TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS
BOARD WORKSHOP

March 12, 2008
4:00 p.m.

221 East 11th Street
Austin, Texas

BOARD MEMBERS:

C. KENT CONINE, Chair
GLORIA RAY
SONNY FLORES
LESLIE BINGHAM ESCAREÑO

STAFF:

MICHAEL GERBER, Executive Director

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P R O C E E D I N G S

MR. CONINE: We just got word from Leslie that she's at the airport on her way in, and I don't want to hold all these -- everybody up, because we're somewhat on a short time leash, I'm sure, for the pontification that we're going to hear here shortly. So let's go ahead and call the meeting to order, call the roll. Leslie will be here in a minute. Thomas Cardenas is not here. Kent Conine is here. Juan Munoz is not here. Gloria Ray?

MS. RAY: Here.

MR. CONINE: Sonny Flores?

MR. FLORES: Here.

MR. CONINE: I'm not going to worry about a quorum at this point.

Any public comment? We normally hear some public comment. Don't see any public comment. Don't have any witness affirmation forms. We'll move right on.

Today we're here for a couple of presentations. We'll turn it over to -- well, first off, I'll tell you, since we're kind of in a semi-intimate setting, and I see some faces I haven't seen before, let's just do a once around the room right quick and let everybody quickly introduce themselves. And if you want to say what you're doing here or what you're not doing here, it's fine with

me, but I'll start. Kent Conine, the Board Chair.

MR. MELVEAUX: I'm Mark Melveaux with McCall, Parkhurst & Horton and disclosure counsel to TDHCA.

MS. RIPPY: Elizabeth Rippy with Vinson & Elkins, Bond Counsel for TDHCA.

MR. GERDES: Steve Gerdes with Vinson & Elkins, tax lawyer.

MR. MORRIS: Ed Morris in Bond Finance.

MR. POGOR: Matt Pogor, Director of Bond Finance.

MR. MACHAK: Gary Machak with RBC Capital Markets and Financial Advisor to the Department.

MR. FLORES: Sonny Flores, board member.

MS. RAY: Gloria Ray, board member.

MR. GERBER: Mike Gerber, Executive Director.

MS. DONOHO: Sandy Donoho, Director of Internal Audit.

MR. KIKER: Bobby Kiker, State Auditor's Office.

MS. GUTIERREZ: Cathy Gutierrez, Texas Homeownership Division.

MS. EVERETT: Sharon Everett, Single Family.

UNIDENTIFIED SPEAKER: Our newest addition to Single Family, I might add. We're delighted to have her

there working for the First Time Homeowner Program.

MR. CONINE: Welcome aboard.

MS. EVERETT: Thank you.

MR. GOURIS: Tom Gouris, Acting Deputy Executive Director --

(Laughter)

MS. OEHLER: Amy Oehler, Director of the Community Affairs Division.

MS. KING: Jackie King, Governor's Office.

MS. MEYER: Robbye Meyer, Director of Multifamily Finance.

MR. PIKE: Eric Pike, Texas Homeownership Division.

MS. CRAWFORD: Kelly Crawford, Deputy for Disaster Recovery.

MR. DALLY: Bill Dally, Deputy Executive Director of Administration.

MR. HOWELL: J.C. Howell with RBC Capital Markets.

MR. ETTELDORF: Rob Etteldorf, RBC Capital Markets.

MR. WITHROW: Barton Withrow, RBC Capital Markets.

MS. CHERN: Lillian Chern, Swap Financial

Group.

MR. CONINE: Great. We know who you are, too, Counselor. Charlie [phonetic], you can introduce yourself if you like.

Okay. Amy, you're up.

MS. OEHLER: Good afternoon. Again, I'm Amy Oehler, the Director of the Community Affairs Division. And today we're going to walk through three of the five federally funded programs in the Community Affairs Division. These three programs that are listed here, they represent $80 million of the $90 million that are funded through the Community Affairs Division at the Department of Housing and Community Affairs.

In these three programs, we serve over half a million households, 548,000 households a year. And these programs are administered through a network of subrecipients. And we have over 50 subrecipients that represent community action agencies, private nonprofit entities, and units of local governments. We also have 31 full-time equivalents who work in these three programs, the Comprehensive Energy Assistance Program, the Weatherization Assistance Program, and Community Services Block Grant.

The next slide is a picture of an outreach

center at Panhandle Community Services. And this is just a representation of the three programs working in conjunction with each other. The regulations encourage the use of these three funds together to meet the myriad of needs among Texas low-income households.

