 318,023 | 23.0 |
| | | | | |
| **Deferred Outflows of Resources** | | | | |
| Deferred outflows for pensions | $ 3,240 | $ 788 | $ 2,452 | 311.2 |
| Accumulated decrease in fair value of hedging derivative | 2,673 | 5,174 | (2,501) | (48.3) |
| **Total Deferred Outflows of Resources** | $ 5,913 | $ 5,962 | $ (49) | (0.8) |
| | | | | |
| **Liabilities*** | | | | |
| Bonds payable, net | $ 880,348 | $ 638,902 | $ 241,446 | 37.8 |
| Accrued interest payable | 11,183 | 11,388 | (205) | (1.8) |
| Accounts payable | 4,866 | 3,816 | 1,050 | 27.5 |
| Derivative instrument – interest rate swap | 2,673 | 5,174 | (2,501) | (48.3) |
| Unearned revenues | 72,252 | 36,804 | 35,448 | 96.3 |
| Other liabilities | 12,141 | 6,975 | 5,166 | 74.1 |
| **Total Liabilities** | $ 983,463 | $ 703,059 | $ 280,404 | 39.9 |

| | 2017 | 2016 | Change | % |
|---|---|---|---|---|
| **Condensed Statement of Net Position** | | | | |
| **Deferred Inflows of Resources** | | | | |
| Deferred state grant | $ 4,221 | $ 5,520 | $ (1,299) | (23.5) |
| Deferred inflows for pensions | 218 | 423 | $ (205) | (48.5) |
| **Total Deferred Inflows of Resources** | $ 4,439 | $ 5,943 | $ (1,504) | (25.3) |
| | | | | |
| **Net Position** | | | | |
| Restricted | $ 701,860 | $ 664,330 | $ 37,530 | 5.6 |
| Unrestricted | 19,300 | 17,756 | 1,544 | 8.7 |
| **Total Net Position** | $ 721,160 | $ 682,086 | $ 39,074 | 5.7 |

| | | | | |
|---|---|---|---|---|
| **Condensed Statement of Revenues, Expenses and Changes in Net Position** | | | | |
| **Operating Revenues** | | | | |
| Interest on investments | $ 8,024 | $ 6,973 | $ 1,051 | 15.1 |
| Net increase in fair value of investments | 5,417 | 2,303 | 3,114 | 135.2 |
| Interest on mortgage loans | 37,337 | 42,885 | (5,548) | (12.9) |
| Federal program awards received | 255,607 | 236,308 | 19,299 | 8.2 |
| Program income/fees | 73,875 | 66,663 | 7,212 | 10.8 |
| Other revenues | 1,021 | 1,951 | (930) | (47.7) |
| **Total Operating Revenues** | $ 381,281 | $ 357,083 | $ 24,198 | 6.8 |
| | | | | |
| **Operating Expenses** | | | | |
| Interest on bonds | $ 26,163 | $ 26,060 | $ 103 | 0.4 |
| Mortgage servicing expense | 2,141 | 2,422 | (281) | (11.6) |
| Federal program expense | 251,409 | 239,071 | 12,338 | 5.2 |
| Nonfederal program expense | 25,769 | 20,933 | 4,836 | 23.1 |
| General and administrative expense | 29,197 | 23,764 | 5,433 | 22.9 |
| Other expenses | 1,839 | 2,610 | (771) | (29.5) |
| **Total Operating Expenses** | $ 336,518 | $ 314,860 | $ 21,658 | 6.9 |
| **Operating Income** | $ 44,763 | $ 42,223 | $ 2,540 | 6.0 |
| | | | | |
| **Non-Operating Revenues (Expenses)** | | | | |
| State appropriations received | $ 50,660 | $ 21,619 | $ 29,041 | 134.3 |
| State grants received | 13,195 | 9,814 | 3,381 | 34.5 |
| State program expense | (69,544) | (74,157) | 4,613 | (6.2) |
| **Total Non-Operating Revenues (Expenses)** | $ (5,689) | $ (42,724) | $ 37,035 | (86.7) |
| **Change in Net Position** | $ 39,074 | $ (501) | $ 39,575 | (7899.2) |

*For information on current and noncurrent statement of net position items, please see the audited Statement of Net Position in the accompanying financial statements.

**New Business**

Fiscal year 2017 brought challenges to North Carolina, including a volatile economic market and Hurricane Matthew. However, the Agency proactively turned difficult circumstances into opportunities to serve North Carolinians.

*Appropriations and Awards*

For fiscal year 2017, the Agency received the following appropriations and awards from the federal government, the General Assembly and other State departments, which are discussed in more detail below:

Federal:

| | | |
|---|---|---|
| $ | 154.2 million | Section 8 Project-Based and Traditional Contract Administration |
| $ | 12.4 million | HOME Investment Partnerships Program (anticipated*) |
| $ | 3.3 million | National Housing Trust Fund |

North Carolina:

| | | |
|---|---|---|
| $ | 27.7 million | Housing Trust Fund appropriations |
| $ | 20.0 million | Workforce Housing Loan Program appropriation |
| $ | 3.0 million | HOME Match appropriation |
| $ | 5.5 million | Community Living Housing Fund (from DHHS) |
| $ | 2.2 million | Transitions to Community Living Voucher (from DHHS) |
| $ | 5.5 million | Key Rental Assistance (from DHHS) |

*The State received a letter from the US Department of Housing and Urban Development (HUD) in June 2017 indicating that the State's available HOME funding would be approximately $12.4 million; however, a final contract has not yet been signed as of the issuance of these financial statements. If finalized, the anticipated HOME appropriation of $12.4 million will be approximately $60,000 greater than the fiscal year 2016 appropriation. The HOME Match appropriation of $3 million is an approximate $1.5 million increase over last year's appropriation.

The Agency received a recurring $7.7 million appropriation for the HTF in fiscal year 2017, consistent with the prior year. As a result of Hurricane Matthew and other disasters experienced in the State during fiscal year 2017, the Agency was awarded an additional $20 million of HTF appropriations for disaster recovery efforts, discussed in more detail below. These appropriations total $27.7 million, representing a $20 million increase over the prior year HTF appropriations.

In addition, the Agency received a $20 million appropriation for WHLP, a State program that replaced the STC, which expired in 2015. WHLP provides loans to fund construction or substantial rehabilitation of affordable rental developments, administered in combination with the federal LIHTC. The fiscal year 2017 WHLP appropriation of $20 million was a $7.5 million increase over the fiscal year 2016 WHLP appropriation.

The National Housing Trust Fund (NHTF) is a federal award, distinct from the State's HTF, established in the Housing and Economic Recovery Act of 2008. The goal of the NHTF is to increase and preserve the supply of affordable housing for extremely low and very low-income households. Funds are allocated to states by a needs-based formula and the cost of construction in each state. In fiscal year 2017, the Agency received its first NHTF appropriation for $3.3 million; however, the Agency has not yet received or disbursed any of the funds under the program.

The Agency received $154.2 million in fiscal year 2017 to administer the Section 8 programs, which represents an increase of $738,000 from the prior year. The Agency received $5.5 million in fiscal year 2016 for CLHF, which was appropriated in fiscal year 2017. The Agency also received $2.2 million for the Transitions to Community Living Voucher (TCLV) program and $5.5 million for the Key program, which are discussed in greater detail below.

*New Activities*

The Agency's HomeAd production continued to increase in fiscal year 2017. The popularity of the program was due in part to the introduction of the HHF's Down Payment Assistance program (HHF DPA). The HHF DPA is a $15,000 down payment assistance loan with 0% interest, forgiven over five years at a rate of 20% per year. This program is offered to first-time home buyers, veterans or borrowers located in a targeted area who are purchasing an existing home in one of five counties: Cabarrus, Cumberland, Guilford, Johnston and Mecklenburg. These counties were selected based on the presence of distressed housing areas relative to performance factors in the State as a whole. The performance factors include seriously delinquent mortgage loans, negative equity, short sales, real estate owned sales, and foreclosures. The program began in fiscal year 2016 with $15 million of HHF awards. In May 2016, the Agency was approved to use an additional $45 million of HHF money towards the HHF DPA. The $45 million in additional funds was made available to borrowers in October 2016 and will serve a total of 3,000 home buyers. The Agency used tax-exempt bonds to finance the first mortgage loans associated with these HHF DPA loans, which culminated in the issuance of Series 37 and Series 38 bonds in fiscal year 2017. More detail on these bond transactions is provided in the "Debt Administration" section.

In fiscal year 2017, the Agency signed an agreement with its master servicer, ServiSolutions, to purchase a portion of HomeAd mortgage loans to hold from the time of purchase to the time of settlement. Under this arrangement, ServiSolutions purchases up to $60 million of the HomeAd loans, and the Agency purchases up to $40 million. The mortgage loans purchased by the Agency are reflected as *Mortgage loans held for resale* on the Statement of Net Position, which is a current asset due to the short duration of time the loans are owned. Since the Agency earns interest equal to the mortgage rate minus the servicing fee on the mortgage loans, this arrangement has been a favorable investment vehicle for the Agency.

In December 2016, the General Assembly appropriated $20 million to the HTF in the Disaster Recovery Act of 2016 following Hurricane Matthew, tropical storms and wildfires experienced in the State. The purpose of the funds is to directly benefit persons affected by natural disasters whose incomes do not exceed median income, who have damaged homes, and who do not qualify for federal assistance or insurance. Of the $20 million appropriation, the North Carolina Housing Partnership approved $15 million for the Essential Single-Family Rehabilitation Loan Pool – Disaster Recovery program and the remaining $5 million for multifamily and supportive housing rehabilitation. The loan pool provides for up to $150,000 per partner, then additional commitments on a unit-by-unit basis. The program will provide unsecured, deferred, interest-free, forgivable loans up to $40,000 to repair flood-affected homes to comply with the Agency's Essential Property Standard. All loans are forgiven at $5,000 per year starting after year one. As of June 30, 2017, the Agency had committed approximately $550,000, but funds had not yet been disbursed.

In 2012, the State entered into a voluntary settlement agreement with the US Department of Justice for housing people with mental illness. In response to the settlement, DHHS created the Transitions to Community Living Initiative (TCLI). The purpose of TCLI is to ensure that people with severe mental illness can receive the necessary services and support to successfully live in the communities of their choice, and it includes a goal to house 3,000 people with mental illness in their local communities by June 2020. To support the housing aspects of TCLI, DHHS created TCLV, a tenant-based rental assistance subsidy which leverages the existing Key program, a project-based rental assistance subsidy for people with disabilities. The Agency has administered the Key program on behalf of DHHS since 2004. In June 2016, DHHS contracted with the Agency to provide housing administration services, which included transitioning subsidy administration duties from the existing statewide subsidy administrator to seven Local Management Entity/Managed Care Organizations (LME/MCOs). Ongoing services include reimbursing LME/MCOs for TCLV housing expenses from funds provided by DHHS through the Community Living Initiative Verification (CLIVe) software system. The CLIVe system was developed and implemented by the Agency during fiscal year 2017 to manage TCLV and other housing initiatives. The Agency continues to support and collaborate with DHHS in the automation of vacancy and referral processes, scheduling fair housing trainings, redesigning and promoting www.NCHousingSearch.org, creating a statewide permanent supportive housing planning process, and designing a development program with the LME/MCOs.

The Agency's Executive Director, A. Robert Kucab, retired in fiscal year 2017 after 30 years of service to the Agency. The Agency conducted a nationwide search for a new Executive Director with the help of an outside consulting firm. Candidates were presented to the Agency's Human Resources committee, comprised of a subset of the Board of Directors, A. Robert Kucab, and the Agency's Director of Human Resources and Administration. After evaluating hundreds of applicants, the Human Resources committee selected Scott Farmer as the Agency's new Executive Director. With over 17 years of service to the Agency, Scott Farmer previously served as the Director of Rental Investment at the Agency, and he brings to the position a broad depth of Agency program knowledge and rapport with outside business partners.

**Debt Administration**

The Agency issued tax-exempt bonds in November 2016 and June 2017 to finance HomeAd production and refund existing bond series. Prior to these bond issuances, the Agency had not issued tax-exempt debt since 2011. In April, the Agency received additional HHF funding, out of which $45,000,000 was allotted to the HHF DPA. Because the requirements for the HHF DPA comply with the tax-exempt bond requirements, the Agency chose to use tax-exempt financing to finance the first mortgages associated with the HHF DPA loans in fiscal year 2017. Unlike the Agency's FirstHome program, in which the Agency purchases mortgage loans with bond proceeds, the bond proceeds for HomeAd loans are used to purchase MBS. Therefore, bond-financed HomeAd loans are reflected on the Statement of Net Position as *Investments* whereas the FirstHome loans are reflected as *Mortgage loans receivable, net.*

Series 37 closed in November 2016 for a total of $216,745,000. Of this amount, $192,000,000 of the bonds were sold publicly (Series 37A for $96,745,000 and Series 37B for $95,255,000), and $24,745,000 were sold as a direct placement (Series 37C). Series 37B and 37C were used to finance new HomeAd production, discussed above. Series 37A was used to refund Series 15, 16, 17, 18, 25, 28, 29 and 30. Series 15, 16 and 18 had associated repurchase agreements, but because of their refunding, the Agency has no remaining repurchase agreements.

Series 15, 16, 17 and 18 contained variable-rate debt, which had associated swaps discussed in detail in Note E, "Derivative Instrument – Interest Rate Swap." Although Series 37A refunded the Agency's existing variable-rate debt, Series 37C was issued as new variable-rate debt directly purchased by TD Bank. Because the new variable-rate debt was directly placed with TD Bank, the Agency no longer incurs a liquidity fee or a remarketing fee on its variable-rate debt.

In conjunction with Series 37, the Agency paid $797,000 to terminate the swap associated with Series 15, for which UBS was the counterparty. In addition, the termination of this swap also terminated the Agency's remaining bond-insurance arrangement with Assured Guaranty. The Agency retained the swaps associated with Series 16, 17 and 18, although they are now associated with the Series 37C bonds. The swap originally associated with Series 16 is the only swap that continues to have optional cancellations, which the Agency takes advantage of since there is no associated termination fee. The counterparty for this swap is Bank of America, and the Agency exercised its optional cancellation for $365,000 on July 1, 2016 and $335,000 on January 1, 2017.

Series 38 closed in June 2017 for a total of $255,560,000. The majority of the proceeds will be used to finance HomeAd loans, but $17,725,000 of the total will be used to refund Series 31, which was not eligible to be refunded until July 1, 2017.

The Agency issued conduit multifamily mortgage revenue bonds of $14,800,000 in December 2016 for the acquisition and rehabilitation of nine existing multifamily properties located in six counties serving families and the elderly. These bonds are not a debt of the Agency and are secured by the related properties. After the projects are placed in service and the rehabilitation is complete, the bonds will be paid off with the proceeds of a US Department of Agriculture Rural Development (USDA RD) Section 515 loan.

Apart from scheduled debt service payments, the Agency had multiple bond calls in fiscal year 2017 which totaled $217,205,000. These bond calls included prepayment calls, debt service reserve calls, and excess revenue calls.

**Programs**

For the year ended June 30, 2017, the Agency made cash disbursements of $283,381,000 in federal funds for the following programs:

- Carryover Loan Program (COLP)
- Community Partners Loan Pool (CPLP)

- Essential Single-Family Rehabilitation Loan Pool (ESFRLP)
- Hardest Hit Fund Down Payment Assistance (HHF DPA)
- Modification Enabling Program (MEP)
- Mortgage Payment Program (MPP)
- National Foreclosure Mitigation Counseling (NFMC)
- Principal Reduction Recast/Lien Extinguishment (PRRLE)
- Rental Production Program (RPP)
- Second Mortgage Refinance Program (SMRP)
- Section 8 Project-Based Contract Administration (Section 8 PBCA)
- Section 8 Traditional Contract Administration (Section 8 TCA)
- Self-Help Loan Pool (SHLP)

For the year ended June 30, 2017, the Agency made cash disbursements of $72,149,000 in State funds for the following programs:

- Community Partners Loan Pool (CPLP)
- Displacement Prevention Partnership (DPP)
- Housing Counseling Capacity Building Program (HCCBP)
- Housing Placement Services (HPS)
- Housing Services (HS)
- Key Rental Assistance (Key)
- Rental Production Program (RPP)
- State Tax Credit (STC)
- Supportive Housing Development Program (SHDP)
- Transitions to Community Living Voucher (TCLV)
- Urgent Repair Program (URP)
- Workforce Housing Loan Program (WHLP)

For the year ended June 30, 2017, the Agency made cash disbursements of $223,889,000 from other funding sources for the following programs:

- Affordable Home Ownership Program (AHOP)
- Community Partners Loan Pool (CPLP)
- Construction Training Partnership (CTP)
- Essential Single-Family Rehabilitation Loan Pool (ESFRLP)
- FirstHome
- Multifamily Rental Assistance (MF RA)
- NC Home Advantage Down Payment Assistance (HomeAd DPA)
- NC Home Advantage Mortgage (HomeAd)
- State Home Foreclosure Prevention Project (SHFPP)

For the year ended June 30, 2017, the Agency made awards of $798,162,000 for the following programs:

- Low-Income Housing Tax Credit (LIHTC)
- Mortgage Credit Certificate (MCC)
- NC Home Advantage Mortgage (HomeAd)

The Agency’s mission is to create affordable housing opportunities for North Carolinians whose needs are not met by the market. The Agency focuses its efforts on providing assistance to borrowers purchasing their home, financing affordable rental housing, and helping homeowners who are facing foreclosure or living in substandard housing.

Home Ownership Programs The Agency supported over 8,500 home buyers with disbursements from its home ownership programs in fiscal year 2017.

The HomeAd program offers 30-year mortgages to low and moderate-income home buyers for the purchase of a home, subject to applicable income and credit score limits. These mortgage loans are financed through the sale of MBS or tax-exempt bond proceeds. Down payment assistance options are also available for borrowers who obtain a HomeAd mortgage. The HomeAd DPA is an interest-free, deferred, forgivable, second mortgage up to 5% of the first mortgage amount. The Agency also offers the HHF DPA for qualifying borrowers, discussed in more detail under “Foreclosure Prevention Financing Programs” below.

The Mortgage Credit Certificate program permits qualifying home buyers who meet federal guidelines for family income and acquisition costs to take a federal income tax credit for every year the home buyer occupies the home. The home buyer may take 30% of annual mortgage interest as a tax credit if purchasing existing housing, or 50% if purchasing new construction housing, with a maximum tax credit of $2,000 per year.

The Agency helps local governments and nonprofit organizations finance new and existing housing for North Carolinians with low and moderate incomes. The Community Partners Loan Pool (CPLP) offers zero-interest, deferred, second mortgages that are generally used with HomeAd or USDA RD Section 502 loans. The Self-Help Loan Pool (SHLP) provides amortizing zero-interest mortgages, complimenting Habitat for Humanity funds and leveraging more productivity through a model of sweat equity, volunteers, home buyer education, household selection, and donations. Incentive funding is available to both CPLP and SHLP borrowers when homes are built to a certain energy efficiency level. Home buyers in both pools must have a household income at or below 80% of the county median income, complete a home buyer education course, and receive home ownership counseling.

Housing Preservation Programs The Agency supported nearly 1,900 households with disbursements from its housing preservation programs in fiscal year 2017.

The Urgent Repair Program provides loans to assist households at or below 50% of the area median income for emergency repairs to correct a specific housing problem which poses an imminent threat to life, safety, or displacement of homeowners. The Agency operates this program statewide through local governments and nonprofit agencies.

The Displacement Prevention Partnership provides forgivable loans for very low-income households who are facing displacement due to mobility limitations. The Agency operates this program in partnership with local offices of the Independent Living Rehabilitation Program within DHHS.

The Essential Single-Family Rehabilitation Loan Pool provides deferred, forgivable loans to homeowners through regional agencies, units of local government, and nonprofit organizations. The program focuses on financially-feasible, essential rehabilitation of owner-occupied homes to address critical repairs for health and safety, reasonable energy-efficiency measures, and life expectancy of major building systems. The program assists households with elderly, disabled or veteran members, or homes with lead hazards housing a child under age six.

The Construction Training Partnership program, a partnership with the North Carolina Home Builders Association (NCHBA) and local governments, provides funding for the hard costs of new construction or rehabilitation projects. NCHBA conducts a range of training services to low-income, unemployed persons. Training consists of classroom and “hands on” residential field training followed by job placement activities. The local government pays for the cost of training, identifies eligible projects, and serves as or procures a general contractor.

Foreclosure Prevention Financing Programs The Agency helped approximately 4,600 households in fiscal year 2017 with disbursements from the North Carolina Foreclosure Prevention Fund (NCFPF), a suite of Agency-developed programs funded through the HHF. More information on the Agency’s NCFPF can be found on its website at www.ncforeclosureprevention.gov.

The Mortgage Payment Program pays mortgage payments and related expenses for qualifying homeowners who are unemployed, underemployed, or have suffered temporary financial hardship, and are struggling to make their mortgage payments. Payments are made up to 18 months for homeowners in a job search and up to 36 months for those in an education or job-training program. The assistance is in the form of an interest-free deferred loan, which will be forgiven if the homeowner continues to live in the home for 10 years.

The Second Mortgage Refinance Program helps employed homeowners who have an unaffordable second mortgage due to prior unemployment, underemployment, or other program-eligible financial hardship. The assistance is in the form of an interest-free, non-recourse, deferred-payment, subordinate loan.

The Principal Reduction Recast/Lien Extinguishment program helps homeowners by providing a principal reduction either to reduce a homeowner's unaffordable mortgage payment or to extinguish his or her remaining debt. The assistance is an interest-free deferred loan which is forgiven if the homeowner continues to live in the home for 10 years.

The HHF DPA program was designed to promote stabilization of distressed housing areas by encouraging the purchase of an existing home in one of five North Carolina counties. Assistance is in the form of a zero-interest, deferred loan, which is forgiven if the homeowner continues to live in the home for five years.

Foreclosure Counseling The Agency funded over 6,900 foreclosure prevention counseling sessions for households across the State through disbursements to local counseling agencies in fiscal year 2017.

The National Foreclosure Mitigation Counseling program provides federal funds for foreclosure prevention counseling across the State. Counseling is provided by organizations that have been approved by HUD.

Through the State Home Foreclosure Prevention Project (SHFPP), homeowners facing foreclosure are notified of available statewide HUD-approved housing counseling services. Counselors provide homeowners with information on foreclosure alternatives, assist in the communication between the loan servicer and homeowner, and refer legal assistance as needed. These services are funded through foreclosure filing fees, which are paid by servicers for the North Carolina home loans registered in the SHFPP system.

The Housing Counseling Capacity Building Program received funding from the 2012 National Mortgage Settlement, a landmark agreement between state Attorneys General and the five largest mortgage servicers. In fiscal year 2017, the Agency reimbursed 32 counseling organizations over $285,000 for industry standard training, including foreclosure prevention, home buyer education, reverse mortgage counseling and financial literacy.

Rental Development Programs The Agency supported approximately 5,600 households with disbursements from its rental development programs in fiscal year 2017.

The Agency administers the LIHTC program. These tax credits are available to developers on a competitive basis to fund the creation or preservation of affordable rental housing in the State. The Agency's goals include awarding tax credits to the best developments possible given limited resources available. The Qualified Allocation Plan establishes criteria that include the following for selecting developments that serve low-income residents: locations with strong market demand, healthy financial structures, attractive architectural design, and the best quality of building materials and workmanship.

The Workforce Housing Loan Program is a State program under which funds are made available as a loan to fund construction or substantial rehabilitation of affordable rental developments, and is administered in combination with the LIHTC program.

The Rental Production Program (RPP) provides loans for rental housing projects, primarily targeting households below 50% of area median income. These RPP loans usually serve as gap financing for the projects financed with the LIHTC.

The Carryover Loan Program provides funding to acquire land for LIHTC properties, primarily targeting rental developments serving households below 60% of area median income.

Rental Assistance Programs The Agency supported over 24,800 households with disbursements from its rental assistance programs in fiscal year 2017.

For Section 8 projects, the Agency serves as the administrator for the State for certain project-based Section 8 Housing Assistance Payment contracts on behalf of HUD. For Section 8 Project-Based Contract Administration projects, the Agency partners with Quadel Consulting Corporation to manage the contract administration duties. For Section 8 Traditional Contract Administration (Section 8 TCA) projects, the Agency is directly responsible for receiving and distributing rental assistance payments from HUD. To assist in the Section 8 TCA process, the Agency contracts with Independent CA Professionals, LLC to electronically process vouchers and submit to HUD.

The Agency and DHHS partnered to create the Key program by providing operating assistance and services for low-income persons with disabilities and those who are homeless. Funding is available to all targeted units produced under the LIHTC, Supportive Housing Development Program (SHDP), and the Preservation Loan Program; however, the Key program does not provide assistance if rental subsidies are available through another program.