The next slide --

MR. GERBER: So just to give you kind of a sense of this, the Community Services Block Grant Program, which Amy will talk about in greater detail, is really the administrative anchor for the Community Action Network and for a number of other partners that we have around the state. Other programs get really aligned with CSBG, CSBG being the anchor, Energy Assistance and Weatherization will be aligned with it, but there may also be Headstart, a myriad of Health and Human Services programs and other things.

So we might have, in Community Services Block Grant funding, a million dollars into a particular community action agency partner, but the overall programs that are operating out of that community action agency may total, you know, $20- or $30 million.

MS. OEHLER: The purpose of the Comprehensive Energy Assistance Program is to meet the immediate energy needs of low-income households. And this is done by

utility assistance for electric, gas and propane bills; as well as repair and replacing and retrofitting heating and cooling systems, HVAC systems and refrigerators.

The primary purpose of the Weatherization Assistance Program is to reduce the energy consumption in low-income households; and, therefore, that frees up some of their household income to be able to meet other needs.

We're also -- we also address health and safety needs of the household. We test for carbon monoxide. We're able to install smoke detectors. We're able to check for gas leaks and address those problems as they arise.

As it shows here, there's $36 million each year in the Comprehensive Energy Assistance Program, and 13.7- in the Weatherization Program. The funding sources for these programs are the U.S. Department of Energy and the U.S. Department of Health and Human Services. And each year we provide our funding -- our plan, our annual plan, to these entities. And these plans will come before you. One will be presented to you tomorrow, the 2008 Department of Energy Plan, that is required by DOE.

I also want to mention that the one private-funded, or privately funded program between [inaudible] are the investor-owned utility contracts. And those are

as a result of rate cases settled at the PUC in the 1990s. These are three of the companies that we receive funding for to leverage with our federal funds.

As I mentioned, the plan -- the annual plan will come before you, as well as the opportunity to comment on the formulas that we use to allocate the funds for these programs. At the moment, the focus of the allocation is on the percentage of poverty in each county. And we have to take some other factors into account -- the heating and cooling degree days in accounting, as well as the inverse entity ratio. And that relates to, you know, providing services in sparsely populated areas.

The eligibility for the programs, these three programs, is that households are at or below 125 percent of the federal poverty. And this is something that is at the discretion of the Board. At the moment, with this level, we're about to serve about 7 percent of the eligible population in Texas with these programs. And the Board does have the option to raise that to 150 percent of federal poverty. Staff probably wouldn't recommend that, because, really, it would just -- it would increase the number of households that we couldn't serve.

The next slide, the Weatherization Policy Advisory Council, this is a council that's required or

mandated by the Department of Energy. And there are three different groups that are represented on this advisory council: weatherization providers, energy conservation interests, and consumer-related interests. And these appointments can be made by the Board or approved by the Board.

The next slide -- I think I have a few pictures of some work that's being done on a weatherization household. This -- it's difficult to see, but it's what's called a blower door that we set up in the door and it creates a vacuum. And it measures the cubic feet per minute of the air infiltration in your home, in a resident's home. And it helps us determine -- this is one of the tools that we use to determine the work that's necessary in the home.

Along with the blower door, we also use a duct blaster, which helps determine if there are problems in the duct system. Because if you just address an HVAC system but you don't address the duct system, sometimes that can cause problems. And so we assess the entire home. It's a whole-house assessment, and it takes about an hour and a half for a weatherization assessor to go into the home and address all of the appliances and the air infiltration in and out of the home. And that

information is then put into a computerized energy audit that has been approved by the Department of Energy, and that information is calculated, and there's a savings-to-investment ratio that helps determine what measures are most cost-effective to addressing the home.

And the local weatherization provider takes that information and then they take the funding that's available for that particular unit, and they make decisions on what is the most effective use of these funds to help lower the energy consumption and then effectively lower the utility bills.

This is just a picture of, where we replaced an old AC unit with a new one, and we require Energy Star units.

The next picture is where we're testing the consumption of an HVAC system. We also do the same thing in the home on the refrigerator with a meter, where you can determine the amount of energy that your refrigerator uses. And with that, you can determine if the refrigerator needs to be replaced or repaired.

The next picture is two years ago we had an HVAC pilot program, and based on this pilot program, we're now requiring that all of our weatherization providers produce what's called a heat-load calculation. And the

reason for this -- and this is something that affects all of us. It doesn't just affect the low-income households.

In fact, there was research done nationwide. And when you take into account all of the -- the sample that was taken for the HVAC systems across the U.S., the systems are only working at 66 percent of their efficiency. And the reason for that is because most of them are mis-sized. And everyone thinks that bigger is better, and that's not necessarily the case when you're dealing with HVAC systems. And so most homes -- your home, my home -- most homes have oversized HVAC systems. And so this is one of the most cost-effective ways to address energy consumption in a home.

And this is -- you know, like I said, we -- there was a pilot program that was tested. And now, as of April 1 of this year, we're going to require heat-load calculation. And the purpose of that is to hold the HVAC contractors accountable. They're procured at the local level by the weatherization assessors to install the HVAC equipment, and they still perform the assessments, but the local assessors now are required to understand how to size a system so that they can hold their contractors accountable. And the end result is to produce better efficiency in the home.

As I mentioned earlier, as a whole, these three programs serve over half a million households. The utility assistance, in particular, serves over 51,000 households, and we weatherize about 3,000 units a year. And to put this into perspective, we have 14,000 clients on waiting lists for weatherization services. And so every year, we're able to serve about 3,000, and that helps, you know, chip away at the 14,000. But, of course, that list is always growing, because the need is always there to address the low-income homes.

The next program I'm going to talk about is the Community Services Block Grant that Mike mentioned earlier. The purpose of this program is to reduce poverty. And what's really -- what's great about this program and -- that you can -- as Mike said, you can leverage it with other -- it can be used to provide the administration for most low-income programs.

Several years ago, the program year 2004, the network in Texas was able to transition 1,500 households out of poverty. There is a goal that was set for -- by Mr. Gerber to transition over 3,000 households out of poverty. And as of the 2007 program year, that number has been met. And so we will continue to encourage our local network to transition more clients out of poverty.

And I think what's important to know about all of these programs is that they're not entitlement programs, and they are not intended to be used year after year. The purpose of them -- of the Weatherization Program, is to really make an impact on these homes so that the clients can move out of poverty. And CSBG is just another way that we help low-income households in Texas not need this assistance anymore. And that's the primary purpose.

The Board --

MR. HAMBY: Can I say something real quick? It's not an entitlement program for individuals who receive the funding. It is an entitlement program --

MS. OEHLER: For the state.

MR. HAMBY: -- for the assistance -- for the community action agencies. It's an Evergreen program. They've had these programs since the '60s. So in order to take funds away, we had to go through an elaborate hearing process. So it's not an entitlement program for individuals receiving, but it is, to a large degree, an entitlement program for people who have been designated by the government.

MS. OEHLER: The -- and thank you for that.

The provider network that we call the

subrecipient network, most of those were designated in the 1960s. The ones that have changed are ones -- if there have been performance problems throughout the years, there's a handful that have been released to request for proposal or we've determined the best provider for that particular area. But the funds do automatically go to the subrecipient network every year, and it comes to the State of Texas every year. It's not something that Texas has to apply for. They automatically come to the State.

There are over 46 eligible entities or subrecipients in the state of Texas. And another action item that you will see tomorrow is we are -- we released the request for application in December for a new eligible entity, or several new eligible entities in South Texas, based on the voluntary relinquishment of programs at the Community Action Council of South Texas and at Rio Grande City.

And, again, that's a very rare situation, but when that does occur, then we certainly want to make these programs competitive and open for anyone who could provide the services.

MR. GERBER: And that was the case, just since you highlighted it, where the health-care programs that they had really got them overextended, and they are, I

think, in the hole by about $5 million. And they felt that they just could not continue to operate their other programs because they were so overextended. So that's why they voluntarily relinquished these programs. There's no evidence of any, you know, problems on our programs or the CSBG dollars, but since they can't operate, we'll -- we need to find a new provider.

There have been other instances of CSBG providers or community action agencies like, for example, the one -- what's the name of the one in Sequin? I forgot the --

MS. OEHLER: Community Council of Central Texas.

MR. GERBER: -- where we have -- where they have also gotten overextended, but they are not so in the red that through some intensive work and technical assistance we can't get them through, and we're providing that. But we have to put them on a cost-reimbursement basis so as to ensure that the things that they're supposed to be paying for they are, in fact, paying for. And I think that's true across other program areas that are also served by the community action agency.

MR. FLORES: Amy, so long as we've gotten to a stopping point, I've been dying to find out --

eligibility, when do we decide the eligibility status? What time of the year? Is it coming up any time soon?

MS. OEHLER: Whenever the plans -- whenever the draft plans are brought before the Board.

MR. FLORES: When is that? What month?

MS. OEHLER: Okay. Well -- and actually, there's several different plans. The Community Services Block Grant, that plan is due September 1 every year, as well as the Low Income Home Energy Assistance Program. Those are the two that are due September 1. And then the Department of Energy State Plan is due March 1. And actually that one's going to be a little bit late, but you'll see that one tomorrow.

MR. FLORES: And do we get to discuss that [electronic interference] I'm not so sure I like this idea 125 percent of the federal funded guideline. How did we arrive at that?

MS. OEHLER: Well --

MR. FLORES: How did we arrive at that particular number?