In fiscal year 2016, the Agency and DHHS partnered to establish the TCLV program to create a more efficient and effective State Housing Administration system to allow people with mental illness to receive the necessary services and supports to successfully live in the communities of their choice. DHHS established relationships with seven LME/MCOs across the State to provide subsidy administration and other housing-related services for the tenant-based rental assistance voucher program. The Agency created and supports an electronic funds management and document collection system to support the LME/MCOs in administering the vouchers.

Supportive Housing Development Program The Agency supported over 210 households with SHDP disbursements in fiscal year 2017. This program provides funding for emergency, transitional, and permanent housing for households below 30% of area median income with special needs. Eligible populations include children and adults with a wide range of disabilities or special housing needs. Eligible applicants are mission-driven, non-profit organizations and units of local government.

**Additional Information**

This discussion and analysis is intended to provide additional information regarding the activities of the North Carolina Housing Finance Agency. If you have questions about the report or need additional financial information, contact S. Carrie Freeman, Chief Financial Officer, North Carolina Housing Finance Agency, P.O. Box 28066, Raleigh, North Carolina 27611-8066, (919) 877-5680, scfreeman@nchfa.com, or visit the Agency's website at www.nchfa.com.

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**Independent Auditor's Report**

The Board of Directors
North Carolina Housing Finance Agency

**Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities and programs of the North Carolina Housing Finance Agency (the "Agency"), a public agency and component unit of the State of North Carolina, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements as listed in the table of contents.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina Housing Finance Agency as of June 30, 2017, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

*Other Matters*

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management discussion and analysis on pages 3 through 13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Reporting Required by** *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 25, 2017 on our consideration of the Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is soley to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Agency's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Agency's internal control over financial reporting and compliance.

BDO USA, LLP

September 25, 2017

# NORTH CAROLINA HOUSING FINANCE AGENCY

**STATEMENT OF NET POSITION**

**AS OF JUNE 30, 2017**

| (in thousands) | | |
|---|---|---|
| **ASSETS** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ | 12,755 |
| Restricted cash and cash equivalents | | 641,344 |
| Investments | | 1,008 |
| Restricted investments | | 6,021 |
| Accrued interest receivable on investments | | 1,423 |
| Mortgage loans receivable | | 139,723 |
| Mortgage loans held for resale | | 23,341 |
| Accrued interest receivable on mortgage loans | | 4,775 |
| State receivables | | 131 |
| Other assets | | 7,843 |
| **TOTAL CURRENT ASSETS** | $ | 838,364 |
| **Noncurrent assets:** | | |
| Investments | $ | 2,038 |
| Restricted investments | | 289,805 |
| Mortgage loans receivable, net | | 569,768 |
| Other assets, net | | 3,174 |
| **TOTAL NONCURRENT ASSETS** | $ | 864,785 |
| **TOTAL ASSETS** | $ | 1,703,149 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | |
| Deferred outflows for pensions | $ | 3,240 |
| Accumulated decrease in fair value of hedging derivative | | 2,673 |
| **TOTAL DEFERRED OUTFLOWS OF RESOURCES** | $ | 5,913 |
| **LIABILITIES** | | |
| **Current liabilities:** | | |
| Bonds payable | $ | 25,730 |
| Accrued interest payable | | 11,183 |
| Accounts payable | | 4,866 |
| Unearned revenues | | 59,507 |
| Other liabilities | | 170 |
| **TOTAL CURRENT LIABILITIES** | $ | 101,456 |
| **Noncurrent liabilities:** | | |
| Bonds payable, net | $ | 854,618 |
| Derivative instrument - interest rate swap | | 2,673 |
| Unearned revenues | | 12,745 |
| Other liabilities | | 11,971 |
| **TOTAL NONCURRENT LIABILITIES** | $ | 882,007 |
| **TOTAL LIABILITIES** | $ | 983,463 |
| **DEFERRED INFLOWS OF RESOURCES** | | |
| Deferred state grant | $ | 4,221 |
| Deferred inflows for pensions | | 218 |
| **TOTAL DEFERRED INFLOWS OF RESOURCES** | $ | 4,439 |
| **NET POSITION** | | |
| Restricted | $ | 701,860 |
| Unrestricted | | 19,300 |
| **TOTAL NET POSITION** | $ | 721,160 |

**The accompanying notes are an integral part of this financial statement.**

# NORTH CAROLINA HOUSING FINANCE AGENCY

**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**

**YEAR ENDED JUNE 30, 2017**

**(in thousands)**

| | | |
|---|---|---|
| **OPERATING REVENUES** | | |
| Interest on investments | $ | 8,024 |
| Net increase in fair value of investments | | 5,417 |
| Interest on mortgage loans | | 37,337 |
| Federal program awards received | | 255,607 |
| Program income/fees | | 73,875 |
| Other revenues | | 1,021 |
| **TOTAL OPERATING REVENUES** | $ | 381,281 |
| | | |
| **OPERATING EXPENSES** | | |
| Interest on bonds | $ | 26,163 |
| Mortgage servicing expense | | 2,141 |
| Federal program expense | | 251,409 |
| Nonfederal program expense | | 25,769 |
| General and administrative expense | | 29,197 |
| Other expenses | | 1,839 |
| **TOTAL OPERATING EXPENSES** | $ | 336,518 |
| | | |
| **OPERATING INCOME** | $ | 44,763 |
| | | |
| **NON-OPERATING REVENUES (EXPENSES)** | | |
| State appropriations received | $ | 50,660 |
| State grants received | | 13,195 |
| State program expense | | (69,544) |
| **TOTAL NON-OPERATING REVENUES (EXPENSES)** | $ | (5,689) |
| | | |
| **CHANGE IN NET POSITION** | $ | 39,074 |
| | | |
| **TOTAL NET POSITION - BEGINNING** | $ | 682,086 |
| **TOTAL NET POSITION - ENDING** | $ | 721,160 |

**The accompanying notes are an integral part of this financial statement.**

# NORTH CAROLINA HOUSING FINANCE AGENCY

**STATEMENT OF CASH FLOWS**

**YEAR ENDED JUNE 30, 2017**

| **(in thousands)** | | |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Interest on mortgage loans | $ | 38,480 |
| Principal payments on mortgage loans | | 127,148 |
| Purchase of mortgage loans | | (14,925) |
| Principal payments on mortgage loans held for resale | | 255,318 |
| Purchase of mortgage loans held for resale | | (278,659) |
| Federal program awards received | | 290,513 |
| Federal program expense | | (251,550) |
| Nonfederal program expense | | (25,769) |
| Federal grant administration income | | 16,005 |
| Program income/fees | | 58,796 |
| Other expenses | | (27,076) |
| Other revenues | | (1,377) |
| **Net cash provided by operating activities** | $ | 186,904 |
| **Cash flows from non-capital financing activities:** | | |
| Issuance of bonds | $ | 472,305 |
| Principal repayments on bonds | | (241,425) |
| Interest paid | | (11,930) |
| Bond issuance costs paid | | (3,872) |
| State appropriations received | | 50,660 |
| State grants received | | 12,859 |
| State tax credits | | 29,752 |
| State program expense | | (69,544) |
| **Net cash provided by non-capital financing activities** | $ | 238,805 |
| **Cash flows from investing activities:** | | |
| Proceeds from sales or maturities of investments | $ | 3,772 |
| Purchase of investments | | (202,944) |
| Earnings on investments | | 8,550 |
| **Net cash used in investing activities** | $ | (190,622) |
| Net increase in cash | $ | 235,087 |
| Cash and cash equivalents at beginning of year | | 419,012 |
| **Cash and cash equivalents at end of year** | $ | 654,099 |
| **Reconciliation of operating income to net cash provided by operating activities:** | | |
| Operating income | $ | 44,763 |
| **Adjustments to reconcile operating income to net cash provided by operating activities:** | | |
| Interest on investments | | (8,024) |
| Increase in fair value of investments | | (5,417) |
| Interest on bonds | | 26,163 |
| **Change in assets and liabilities:** | | |
| Decrease in mortgage loans receivable | | 112,484 |
| Decrease in accrued interest receivable on mortgage loans | | 1,359 |
| Increase in mortgage loans held for resale | | (23,341) |
| Increase in other assets | | (3,222) |
| Increase in accounts payable and other liabilities | | 6,691 |
| Increase in unearned revenues | | 35,448 |
| **Total adjustments** | $ | 142,141 |
| **Net cash provided by operating activities** | $ | 186,904 |

**The accompanying notes are an integral part of this financial statement.**

# NOTES TO FINANCIAL STATEMENTS
*Year Ended June 30, 2017*

## A. AUTHORIZING LEGISLATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Authorizing Legislation** The North Carolina Housing Finance Agency (Agency) is a public agency and component unit of the State of North Carolina (State). The accompanying financial statements represent the financial position of the Agency only. The Agency was created to provide financing for residential housing construction, new or rehabilitated, for sale or rental, to residents of the State with low and moderate incomes. Pursuant to its enabling legislation, the Agency is authorized to issue bonds and other obligations to fulfill its corporate purpose up to a total outstanding amount of $3 billion. The debt obligations of the Agency do not constitute a debt, grant or line of credit of the State, and the State is not liable for the repayment of such obligations.

**Basis of Presentation** The accompanying financial statements of the Agency have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) as applicable to governments. The Governmental Accounting Standards Board (GASB) establishes standards of financial accounting and reporting for state and local government entities.

**Measurement Focus and Basis of Accounting** The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

**Programs** The Agency's accounts are organized on the basis of programs. Each program represents a separate accounting entity. Agency resources are allocated to these programs based on legal responsibility, fiscal accountability, and management designation. The Agency's primary programs are summarized below:

Agency Programs Direct administrative and operational activities, including operating expenses of various programs, are recorded in Agency Programs.

The North Carolina General Assembly (General Assembly) provides tax credits to the Agency for use in developing housing credit properties. While the State Tax Credit (STC) officially expired on January 1, 2015, the Agency received its final STC allocation of $29,752,000 during fiscal year 2017 and is continuing to disburse funds to approved properties. Under this program, projects receive the credit in the form of a loan or direct refund. The General Assembly replaced the STC with the Workforce Housing Loan Program (WHLP). See "Housing Trust Fund Programs" below for additional information on the WHLP appropriation.

In 2008, the State authorized the formation of the State Home Foreclosure Prevention Project (SHFPP) in response to the foreclosure crisis. State statute requires that all parties who wish to initiate a foreclosure against a home in North Carolina remit a $75 fee to the Agency. The fees collected are used to counsel and/or provide legal assistance to homeowners who are at risk of foreclosure. Any excess funds are allocated to the North Carolina Housing Trust Fund (HTF) annually. SHFPP transferred $59,000 to the HTF for fiscal year 2017. Funds in the amount of $2,197,000 were received and recorded as *Program income/fees* under Agency Programs. Expenses of $1,284,000 related to SHFPP are reflected in *Nonfederal program expense.* During fiscal year 2017, the Agency earned fees of $859,000 for the administration of this program.

Housing Trust Fund Programs The North Carolina Housing Trust and Oil Overcharge Act created the HTF and the North Carolina Housing Partnership (Housing Partnership). The purpose of the

HTF is to increase the supply of decent, affordable, and energy-efficient housing for residents of the State with low and moderate incomes. The Housing Partnership is responsible for developing policy for the operation of most programs within the HTF. The Agency staff provides services to the Housing Partnership and administers the HTF programs. The Agency received State appropriations in the amount of $47,660,000 for the year ended June 30, 2017. Of this amount, $7,660,000 is a recurring appropriation that is used to make loans and grants under the HTF programs. The remaining $40,000,000 nonrecurring appropriation includes $20,000,000 for WHLP and $20,000,000 for the Disaster Recovery Act of 2016. State appropriations are reported in *Non-Operating Revenues (Expenses)* in the accompanying financial statements.

In fiscal year 2016, the Agency received $5,520,000 from the North Carolina Department of Health and Human Services (DHHS) for the Community Living Housing Fund (CLHF), which was appropriated by the General Assembly in fiscal year 2017 and is reported in *State grants received*. Additional funds for CLHF in the amount of $4,221,000 were received and recorded as *Deferred state grant* in *Deferred Inflows of Resources*. These funds will only be available for disbursement upon appropriation by the General Assembly.

<u>Federal and State Programs</u> The Agency administers seven federal programs. Of the Agency's federal programs, the Section 8 programs, the Hardest Hit Fund (HHF), and the HOME Investment Partnerships Program (HOME) represent 54%, 33%, and 9% of federal expenditures, respectively. The Agency receives a fee for administering these programs. The HOME Program is matched with State funds appropriated by the General Assembly; in fiscal year 2017, $3,000,000 of HOME Match funds were received.

The State was awarded $338 million from the National Mortgage Settlement in fiscal year 2012. The Agency signed a Memorandum of Understanding with the North Carolina Department of Justice (DOJ) in fiscal year 2013 to oversee $30,590,000 of these funds, and in fiscal year 2016, the Agency received an additional $572,000 in residual funds from DOJ. These funds are used to help build the capacity of housing counseling agencies in the State and to provide funding for legal services. For fiscal year 2017, $494,000 was disbursed and is reflected in *State program expense*. The Agency earned fees of $21,000 for the administration of the program.

In fiscal year 2017, the Agency received $2,170,000 from DHHS for the Transitions to Community Living Voucher program (TCLV) and other housing outcomes. TCLV is a tenant-based, rental assistance program, which also provides assistance with security deposits, holding fees and risk mitigation claims. These funds are reported in *State grants received.* As of June 30, 2017, $1,513,000 related to TCLV is recorded as *State program expense.* The Agency earned fees of $657,000 for the administration of this program.

The Agency received $5,505,000 from DHHS for the administration of the Key Rental Assistance (Key) program, which is reflected in *State grants received.* The Key program provides assistance and services to low-income individuals with disabilities and those who are homeless. During fiscal year 2017, $10,119,000 was disbursed and is reflected in *State program expense.* The Agency earned fees of $250,000 for the administration of the program.

<u>Home Ownership Bond Programs</u> The Home Ownership Bond Programs were created through various single-family trust agreements and are restricted as to their use. The proceeds of individual bond issues are used to purchase first-time home buyer mortgage loans for single-family residential units.

The operations for the NC Home Advantage Mortgage program (HomeAd) are reflected in the 1998 Home Ownership Bond Program. Initially, the HomeAd program was only financed through the sale of mortgage-backed securities (MBS) on the secondary market. Starting in fiscal year 2017, a portion of the HomeAd program was financed using tax-exempt bonds.

For the HomeAd loans financed through the sale of MBS, the 1998 Home Ownership Bond Program recorded program income of $32,808,000 related to HomeAd, which is included as part of

*Program income/fees*. Deferred forgiven loans totaling $16,990,000 and lender compensation totaling $6,195,000 related to the HomeAd program are reflected as a part of *Nonfederal program expense*. Recording fees of $215,000 are reflected in *General and administrative expense*.

For the HomeAd loans financed with tax-exempt bond proceeds, the related MBS are reflected in *Investments*, with the earnings from the MBS reflected in *Interest on investments*. *Investments* also includes other government securities held by the Agency. See Note B, "Cash, Cash Equivalents, Investments, Fair Value Measurements and Securities Lending Transactions," for more information regarding HomeAd loans financed with tax-exempt bonds.

**Significant Accounting Policies** Below is a summary of the Agency's significant accounting policies:

Cash and cash equivalents *Cash and cash equivalents* are comprised of cash on hand, amounts on deposit with financial institutions which are insured or collateralized under provisions of State laws and regulations, amounts in pooled cash accounts managed by the North Carolina State Treasurer, and highly liquid investments with original maturities of three months or fewer. Funds deposited in an investment pool of the State Treasurer are invested in a variety of instruments as authorized by State law. The majority of *Cash and cash equivalents* classified as restricted on the accompanying Statement of Net Position are for the Agency's debt service payments, bond calls, and for funding home ownership under the Agency's different programs.

Investments *Investments* are reported at fair value in accordance with GASB Section I50, *Investments*.

Mortgage loans receivable, net *Mortgage loans receivable, net* are carried at cost less a loan loss reserve. It is the Agency's policy to provide for potential mortgage loan losses based on a periodic evaluation of the loan portfolios.

Mortgage loans held for resale Historically, the Agency's master servicer purchased all HomeAd mortgage loans from the Agency's originating lenders, after which the loans were securitized into MBS. Starting in fiscal year 2017, the Agency began purchasing a portion of these mortgage loans to hold between the time of purchase and the securitization of the loan. These purchased loans are reflected in *Mortgage loans held for resale*. The interest income from these loans is reflected in *Interest on mortgage loans*, and the associated servicing fee is reflected in *Mortgage servicing expense*.

Other assets, net Fixed assets, net of accumulated depreciation, in the amount of $3,174,000 are included in *Other assets, net* in the accompanying financial statements. Assets of $5,000 or greater are capitalized and depreciated over a five-year economic useful life using the straight-line method. *Other assets* (current) for Federal and State Programs of $1,724,000 includes receivables related to the HOME, Section 8, HHF and National Foreclosure Mitigation Counseling (NFMC) programs. *Other assets* (current) in the amount of $5,834,000 are reflected in the Home Ownership Bond Programs and include mortgage payments collected by servicers that will be remitted to the Agency in fiscal year 2018.

Bond Premium Bond premium represents the difference in the amount received upon the sale of bonds and the par value and is included as a part of *Bonds payable, net* in the accompanying financial statements. The premiums relate to the planned amortization class (PAC) bonds sold in conjunction with many series in the 1998 and 2009 Trust Agreements. The bond premium is amortized using the effective interest rate method over the life of the related PAC bonds and is adjusted accordingly for any bond calls that occur during the year. The amortization of the bond premium is included as a component of *Interest on bonds* in the accompanying financial statements.

Unearned revenues *Unearned revenues* are primarily monitoring fees received for the Low-Income Housing Tax Credit. These fees are amortized on a straight-line basis over the life of the tax credit or over the life of the loan. Also included in *Unearned revenues* is funding from the US Department of the Treasury (Treasury) for the HHF, which is used to assist homeowners at risk of foreclosure.

Interprogram receivable (payable) During the normal course of operations, the Agency has numerous transactions among programs to provide services. If certain transactions among programs have not been settled as of June 30, 2017, these balances are recorded as *Interprogram receivable (payable)*. These interprogram transactions are eliminated in the accompanying financial statements.

Deferred Outflows/Inflows of Resources In addition to Assets, the Statement of Net Position includes a separate section for *Deferred Outflows of Resources*. This section of the financial statements represents a consumption of net position that applies to a future period and will not be recognized as an expense or expenditure until then. The Agency has two items that meet this criterion in fiscal year 2017: contributions made to the pension plan and an accumulated decrease in fair value of hedging derivative instruments. In addition to Liabilities, the Statement of Net Position includes a separate section for *Deferred Inflows of Resources*. This section of the financial statements represents an acquisition of net position that applies to a future period and will not be recognized as revenue until then. The Agency has two items that meet the criterion: Deferred state grant revenue and deferrals of pension expense that result from the implementation of GASB No. 68, *Accounting and Financial Reporting for Pensions*.

Net Position *Net Position* is reported as restricted when constraints placed on it are externally imposed by creditors, grantors, laws or regulations, or by law through constitutional provisions.

The Agency's Board of Directors approves an operating budget annually that is funded with revenues generated by administrative fees earned on federal programs, interest income earned on investments, earnings from HomeAd, repayment of program funds, and reserves from trust agreements. All these revenue sources are earmarked to cover operating expenses. The decision to use restricted or unrestricted receipts to fund a payment is transaction-based.

As of June 30, 2017, the Agency had $19,300,000 of unrestricted net position. The Agency intends to use net position for potential home ownership mortgage loan losses, to meet rating agencies' requirements, to cover the operating budget, and to support other Agency housing commitments.

Net position of the Home Ownership Bond Programs is restricted pursuant to the Agency's agreements with its bondholders as determined in each trust agreement. The Agency has restricted these funds in amounts sufficient to meet required debt service and operating expenses as defined by each trust agreement.

Net position of the HTF is restricted in accordance with the policies of the Housing Partnership. The Federal and State Programs' net position is restricted in accordance with each specific program's requirements.

Operating Revenues and Expenses As one of its primary funding resources, the Agency has the authority to issue bonds to the investing public to create a flow of private capital. These funds are used to finance mortgage loans for qualified borrowers. A significant portion of operating income is derived from interest earned on mortgage loans and MBS less the interest expense of bonds outstanding. Additional operating income is earned from the administration of federal programs and the sale of MBS associated with the HomeAd program.

Non-Operating Revenues and Expenses *State appropriations received* and *State grants received* are classified as *Non-Operating Revenues (Expenses).* The related expenses are classified as *State program expense*.

General and administrative expense *General and administrative expense* is classified by the related program. To the extent allowed by the trust agreements and federal and state programs, transfers are made from the funds of the bond issue or the federal and state programs to the Agency to reimburse certain general and administrative expenses. If the trust agreements or programs do not permit payment of general and administrative expenses, expenses are paid from Agency reserve funds. Certain indirect costs are allocated to Federal and State Programs based on an independently prepared cost allocation plan. These costs are allocated based on certain parameters such as office square footage, number of approved positions, and number of transactions processed.

Use of Estimates The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the contingent and reported amounts of assets, liabilities and deferred inflows and outflows of resources at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period (e.g., loan loss reserve). Actual results could differ from those estimates.

## B. CASH, CASH EQUIVALENTS, INVESTMENTS, FAIR VALUE MEASUREMENTS AND SECURITIES LENDING TRANSACTIONS

**Cash and cash equivalents** As of June 30, 2017, the Agency had deposits in pooled investment accounts of the State Treasurer with a carrying value of approximately $226,547,000, and a bank balance of approximately $227,270,000. The State Treasurer investment account has the characteristics of a demand deposit account in that the Agency may deposit and withdraw cash at any time without prior notice or penalty. Included in the investment accounts of the State Treasurer is $6,327,000 of escrow and replacement reserves maintained on behalf of multifamily and single-family mortgagors; accordingly, a corresponding liability of the same amount is also included on the Statement of Net Position.

The Agency had deposits with a carrying value of $427,552,000 and a bank balance approximating $427,828,000 on deposit with the Agency's fiduciary agent. Such deposits are collateralized with eligible securities held by a third-party custodian.

Deposits - Custodial Credit Risk Custodial credit risk is the risk that in the event of a bank failure, the Agency's deposits may not be returned. At June 30, 2017, the Agency was not exposed to any material custodial credit risk.

**Investments** The Agency's investments include government securities (Federal Farm Credit Bank, Federal Home Loan Bank and Federal Home Loan Mortgage Corporation) and MBS insured by the Federal National Mortgage Association (FNMA) and the Government National Mortgage Association (GNMA).

The General Statutes of the State (State statutes) authorize the Agency to invest in repurchase agreements. Repurchase agreements are collateralized by obligations of the US Government, its agencies, or direct investments of such obligations. The market value of securities subject to such agreements must be maintained at least equal to 100% of the principal and accrued interest on the invested funds daily. The Agency was invested in repurchase agreements through November 2016. However, Series 37 refunded the remaining series with an associated repurchase agreement. As a result of the refundings, the remaining repurchase agreements were terminated in fiscal year 2017.

In fiscal year 2017, the Agency funded a portion of its HomeAd production with tax-exempt bonds. In the HomeAd program, mortgages are made by lenders, purchased by the Agency's master servicer and securitized into MBS. For MBS that are financed with tax-exempt bonds, the MBS are reflected in *Investments* on the Statement of Net Position.

At June 30, 2017, the Agency held the following investments with the listed maturities at annual rates ranging from 1.25% to 6.90%. Ratings are displayed with Moody's Investors Service (Moody's) rating listed first and Standard & Poor's (S&P) rating listed second (*in thousands*):

| | | Investment Maturities (*In Years*) | | | |
|---|---|---|---|---|---|
| **Investments** | **Carrying Amount** | **Less Than 1** | **1 – 5** | **6 – 10** | **More Than 10** |
| GNMA MBS | | | | | |
| Rated Aaa/AA+ | $ 75,450 | $ - | $ - | $ 650 | $ 74,800 |
| FNMA MBS | | | | | |
| Rated Aaa/AA+ | 135,815 | - | - | 98 | 135,717 |
| Government Securities | | | | | |
| Rated Aaa/AA+ | 87,607 | 7,029 | 70,345 | 8,459 | 1,774 |
| **Total Categorized** | **$298,872** | **$ 7,029** | **$70,345** | **$ 9,207** | **$212,291** |

Interest Rate Risk Interest rate risk is the risk that changes in market rates will adversely affect the fair market value of an investment. The Agency does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. In practice, the Agency does limit investments to 20 years to minimize fair value losses arising from interest rate risk, with the exception of the MBS that the Agency holds related to its Home Ownership Bond Programs.

Credit Risk Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. State statutes authorize the Agency to invest in (i) direct obligations or obligations on which the principal and interest are unconditionally guaranteed by the US Government; (ii) obligations issued by an approved agency or corporation wholly-owned by the US Government; (iii) interest-bearing time deposits, certificates of deposit, or other approved forms of deposits in any bank or trust company in North Carolina which satisfies insurance and, if necessary, collateral requirements for holding Agency money; (iv) duly established investment programs of the State Treasurer; (v) repurchase agreements; and (vi) repurchase agreements with banks and financial institutions which are chartered outside of the State and meet specified rating and collateral requirements of the various trust agreements. The MBS are securitized by FNMA (fair value - $135,815,000, rated Aaa/AA+) and by GNMA (fair value - $75,450,000, rated Aaa/AA+). GNMA is a direct obligation of the US Government. The government securities are direct obligations of the Treasury (rated Aaa/AA+) and have a fair value of $87,607,000.

Concentration of Credit Risk The Agency has a historical practice of entering into repurchase agreements with several investment providers. This practice minimizes the Agency's exposure to a potential bond rating downgrade due to an unforeseen ratings event related to one of the providers. However, all investment agreements were terminated by refunding the bonds with the associated repurchase agreements in fiscal year 2017.

Investments in any one issuer that represent 5% or more of total investments as of June 30, 2017 are as follows *(in thousands)*:

| **Investment Issuer** | **Amount** |
|---|---|
| FNMA - MBS | $135,815 |
| Federal Home Loan Bank | 63,314 |
| Federal Farm Credit Bank | 17,225 |

Custodial Credit Risk Custodial credit risk occurs when investment securities are uninsured and are not registered in the name of the Agency, and there is a failure of the counterparty. At year end, the Agency was not exposed to custodial credit risk. The government securities are on deposit with the Agency's fiduciary agent, which holds these securities by book entry in its fiduciary Federal Reserve accounts. The Agency's ownership of these securities is identified through the internal records of the fiduciary agent.

Foreign Currency Risk Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Agency does not have exposure to foreign currency risk.

**Fair Value Measurements** To the extent available, the Agency's investments are recorded at fair value, which are within the fair value hierarchy established by GAAP, in accordance with GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72). GASB 72 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

| | |
|---|---|
| Level 1 | Investments whose values are based on quoted prices (unadjusted) for identical assets (or liabilities) in active markets that a government can access at the measurement date. |
| Level 2 | Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset (or liability), either directly or indirectly. |
| Level 3 | Investments with unobservable inputs and may require a degree of professional judgment. |

The Agency had the following recurring fair value measurements as of June 30, 2017 *(in thousands)*:

| Investment Type | Fair Value | Input Level | Description |
|---|---|---|---|
| Short Term Investment Fund (STIF) | $409,941 | Level 2 | The ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year-end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the State's custodian. |
| Government Securities | $87,607 | Level 2 | Valuation of the underlying assets is performed using the policies and procedures established by the Agency's custodian. |
| MBS | $211,265 | Level 2 | Valuation of the underlying assets is performed using the policies and procedures established by the Agency's custodian. |
| Derivative Instrument - Interest Rate Swap | $2,673 | Level 2 | The fair value was estimated by a consulting firm using the zero coupon method. |

**Securities Lending Transactions** GASB Section I60, *Investments—Security Lending* (GASB I60), establishes accounting and financial reporting standards for transactions where governmental entities transfer their securities to broker-dealers and other entities (borrowers) in exchange for collateral (which may be cash, securities, or letters of credit) and simultaneously agree to return the collateral in exchange for the original securities in the future. The Agency does not directly engage in securities lending transactions; however, the State Treasurer is authorized to engage in these types of transactions under State Statute 147-69.3e. The types of securities include government securities and corporate bonds and notes which are held in the pooled investment accounts of the State Treasurer. A securities custodian manages the securities lending program for the State and receives cash as collateral from the borrowers. Collateral is invested in a collateral investment pool and must be maintained at 100% of the market value of the original securities. This investment in the collateral investment pool is considered to be a highly liquid investment. The State has a custodial credit risk related to the transactions.

Throughout fiscal year 2017, the Agency had deposits in the pooled investment accounts of the State Treasurer. The risk associated with these transactions will be recorded by the State in its fiduciary funds. No allocation will be made to the Agency; therefore, the accompanying financial statements do not reflect the risk associated with securities lending transactions in accordance with GASB I60.

## C. MORTGAGE LOANS RECEIVABLE

FirstHome mortgage loans purchased with the proceeds of the various single-family bond issuances have stated interest rates ranging from 3% to 10.35%.

The existing and future mortgage loans which the Agency may purchase under the bond programs must comply with guidelines established by the Agency, including the requirement that all such mortgage loans be insured by the Federal Housing Administration, guaranteed by the Veterans Administration, guaranteed by the US Department of Agriculture, Rural Development, insured under a private mortgage insurance program, or have a loan-to-value ratio equal to or less than 80%. As of June 30, 2017, all outstanding FirstHome mortgage loans purchased with mortgage revenue bond proceeds satisfy these requirements. The Agency has an allowance for loan losses in the single-family FirstHome mortgage loan program of $1,092,000 as of June 30, 2017.

Mortgage loans made with funds from the Agency Programs, Housing Trust Fund Programs, and Federal and State Programs have allowances for loan losses of $7,000, $139,000 and $170,000, respectively, as of June 30, 2017.

For the Home Ownership Bond Programs, the Agency has collateralized $595,586,000 in mortgage loans receivable and $491,492,000 in cash and investments pledged to repay the $868,070,000 single-family bonds payable outstanding as of June 30, 2017. Proceeds from the bonds issued were used to finance housing throughout the State. The outstanding bonds are payable through July 2047 and are repaid from cash collections on mortgage loans receivable, interest receivable on mortgage loans and MBS, unexpended bond proceeds, MBS and mortgage loan repayments, and proceeds from the sale of investments. The Agency expects 100% of the mortgage loans and MBS, both principal and interest, to pay the principal and interest debt service requirements on the bonds. The total debt service requirement to be paid based on projected cash flows as of June 30, 2017 is $1,271,411,000 (see "Maturities" under Note D).

For the current fiscal year, debt service payments, bond calls and related interest payments totaling $253,355,000 were made for the Home Ownership Bond Programs. Principal and interest payments received on mortgage loans and MBS for the Home Ownership Bond Programs were $148,391,000 and $2,098,000 respectively, in fiscal year 2017.

## D. BONDS PAYABLE

Bonds payable activity for the year ended June 30, 2017 was as follows (*in thousands*):

| | Beginning Balance | Additions | Reductions | Ending Balance |
|---|---|---|---|---|
| **Bonds payable** | | | | |
| Home Ownership | $ 637,190 | $ 472,305 | $ (241,425) | $ 868,070 |
| Bond premium | 1,712 | 11,312 | (746) | 12,278 |
| **Total Bonds payable, net** | **$ 638,902** | **$ 483,617** | **$ (242,171)** | **$ 880,348** |

Bonds payable as of June 30, 2017 are as follows (*in thousands*):

| Issue | Stated Rates (%) | Final Maturity | Principal Amount |
|---|---|---|---|
| **Home Ownership Revenue Bonds** | | | |
| (1998 Housing Revenue Bonds Trust Agreement) | | | |
| Series 22 CE | 5.100 - 5.250 | 1/1/2039 | $ 21,685 |
| Series 27 A | 6.00 | 1/1/2038 | 4,860 |
| Series 31 | 3.850 - 5.250 | 7/1/2038 | 19,315 |
| Series 32 | 4.00 | 1/1/2030 | 53,445 |
| Series 33 | 1.967 - 4.319 | 1/1/2034 | 59,630 |
| Series 34 | 1.662 - 3.852 | 7/1/2035 | 34,215 |
| Series 35 | 1.444 - 3.786 | 7/1/2032 | 31,805 |
| Series 36 | 1.201 - 3.907 | 1/1/2033 | 49,085 |
| Series 37 | Variable - 3.600 | 7/1/2041 | 216,745 |
| Series 38 | 1.200 - 4.000 | 7/1/2047 | 255,560 |
| | | | $ 746,345 |

| Issue | Stated Rates (%) | Final Maturity | Principal Amount |
|---|---|---|---|
| **Home Ownership Revenue Bonds** | | | |
| (2009 Housing Revenue Bonds Trust Agreement) | | | |
| Series A-1 and Series 1 | 2.450 - 4.500 | 7/1/2041 | $ 50,955 |
| Series A-2 and Series 2 | 2.300 - 4.250 | 7/1/2041 | 70,770 |
| | | | $ 121,725 |
| **Total Bonds Outstanding** | | | $ 868,070 |
| **Plus Bond Premium** | | | $ 12,278 |
| **Total Bonds Payable, Net** | | | **$ 880,348** |

See Note E, "Derivative Instrument - Interest Rate Swap," for variable rate interest calculation methodology.

**Maturities** Debt service requirements, including sinking fund requirements on term bonds, subsequent to June 30, 2017, are as follows (*in thousands*):

**Bonds Outstanding without Interest Rate Swaps**

| Fiscal Year Ending June 30 | Principal | Interest |
|---|---|---|
| 2018 | $ 23,475 | $ 25,179 |
| 2019 | 29,200 | 27,727 |
| 2020 | 30,825 | 26,954 |
| 2021 | 32,085 | 26,086 |
| 2022 | 33,725 | 25,128 |
| 2023-2027 | 178,435 | 108,660 |
| 2028-2032 | 181,145 | 77,383 |
| 2033-2037 | 145,285 | 49,586 |
| 2038-2042 | 115,275 | 25,416 |
| 2043-2047 | 64,060 | 9,259 |
| 2048 | 9,815 | 196 |
| **Total Requirements** | **$ 843,325** | **$ 401,574** |

**Bonds Outstanding with Interest Rate Swaps**

| Fiscal Year Ending June 30 | Principal | Interest |
|---|---|---|
| 2018 | $ 2,255 | $ 235 |
| 2019 | 2,120 | 226 |
| 2020 | 1,970 | 205 |
| 2021 | 1,835 | 185 |
| 2022 | 1,710 | 166 |
| 2023-2027 | 8,560 | 569 |
| 2028-2032 | 5,670 | 174 |
| 2033-2035 | 625 | 7 |
| **Total Requirements** | **$ 24,745** | **$ 1,767** |

**Total Bonds Outstanding**

| Fiscal Year Ending June 30 | Principal | Interest |
|---|---|---|
| 2018 | $ 25,730 | $ 25,414 |
| 2019 | 31,320 | 27,953 |
| 2020 | 32,795 | 27,159 |
| 2021 | 33,920 | 26,271 |
| 2022 | 35,435 | 25,294 |
| 2023-2027 | 186,995 | 109,229 |
| 2028-2032 | 186,815 | 77,557 |
| 2033-2037 | 145,910 | 49,593 |
| 2038-2042 | 115,275 | 25,416 |
| 2043-2047 | 64,060 | 9,259 |
| 2048 | 9,815 | 196 |
| **Total Requirements** | **$ 868,070** | **$ 403,341** |

**Bond Redemptions** The bond trust agreements provide for various methods of redemption. Bonds are redeemed at par from prepayments of mortgage loans securing the issues, from unexpended bond proceeds of the issues, from excess revenues, or from funds released via the related decreases in the respective debt service reserve requirements.

For the year ended June 30, 2017, scheduled and unscheduled bond redemptions were as follows (*in thousands*):

| Issue | Amount Redeemed |
|---|---|
| Housing Revenue Bonds (1998 Trust Agreement) | $ 217,770 |
| Housing Revenue Bonds (2009 Trust Agreement) | 23,655 |
| **Total Home Ownership Bond Programs** | **$ 241,425** |

**Special Facilities (Conduits)** The Agency issued Multifamily Housing Revenue Bonds which are not presented in the financial statements of the Agency. These bonds are secured solely by the properties and related revenues of the projects and the applicable credit enhancements, with the exception of the 2002 Resolution, which is secured by payments received on GNMA mortgages. These bonds do not constitute a debt of and are not guaranteed by the State, any political subdivision thereof, or the Agency. Accordingly, these obligations are excluded from the Agency's financial statements.

Bonds payable as of June 30, 2017 for special facilities are as follows (*in thousands*):

| Issue | Bond Type | Bonds Outstanding |
|---|---|---|
| 2002 Resolution* (Series D) | Multifamily Housing Revenue Bonds | $ 2,070 |
| 2016 Resolution (Series A) | Multifamily Housing Revenue Bonds | 14,800 |
| **Total** | | **$ 16,870** |

*This is a Section 501(c)3 entity and did not require volume cap when the bonds were issued.

On October 3, 2016, the 2014 Resolution (Series A), Multifamily Housing Revenue Bonds, were redeemed at par.

## E. DERIVATIVE INSTRUMENT - INTEREST RATE SWAP

**Summary Information** During fiscal year 2017, the Agency did not initiate any new swaps. However, the Agency's existing variable-rate debt under Series 15C, 16C, 17C and 18C was refunded by Series 37A, and $24,745,000 of Series 37C variable-rate debt was issued in November 2016. The Agency paid $797,000 to terminate the Series 15C swap with UBS in November 2016, but the remaining swaps with Bank of America, N.A. and Goldman Sachs Mitsui Marine remain in place and now hedge Series 37C. Series 37C was a private placement, and the interest payment is equal to 70% of the 1-month LIBOR rate plus 28 basis points (bps).

Except for the exercise of certain cancellation options, described in "Market Access Risk", the Agency will continue to monitor the market and explore termination options accordingly. The Agency's three pay-fixed, interest rate swap agreements with two financial counterparties are designated as hedging derivative instruments representing cash flow hedges for the organization (*in thousands*):

| Hedgeable Item | Hedging Derivative Instrument | Notional Amount | Classification | Fair Value at June 30, 2017 Liability | Classification | Net Decrease in Fair Value |
|---|---|---|---|---|---|---|
| Series 37C (formerly Series 16C) | Pay-Fixed Interest Rate Swap | $8,405 | Hedging Derivative | $(795) | Deferred Outflows of Resources | $524 |
| Series 37C (formerly Series 17C) | Pay-Fixed Interest Rate Swap | $11,180 | Hedging Derivative | $(1,360) | Deferred Outflows of Resources | $730 |
| Series 37C (formerly Series 18C) | Pay-Fixed Interest Rate Swap | $5,160 | Hedging Derivative | $(518) | Deferred Outflows of Resources | $322 |

There were no derivative instruments reclassified from a hedging derivative to an investment derivative instrument during the period. There was no deferral amount within investment revenue due to any reclassifications during the period.

**Objective** The Agency entered into interest rate swaps, in connection with all its variable-rate revenue bonds associated with the series listed in the above table, as a means to manage the future cash flow impact associated with the hedged debt. The intention of the swaps is to create more certainty for the Agency associated with the interest rate spread between its assets and liabilities.

**Terms and Credit Risk** The terms and credit risk of the outstanding swaps as of June 30, 2017 were as follows (*in thousands*):

| Notional Amount | Counterparty | Counterparty Credit Rating Moody's/S&P | Date of Swap Execution | Maturity Date of Swap | Fixed Rate | Floating Index |
|---|---|---|---|---|---|---|
| $8,405* | Bank of America, N.A. | A1/A+ | 9/16/2003 | 7/1/2032 | 3.810% | 63%L** + 0.30% |
| $11,180 | Bank of America, N.A. | A1/A+ | 12/11/2003 | 7/1/2032 | 3.725% | 63%L** + 0.30% |
| $5,160 | Goldman Sachs Mitsui Marine | Aa2/AA- | 4/20/2004 | 1/1/2035 | 3.251% | 63%L** + 0.30% |

* The swap contract contains optionality that allows the Agency the right to change the notional to better match the principal schedule on the bonds.

** L represents the USD, 1-Month LIBOR index.

**Fair Value** In total, the swaps have a fair value of negative $2,673,000 as of June 30, 2017. Because the coupons on the Agency's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap. Additionally, if at the time of termination, the swap has a negative fair value, the Agency would be liable to the counterparty for a payment equal to the swap's fair value.

**Interest Rate Risk** Under all of the swaps, the Agency pays the counterparties a fixed rate and receives a variable payment computed as 63% of 1-Month LIBOR plus 30 bps. Prior to the issuance of Series 37C, the bonds' variable-rate coupons were remarketed weekly and generally tracked the variable SIFMA index. However, with the issuance of the new Series 37C variable-rate debt in November 2016, the variable payment to the bondholder is computed based on 70% of 1-month LIBOR plus 28 bps, which was 1.01535% as of June 30, 2017.

**Basis risk and termination risk** The swaps expose the Agency to basis risk as the LIBOR rate changes, changing the synthetic rate on the bonds. The swap contracts for the Agency use a compound formula for the floating rate index to reduce this risk. During the accounting period, the Agency realized a cost of 0.59 bps for all variable-rate series due to the floating rate formula for its swap contracts when compared to the floating rate on the bonds. For all swaps, collateral thresholds have been established if the counterparty ratings reach A2 for Moody's or A for S&P. The Agency's swaps may be terminated if the counterparty's or the Agency's rating falls below Baa2 as issued by Moody's or BBB as issued by S&P.

**Credit Risk** Credit risk is the risk that the counterparty will not fulfill its obligations. All contracts as of June 30, 2017 reflect liabilities and, therefore, the Agency does not have current credit risk on its contracts. The Agency monitors the ratings of its counterparties to ascertain credit risk.

**Foreign Currency Risk** Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. All of the Agency's swaps are denominated in US dollars and are, therefore, not subject to foreign currency risk.

**Rollover Risk** Rollover risk exists when the derivative does not last as long as the associated debt is outstanding. The maturity dates of the Agency's swap contracts match the maturity dates of the hedged debts; therefore, the Agency has no rollover risk.

**Market Access Risk** Market access risk is the risk that the Agency will not be able to enter credit markets as planned or that credit will become more costly. The Agency's current market access risk is limited because the Series 37C variable-rate bonds have been directly purchased by TD Bank as the Agency's sole bondholder. The Bank of America, N.A. swap originally associated with Series 16C is the only swap with optional cancellations available.

**Quantitative Method of Evaluating Effectiveness** In order to assess the effectiveness of each hedging derivative instrument, the Agency employed the Synthetic Instrument Method. Under the Synthetic Instrument Method, a hedging derivative instrument is effective if the synthetic price is substantively fixed. The synthetic price as of the evaluation date, June 30, 2017, is compared to the synthetic price expected at the establishment of the hedge by calculation of an effectiveness percentage. If the effectiveness percentage is within a range of 90 to 111 percent, the synthetic price is substantively fixed. Following are the results of the testing as of the end of the reporting period:

| Hedgeable Item | Hedgeable Item Effective Bond Variable Rate | Derivative Instrument Floating Rate | Floating Rate Basis | Synthetic Price | 90 to 111% Range | Test Performance |
|---|---|---|---|---|---|---|
| Series 37C (formerly Series 16C) | 0.7593 | 0.7534 | (0.0059) | 3.8% | 3.4% – 4.2% | PASS |
| Series 37C (formerly Series 17C) | 0.7593 | 0.7534 | (0.0059) | 3.7% | 3.4% – 4.1% | PASS |
| Series 37C (formerly Series 18C) | 0.7593 | 0.7534 | (0.0059) | 3.3% | 2.9% – 3.6% | PASS |

**Swap Payments and Associated Debt** As rates vary, variable-rate bond interest payments and net swap payments will differ between the fixed rate paid to the counterparty and the variable rate paid to the Agency. Using rates as of June 30, 2017, debt service requirements of the variable-rate debt and net swap payments are as follows (*in thousands*):

| Fiscal Year | Variable-Rate Bond | | Interest Rate | Total |
|---|---|---|---|---|
| Ending June 30 | Principal | Interest | Swap, Net | Interest |
| 2018 | $ 2,255 | $ 235 | $ 662 | $ 897 |
| 2019 | 2,120 | 226 | 591 | 817 |
| 2020 | 1,970 | 205 | 535 | 740 |
| 2021 | 1,835 | 185 | 482 | 667 |
| 2022 | 1,710 | 166 | 434 | 600 |
| 2023-2027 | 8,560 | 569 | 1,482 | 2,051 |
| 2028-2032 | 5,670 | 174 | 448 | 622 |
| 2033-2035 | 625 | 7 | 16 | 23 |
| **Total** | **$ 24,745** | **$ 1,767** | **$ 4,650** | **$ 6,417** |

## F. NONCURRENT LIABILITIES

Noncurrent liabilities for the year ended June 30, 2017 were as follows *(in thousands):*

| | Beginning Balance | Additions | Deletions | Ending Balance | Due Within One Year |
|---|---|---|---|---|---|
| Bonds payable | | | | | |
| Bonds payable, net | $637,190 | $472,305 | $(241,425) | $868,070 | $ 25,730 |
| Bond premium | 1,712 | 11,312 | (746) | 12,278 | - |
| Derivative instrument – interest rate swap | 5,174 | - | (2,501) | 2,673 | - |
| Unearned revenues | 36,804 | 158,710 | (123,262) | 72,252 | 59,507 |
| Other liabilities | | | | | |
| Arbitrage rebate payable | 408 | - | (408) | - | - |
| Compensated absences | 1,129 | 106 | (42) | 1,193 | 161 |
| Deposits payable | 3,535 | 6,462 | (3,655) | 6,342 | 9 |
| Net pension liability* | 1,903 | 2,703 | - | 4,606 | - |
| | **$687,855** | **$651,598** | **$(372,039)** | **$967,414** | **$ 85,407** |

*Additional information regarding the net pension liability is included in Note I, “Pension Plan.”

## G. OPERATING LEASE

The Agency leases two adjacent buildings with future minimum lease payments for fiscal years 2018, 2019, 2020, 2021 and 2022 in the amounts of $736,000, $766,000, $687,000, $576,000 and $580,000, respectively. Rent expenses for all operating leases totaled $639,000 for the year ended June 30, 2017. The Agency’s lease for the main building will expire September 2022.

## H. FEDERAL AWARDS

As a designated Public Housing Authority for the US Department of Housing and Urban Development (HUD) Section 8 programs, the Agency requisitions Section 8 program funds and makes disbursements to eligible landlords. For the year ended June 30, 2017, $149,088,000 was received by the Agency and disbursed to property owners and is included in *Federal program awards received* and *Federal program expense* in Federal and State Programs.

The Agency is designated as the participating entity under grant agreements with HUD for the HOME Program. The HOME Program provides funding for the purpose of developing affordable housing for persons of low and very low income. For the year ended June 30, 2017, $20,108,000 was received and is included in *Federal program awards received* in Federal and State Programs. In fiscal year 2017, the Agency disbursed $23,697,000, which is included in *Federal program expense* and *Mortgage loans receivable, net,* depending on the terms of the transaction.

The Agency was selected as a participating entity under a grant agreement with Treasury passed through NeighborWorks® for the NFMC grant, which provides funding for counseling homeowners at risk of foreclosure. For the year ended June 30, 2017, $1,737,000 was received and disbursed by the Agency and is included in *Federal program awards received* and *Federal program expense* in Federal and State Programs.

The Agency received repayments of mortgage loans that were funded under the Tax Credit Assistance Program. These repayments provide funding for the Carryover Loan Program. For the year ended June 30, 2017, $6,503,000 was disbursed and is included as a part of *Mortgage loans receivable, net* in Federal and State Programs.

The Agency was selected as a participating entity under a grant agreement with Treasury for the HHF, which provides funding for homeowners facing foreclosure and stabilizes neighborhoods with poorly performing housing indicators. For the year ended June 30, 2017, $84,674,000 was received by the Agency and is included in *Federal program awards received* in Federal and State Programs. In fiscal year 2017, $84,979,000 was disbursed by the Agency and is included in *Federal program expense.* Also included in that amount is $305,000 of program income received from lien satisfactions.

The Agency earned fees of $17,065,000 for administering these and other federal programs for the year ended June 30, 2017. Of these fees, $3,966,000 was paid to Quadel Consulting Corporation for Section 8 Project-Based Contract Administration, and $3,367,000 was paid to counseling agencies for HHF counseling services, which are reported in *General and administrative expense*.

Federal awards are subject to audit by the grantor agencies. The Agency could be held liable for amounts received in excess of allowable expenditures.

## I. PENSION PLAN

**Plan Description** All permanent, full-time employees of the Agency participate in the Teachers' and State Employees' Retirement System of North Carolina (TSERS), a cost-sharing multiple-employer defined benefit pension plan administered by the State. TSERS provides retirement benefits to plan members and beneficiaries. State statute assigns the authority to establish and amend benefit provisions to the General Assembly. TSERS is included in the Comprehensive Annual Financial Report (CAFR) for the State. The State's CAFR includes financial statements and required supplementary information for TSERS. The report may be obtained from the website for the North Carolina Office of State Controller using the following link: https://www.osc.nc.gov/public-information/reports.

**Benefits Provided** TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of creditable service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of creditable service. Survivor benefits are available to eligible beneficiaries of members who die while in active service or within 180 days of their last day of service and who have either completed 20 years of creditable service regardless of age or have completed five years of service and have reached age 60. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

**Funding Policy** Plan members are required to contribute 6% of their annual covered salary, and the Agency is required to contribute at an actuarially determined rate. The fiscal year 2017 rate is 9.98% of the annual covered payroll. The contribution requirements of plan members and the Agency are established and may be amended by the General Assembly. The following table represents the three-year trend of the annual contributions made by the Agency to the State retirement system. The Agency made 100% of its required contributions for the years ended June 30, 2017, 2016, and 2015 *(in thousands):*

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Retirement Contribution | $862 | $722 | $710 |
| Percentage of Covered Payroll | 9.98% | 9.15% | 9.15% |

**Net Pension Liability** At June 30, 2017, the Agency reported a liability of $4,606,000 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016.

The total pension liability used to calculate the net pension was determined by an actuarial valuation as of December 31, 2015. The total pension liability was then rolled forward to the measurement date of June 30, 2016 utilizing update procedures incorporating the actuarial assumptions. The Agency's proportion of the net pension liability was based on a projection of the Agency's long-term share of future payroll covered by the pension plan, relative to the projected future payroll covered by the pension plan of all participating TSERS employers, actuarially determined. At June 30, 2016 and at June 30, 2015, the Agency's proportion was 0.05011% and 0.05164%, respectively.

**Deferred Outflows/Inflows of Resources Related to Pensions** For the year ended June 30, 2017, the Agency recognized pension expense of $905,000. At June 30, 2017, the Agency reported *Deferred Outflows of Resources* and *Deferred Inflows of Resources* related to pensions from the following sources *(in thousands)*:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Difference between actual and expected experience | $ - | $ 218 |
| Changes of assumptions | 679 | - |
| Net difference between projected and actual earnings on pension plan investments | 1,643 | - |
| Change in proportion and differences between Agency's contributions and proportionate share of contributions | 56 | - |
| Contributions subsequent to the measurement date | 862 | - |
| **Total** | **$ 3,240** | **$ 218** |

*Deferred Outflows of Resources* of $862,000 related to pensions resulting from Agency contributions subsequent to the measurement date will be recognized as a decrease of the net pension liability in the year ended June 30, 2018. Other amounts reported as *Deferred Inflows of Resources* related to pensions will be recognized in pension expense as follows *(in thousands)*:

| Year ending June 30: | |
|---|---|
| 2018 | $ 373 |
| 2019 | 379 |
| 2020 | 905 |
| 2021 | 503 |
| **Total** | **$ 2,160** |

**Actuarial Assumptions** The total pension liability was determined by an actuarial valuation performed as of December 31, 2015. The total pension liability was calculated through the use of update procedures to roll forward from the actuarial valuation date to the measurement date of June 30, 2016. The update procedures incorporated the actuarial assumptions used in the valuation. The entry age normal actuarial cost method was utilized. Inflation is assumed to be 3%, and salary increases range from 3.50% to 8.10% which includes 3.5% inflation and productivity factor. The long-term expected rate of return on pension plan investments used in the determination of the total pension liability is 7.25% and is net of pension plan investment expense, including inflation.

TSERS currently uses mortality tables that vary by age, gender, employee group (i.e. teacher, general, law enforcement officer) and health status (i.e. disabled and healthy). The current mortality rates are based on published tables and studies that cover significant portions of the US population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2015 valuations were based on the results of an actuarial experience study for the period January 1, 2010 through December 31, 2014.

Future ad hoc Cost of Living Adjustment amounts are not considered to be substantively automatic and are not included in the measurement.

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class as of June 30, 2016 are summarized in the following table:

| Asset Class | Target Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Fixed Income | 29.0% | 1.4% |
| Global Equity | 42.0% | 5.3% |
| Real Estate | 8.0% | 4.3% |
| Alternatives | 8.0% | 8.9% |
| Credit | 7.0% | 6.0% |
| Inflation Protection | 6.0% | 4.0% |
| Total | 100.0% | |

The information above is based on 30-year expectations developed with the consulting actuary and is part of the asset liability and investment policy of the North Carolina Retirement Systems, including TSERS. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. All rates of return and inflation are annualized.

**Discount Rate** The discount rate used to measure the total pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at statutorily required rates, actuarially determined. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

**Sensitivity of the Net Pension Liability to Changes in the Discount Rate** The following presents the Agency's proportionate share of the net pension liability calculated using the discount rate of 7.25%, as well as what the Agency's proportionate share of the net pension asset or net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.25%) or one percentage point higher (8.25%) than the current rate *(in thousands)*:

| | 1% Decrease (6.25%) | Discount Rate (7.25%) | 1% Increase (8.25%) |
|---|---|---|---|
| Agency's proportionate share of the net pension liability | $ 8,662 | $ 4,606 | $ 1,195 |

**Pension Plan Fiduciary Net Position** Detailed information about the pension plan's fiduciary net position is available in the separately issued CAFR for the State of North Carolina.

## J. POST-EMPLOYMENT / DISABILITY BENEFITS

In addition to pension benefits, Agency employees are provided post-employment health care benefits and long-term disability benefits in accordance with State statutes. These benefits are provided through plans administered by the State. The Agency makes monthly contributions to the State for these benefits. Health care benefits are provided to long-term disability beneficiaries of the Disability Income Plan of North Carolina (Disability Income Plan) and retirees who have at least five years of creditable service with TSERS. TSERS pays the full cost of coverage for retirees enrolled in the State's self-funded Teachers' and State Employees' Preferred Provider Organization medical plan who were hired prior to October 1, 2006, and retire with five or more years of State TSERS membership service. For employees hired on or after October 1, 2006, TSERS will pay the full cost of coverage for retirees with 20 or more years of service, TSERS will pay 50% of the cost of coverage for retirees with at least 10 years but less than 20 years of service, and the retiree with less than 10 years of service will pay the full cost of coverage. In addition, persons who became surviving spouses of retirees prior to October 1, 1986 receive the same coverage as retirees. Retirees and the aforementioned surviving spouses pay for the entire cost of coverage of their dependents. The health benefit plans are funded by the State on a pay-as-you-go basis.

Short-term and long-term disability benefits are provided through the Disability Income Plan. Long-term disability benefits are payable from the Disability Income Plan after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five years of contributing membership service with TSERS earned within 96 months prior to the end of the short-term disability period; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period, after salary continuation payments cease, or after monthly payments for workers' compensation cease, whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of employees' usual occupation; (4) the disability must have been continuous, likely to be permanent and incurred at the time of active employment; and (5) the employee must not be eligible to receive unreduced retirement benefits from TSERS. In addition, recipients of long-term disability benefits are eligible to receive the State-paid health insurance coverage. The monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation reduced by any social security or worker's compensation to which the recipient may be entitled up to a maximum of $3,900 per month. When an employee qualifies for an unreduced service retirement allowance from TSERS, the benefits payable from the Disability Income Plan cease, and the employee will commence retirement under TSERS.

All short-term disability benefit payments are made by the various State-administered plans. The Agency has no liability beyond payment of monthly contributions except for short-term disability benefits, which are paid by the Agency during the first six months of the short-term period. Contributions are determined as a percentage of covered monthly payrolls. Annually, the State sets monthly contribution rates for post-employment health care benefits, death benefits and disability benefits, which are the same for all agencies across the State.

The following table represents the three-year trend of the annual contributions made by the Agency to the State post-employment benefit plans. The Agency made 100% of its required contributions for the years ended June 30, 2017, 2016, and 2015 *(in thousands)*:

| | **2017** | **2016** | **2015** |
|---|---|---|---|
| Health Care Benefit | $502 | $442 | $426 |
| Disability Benefit | 33 | 32 | 32 |
| Death Benefit | 14 | 13 | 12 |
| **Percentage of Covered Payroll** | | | |
| Health Care Benefit | 5.81% | 5.60% | 5.49% |
| Disability Benefit | 0.38% | 0.41% | 0.41% |
| Death Benefit | 0.16% | 0.16% | 0.16% |

Since the benefit payments are made by the various State-administered plans and not by the Agency, the Agency does not determine the number of eligible participants.

## K. RISK MANAGEMENT

The Agency's risk management policies provide for participation in the State's risk management programs. The following types of risk are covered under these programs, as disclosed in the State's CAFR:

- Automobile, Fire and Other Property Losses
- Public Officers' and Employees' Liability Insurance
- Employee Dishonesty and Computer Fraud
- Workers' Compensation Program/Fund

The State is responsible for the administration of all liability insurance policies. The deductible and amount of loss in excess of the policy is the responsibility of the Agency.

In addition to the State's policies, the Agency purchased Cyber Liability and Fraudulent Instruction coverage in fiscal year 2017. This coverage is intended to mitigate financial losses associated with criminal acts of breach and fraudulent impersonation of Agency staff.

## L. SEGMENT INFORMATION

The Agency's Home Ownership Bond Programs are initially funded with bond proceeds. These proceeds are used to purchase mortgage loans which provide the income along with investment earnings to repay the debt. Condensed financial statements at June 30, 2017 for this segment are as follows (*in thousands*):

| **STATEMENT OF NET POSITION** | **Home Ownership** |
|---|---|
| **ASSETS** | |
| **Current assets:** | |
| Restricted cash and cash equivalents | $ 342,741 |
| Restricted investments | 1,008 |
| Accrued interest receivable on investments | 1,266 |
| Mortgage loans receivable | 124,862 |
| Mortgage loans held for resale | 23,341 |
| Accrued interest receivable on mortgage loans | 4,647 |
| Other assets | 5,834 |
| Interprogram receivable | 5,540 |
| **TOTAL CURRENT ASSETS** | $ 509,239 |
| **Noncurrent assets:** | |
| Restricted investments | $ 286,682 |
| Mortgage loans receivable, net | 470,724 |
| **TOTAL NONCURRENT ASSETS** | $ 757,406 |
| **TOTAL ASSETS** | $ 1,266,645 |
| **DEFERRED OUTFLOWS OF RESOURCES** | |
| Accumulated decrease in fair value of hedging derivative | $ 2,673 |
| **TOTAL DEFERRED OUTFLOWS OF RESOURCES** | $ 2,673 |
| **LIABILITIES** | |
| **Current liabilities:** | |
| Bonds payable | $ 25,730 |
| Accrued interest payable | 11,183 |
| Accounts payable | 2,498 |
| **TOTAL CURRENT LIABILITIES** | $ 39,411 |
| **Noncurrent liabilities:** | |
| Bonds payable, net | $ 854,618 |
| Derivative instrument - interest rate swap | 2,673 |
| **TOTAL NONCURRENT LIABILITIES** | $ 857,291 |
| **TOTAL LIABILITIES** | $ 896,702 |
| **NET POSITION** | |
| Restricted | $ 372,616 |
| **TOTAL NET POSITION** | $ 372,616 |

| STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION | Home Ownership |
|---|---|
| **OPERATING REVENUES** | |
| Interest on investments | $ 5,529 |
| Net increase in fair value of investments | 5,717 |
| Interest on mortgage loans | 35,517 |
| Program income/fees | 32,808 |
| Other revenues | 415 |
| **TOTAL OPERATING REVENUES** | $ 79,986 |
| **OPERATING EXPENSES** | |
| Interest on bonds | $ 26,163 |
| Mortgage servicing expense | 2,140 |
| Nonfederal program expense | 23,185 |
| General and administrative expense | 849 |
| Other expenses | 1,037 |
| **TOTAL OPERATING EXPENSES** | $ 53,374 |
| **OPERATING INCOME** | $ 26,612 |
| **NON-OPERATING EXPENSES** | |
| Transfers out | $ (62) |
| **TOTAL NON-OPERATING EXPENSES** | $ (62) |
| **CHANGE IN NET POSITION** | $ 26,550 |
| **TOTAL NET POSITION - BEGINNING** | $ 346,066 |
| **TOTAL NET POSITION - ENDING** | $ 372,616 |

**STATEMENT OF CASH FLOWS**

| | |
|---|---|
| Net cash provided by operating activities | $ 132,588 |
| Net cash provided by non-capital financing activities | 215,016 |
| Net cash used in investing activities | (193,037) |
| Net increase in cash | $ 154,567 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | 188,174 |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | $ 342,741 |

# North Carolina Housing Finance Agency

# Supplementary Information

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Suite 300
Raleigh, NC 27601

## Independent Auditor's Report on Supplementary Information

Our audit of the financial statements included in the preceding section of this report was conducted for the purpose of forming an opinion on those statements as a whole. The supplementary information presented in the following section of this report is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

BDO USA, LLP

September 25, 2017

## NORTH CAROLINA HOUSING FINANCE AGENCY

**COMBINING STATEMENT OF NET POSITION**

**AS OF JUNE 30, 2017**

| (in thousands) | AGENCY PROGRAMS | GRANT PROGRAMS: Housing Trust Fund Programs | GRANT PROGRAMS: Federal and State Programs | HOME OWNERSHIP BOND PROGRAMS: 1998 | HOME OWNERSHIP BOND PROGRAMS: 2009 | Total |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| **Current assets:** | | | | | | |
| Cash and cash equivalents | $ 12,755 | - | - | - | - | $ 12,755 |
| Restricted cash and cash equivalents | 51,405 | 95,913 | 151,285 | 331,048 | 11,693 | 641,344 |
| Investments | 1,008 | - | - | - | - | 1,008 |
| Restricted investments | 5,013 | - | - | - | 1,008 | 6,021 |
| Accrued interest receivable on investments | 39 | 90 | 28 | 1,220 | 46 | 1,423 |
| Mortgage loans receivable | 202 | 1,163 | 13,496 | 105,806 | 19,056 | 139,723 |
| Mortgage loans held for resale | - | - | - | 23,341 | - | 23,341 |
| Accrued interest receivable on mortgage loans | 2 | 17 | 109 | 3,902 | 745 | 4,775 |
| State receivables | - | - | 131 | - | - | 131 |
| Other assets | 229 | 56 | 1,724 | 5,231 | 603 | 7,843 |
| Interprogram receivable (payable) | 2,416 | 27 | (7,983) | 5,375 | 165 | - |
| **TOTAL CURRENT ASSETS** | $ 73,069 | 97,266 | 158,790 | 475,923 | 33,316 | $ 838,364 |
| **Noncurrent assets:** | | | | | | |
| Investments | $ 2,038 | - | - | - | - | $ 2,038 |
| Restricted investments | 3,123 | - | - | 279,492 | 7,190 | 289,805 |
| Mortgage loans receivable, net | 2,324 | 15,347 | 81,373 | 371,118 | 99,606 | 569,768 |
| Other assets, net | 3,174 | - | - | - | - | 3,174 |
| **TOTAL NONCURRENT ASSETS** | $ 10,659 | 15,347 | 81,373 | 650,610 | 106,796 | $ 864,785 |
| **TOTAL ASSETS** | $ 83,728 | 112,613 | 240,163 | 1,126,533 | 140,112 | $ 1,703,149 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | | | | | |
| Deferred outflows for pensions | $ 3,240 | - | - | - | - | $ 3,240 |
| Accumulated decrease in fair value of hedging derivative | - | - | - | 2,673 | - | 2,673 |
| **TOTAL DEFERRED OUTFLOWS OF RESOURCES** | $ 3,240 | - | - | 2,673 | - | $ 5,913 |
| **LIABILITIES** | | | | | | |
| **Current liabilities:** | | | | | | |
| Bonds payable | $ - | - | - | 22,410 | 3,320 | $ 25,730 |
| Accrued interest payable | - | - | - | 9,280 | 1,903 | 11,183 |
| Accounts payable | 625 | 46 | 1,697 | 2,319 | 179 | 4,866 |
| Unearned revenues | 1,705 | - | 57,802 | - | - | 59,507 |
| Other liabilities | 166 | - | 4 | - | - | 170 |
| **TOTAL CURRENT LIABILITIES** | $ 2,496 | 46 | 59,503 | 34,009 | 5,402 | $ 101,456 |
| **Noncurrent liabilities:** | | | | | | |
| Bonds payable, net | $ - | - | - | 735,814 | 118,804 | $ 854,618 |
| Derivative instrument - interest rate swap | - | - | - | 2,673 | - | 2,673 |
| Unearned revenues | 12,745 | - | - | - | - | 12,745 |
| Other liabilities | 11,971 | - | - | - | - | 11,971 |
| **TOTAL NONCURRENT LIABILITIES** | $ 24,716 | - | - | 738,487 | 118,804 | $ 882,007 |
| **TOTAL LIABILITIES** | $ 27,212 | 46 | 59,503 | 772,496 | 124,206 | $ 983,463 |
| **DEFERRED INFLOWS OF RESOURCES** | | | | | | |
| Deferred state grant | $ - | 4,221 | - | - | - | $ 4,221 |
| Deferred inflows for pensions | 218 | - | - | - | - | 218 |
| **TOTAL DEFERRED INFLOWS OF RESOURCES** | $ 218 | 4,221 | - | - | - | $ 4,439 |
| **NET POSITION** | | | | | | |
| Restricted | $ 40,238 | 108,346 | 180,660 | 356,710 | 15,906 | $ 701,860 |
| Unrestricted | 19,300 | - | - | - | - | 19,300 |
| **TOTAL NET POSITION** | $ 59,538 | 108,346 | 180,660 | 356,710 | 15,906 | $ 721,160 |

# NORTH CAROLINA HOUSING FINANCE AGENCY

**COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION**

**YEAR ENDED JUNE 30, 2017**

| | AGENCY PROGRAMS | GRANT PROGRAMS | | HOME OWNERSHIP BOND PROGRAMS | | |
|---|---|---|---|---|---|---|
| (in thousands) | | Housing Trust Fund Programs | Federal and State Programs | 1998 | 2009 | Total |
| **OPERATING REVENUES** | | | | | | |
| Interest on investments | $ 942 | 824 | 729 | 5,292 | 237 | $ 8,024 |
| Net (decrease) increase in fair value of investments | (300) | - | - | 6,028 | (311) | 5,417 |
| Interest on mortgage loans | 40 | 578 | 1,202 | 30,719 | 4,798 | 37,337 |
| Federal program awards received | - | - | 255,607 | - | - | 255,607 |
| Program income/fees | 11,979 | 1,431 | 27,657 | 32,808 | - | 73,875 |
| Other revenues | 6 | - | 600 | 415 | - | 1,021 |
| **TOTAL OPERATING REVENUES** | $ 12,667 | 2,833 | 285,795 | 75,262 | 4,724 | $ 381,281 |
| **OPERATING EXPENSES** | | | | | | |
| Interest on bonds | $ - | - | - | 22,350 | 3,813 | $ 26,163 |
| Mortgage servicing expense | 1 | - | - | 1,691 | 449 | 2,141 |
| Federal program expense | - | - | 251,409 | - | - | 251,409 |
| Nonfederal program expense | 2,584 | - | - | 23,185 | - | 25,769 |
| General and administrative expense | 21,015 | - | 7,333 | 814 | 35 | 29,197 |
| Other expenses | 2 | 62 | 738 | 969 | 68 | 1,839 |
| **TOTAL OPERATING EXPENSES** | $ 23,602 | 62 | 259,480 | 49,009 | 4,365 | $ 336,518 |
| **OPERATING (LOSS) INCOME** | $ (10,935) | 2,771 | 26,315 | 26,253 | 359 | $ 44,763 |
| **NON-OPERATING REVENUES (EXPENSES)** | | | | | | |
| Transfers in (out) | $ 18,205 | (21) | (18,122) | (62) | - | $ - |
| State appropriations received | - | 47,660 | 3,000 | - | - | 50,660 |
| State grants received | - | 5,520 | 7,675 | - | - | 13,195 |
| State program expense | (38,252) | (18,234) | (13,058) | - | - | (69,544) |
| **TOTAL NON-OPERATING REVENUES (EXPENSES)** | $ (20,047) | 34,925 | (20,505) | (62) | - | $ (5,689) |
| **CHANGE IN NET POSITION** | $ (30,982) | 37,696 | 5,810 | 26,191 | 359 | $ 39,074 |
| **TOTAL NET POSITION - BEGINNING** | $ 90,520 | 70,650 | 174,850 | 330,519 | 15,547 | $ 682,086 |
| **TOTAL NET POSITION - ENDING** | $ 59,538 | 108,346 | 180,660 | 356,710 | 15,906 | $ 721,160 |

## NORTH CAROLINA HOUSING FINANCE AGENCY

**COMBINING STATEMENT OF CASH FLOWS**

**YEAR ENDED JUNE 30, 2017**

| | AGENCY PROGRAMS | GRANT PROGRAMS | | HOME OWNERSHIP BOND PROGRAMS | | |
|---|---|---|---|---|---|---|
| (in thousands) | | Housing Trust Fund Programs | Federal and State Programs | 1998 | 2009 | Total |
| **Cash flows from operating activities:** | | | | | | |
| Interest on mortgage loans | $ 41 | 577 | 1,186 | 31,815 | 4,861 | $ 38,480 |
| Principal payments on mortgage loans | 360 | 1,193 | 13,880 | 94,814 | 16,901 | 127,148 |
| Purchase of mortgage loans | - | (250) | (14,595) | (80) | - | (14,925) |
| Principal payments on mortgage loans held for resale | - | - | - | 255,318 | - | 255,318 |
| Purchase of mortgage loans held for resale | - | - | - | (278,659) | - | (278,659) |
| Federal program awards received | - | - | 290,513 | - | - | 290,513 |
| Federal program expense | - | - | (251,550) | - | - | (251,550) |
| Nonfederal program expense | (2,584) | - | - | (23,185) | - | (25,769) |
| Federal grant administration income | - | - | 16,005 | - | - | 16,005 |
| Program income/fees | 12,905 | 1,431 | 11,652 | 32,808 | - | 58,796 |
| Other expenses | (19,939) | (121) | (4,096) | (2,300) | (620) | (27,076) |
| Other revenues | (2,410) | 118 | - | 593 | 322 | (1,377) |
| **Net cash (used in) provided by operating activities** | $ (11,627) | 2,948 | 62,995 | 111,124 | 21,464 | $ 186,904 |
| **Cash flows from non-capital financing activities:** | | | | | | |
| Issuance of bonds | $ - | - | - | 472,305 | - | $ 472,305 |
| Principal repayments on bonds | - | - | - | (217,770) | (23,655) | (241,425) |
| Interest paid | - | - | - | (7,570) | (4,360) | (11,930) |
| Bond issuance costs paid | - | - | - | (3,872) | - | (3,872) |
| Net transfers | 18,205 | (21) | (18,122) | (62) | - | - |
| State appropriations received | - | 47,660 | 3,000 | - | - | 50,660 |
| State grants received | - | 4,221 | 8,638 | - | - | 12,859 |
| State tax credits | 29,752 | - | - | - | - | 29,752 |
| State program expense | (38,252) | (18,234) | (13,058) | - | - | (69,544) |
| **Net cash provided by (used in) non-capital financing activities** | $ 9,705 | 33,626 | (19,542) | 243,031 | (28,015) | $ 238,805 |
| **Cash flows from investing activities:** | | | | | | |
| Proceeds from sales or maturities of investments | $ - | - | - | 3,772 | - | $ 3,772 |
| Purchase of investments | - | - | - | (202,944) | - | (202,944) |
| Earnings on investments | 941 | 773 | 701 | 5,901 | 234 | 8,550 |
| **Net cash provided by (used in) investing activities** | $ 941 | 773 | 701 | (193,271) | 234 | $ (190,622) |
| Net (decrease) increase in cash | $ (981) | 37,347 | 44,154 | 160,884 | (6,317) | $ 235,087 |
| Cash and cash equivalents at beginning of year | 65,141 | 58,566 | 107,131 | 170,164 | 18,010 | 419,012 |
| **Cash and cash equivalents at end of year** | $ 64,160 | 95,913 | 151,285 | 331,048 | 11,693 | $ 654,099 |
| **Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:** | | | | | | |
| Operating (loss) income | $ (10,935) | 2,771 | 26,315 | 26,253 | 359 | $ 44,763 |
| **Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:** | | | | | | |
| Interest on investments | (942) | (824) | (729) | (5,292) | (237) | (8,024) |
| Decrease (increase) in fair value of investments | 300 | - | - | (6,028) | 311 | (5,417) |
| Interest on bonds | - | - | - | 22,350 | 3,813 | 26,163 |
| **Change in assets and liabilities:** | | | | | | |
| Decrease (increase) in mortgage loans receivable | 362 | 1,005 | (619) | 94,811 | 16,925 | 112,484 |
| Decrease (increase) in interest receivable on mortgage loans | 1 | (1) | (16) | 1,289 | 86 | 1,359 |
| Increase in mortgage loans held for resale | - | - | - | (23,341) | - | (23,341) |
| (Increase) decrease in other assets | (4,324) | 118 | 307 | 378 | 299 | (3,222) |
| Increase (decrease) in accounts payable and other liabilities | 3,062 | (121) | 3,138 | 704 | (92) | 6,691 |
| Increase in unearned revenues | 849 | - | 34,599 | - | - | 35,448 |
| **Total adjustments** | $ (692) | 177 | 36,680 | 84,871 | 21,105 | $ 142,141 |
| **Net cash (used in) provided by operating activities** | $ (11,627) | 2,948 | 62,995 | 111,124 | 21,464 | $ 186,904 |

NORTH CAROLINA HOUSING FINANCE AGENCY

***Our Mission*** *is to create affordable housing opportunities for North Carolinians whose needs are not met by the market*

***Our Vision*** *is to lead the nation in creating sustainable housing opportunities that people can afford.*

***Our Values:*** *We Care, We Act, We Lead*

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