MS. OEHLER: Okay. The decision was made because it's in line with some of the other -- with Section 8 and some of the other programs. And a lot of it was to provide consistency. And then also, as I

mentioned, if it's -- if the limit is raised, which is an option of yours, it would just increase the number of clients we're not -- we're only able to serve 7 percent of the 125.

MR. FLORES: Seventy. Right?

MS. OEHLER: Seven.

MR. FLORES: Seven percent? I thought you said 70. So there's 93 percent out there waiting.

MS. OEHLER: Unmet, yes.

MR. FLORES: They must be living with somebody else or something, I'm guessing.

MR. GERBER: And the biggest and most frustration part of it --

MR. FLORES: I thought you said 70, but its 7 percent. We're not even scratching the surface.

MR. GERBER: And most frustrating is that we're really only providing a stopgap with utility assistance. We're not --

(Pause.)

MR. FLORES: I realize that. It's just the numbers. I thought she was talking about 70 percent, but it's only 7 percent.

MR. GERBER: Seven percent, and it's frustrating, because we're only really providing stopgap

with utility assistance and not actually able to have enough funds to go in and actually weatherize the home and make the fixes.

And I'll just add we're pleased to be joined by Leslie Bingham Escareño, who is our newest board member for -- and we'll go around the room again to -- when we move into the next section. Welcome.

MS. OEHLER: The next slide -- actually we can move on. Thank you.

Ninety percent of the Community Services Block Grant allocation goes to the network that Kevin and I were speaking of, it goes to the subrecipient network that has been deemed eligible by the governor. The other, the remaining 10 percent, 5 percent is for state administration; the other 5 is discretionary. And up until this year, 2008, the funds have been provided to migrant seasonal farm workers, Native American -- or groups that serve Native Americans, as well as some innovative projects.

There's going to be a change made in the program year 2009. We're going to release a notice of funding availability in the fall, and the public will be made aware of the CSBG discretionary funds, and entities can apply for these funds, to make the process more

competitive.

In some cases, there were some entities that received the programs year after year. What we're really looking for is new and innovative ideas. We want to be able to use these funds, because the funds typically are reduced every year. Oftentimes, federal programs are. We want to make the best use of these funds. And so we have sent letters to all of the recipients of the 2008 CSBG discretionary funds, and we've made them aware that in 2009 the process will become competitive. And it will be released, and the public will be made aware of these funds.

MR. HAMBY: And just for clarification on that, the Board will see that sometime in, probably, August -- September or maybe August meeting. And if you want a briefing on -- beforehand on activities that are eligible, it's very, very broad under CSBG. So if you know of things that you might like to see happen, you know, whether it's --

MR. GERBER: And we'll probably bring some of those to you like, for example --

MR. HAMBY: Right.

MR. GERBER: -- incentivizing use of the earned income tax credit by those community action agencies or

other worthy goals that move people to self-sufficiency.

The problem with the discretionary fund has been that we -- much like with the other, the bigger pot, we've made some contracts really evergreen and made people dependent on those funds year in and year out. And we want them to, you know, also look for other sources of funding so we can continue to expand initiatives around the state and open it up to -- you know, to new Native American tribes or to new migrant seasonal farm worker groups that consist -- it's intended to be seed money to do innovative projects.

And so there are a couple of things that we will probably need to -- although we'll probably be making recommendations to you about a couple of projects. One is our work with the Texas Association of Community Action Agencies, TACAA. They provide a lot of technical assistance to the community action agencies, and there is probably some merit, given the challenges that they are dealing with in improving overall performance, to having a discussion about whether or not we should look to give them a direct grant.

Likewise, this department has responsibility for the Texas Interagency Council on the Homeless, and there may be some value to continuing a relationship with

the Texas Homeless Network. But those would be a relatively small part of that 5 percent.

But those are two sort of outliers that we haven't yet figured out what we want to recommend -- what ideas we want to bring to the Board yet on -- but you can expect to see those too.

MR. HAMBY: But the Board has never had this -- never seen this before, so that's why --

MR. GERBER: This is new.

MR. HAMBY: -- it was new to you.

MR. GERBER: That's right.

MR. HAMBY: It's new to everybody, so --

MS. OEHLER: And then in the back of the packet, there's actually -- there's a list of the eligible uses for CSBG discretionary funds and -- that you could take a look at.

Then we're also -- we'll also propose a set-aside for the Disaster Assistance Unit, something that we're -- you know, we're contacted when disaster affects one of the subrecipients, they're one of the first entities that they contact. So we will propose a set-aside for Disaster Assistance.

In the Community Services Block Grant, we serve about -- or over 480 persons a year. And as I mentioned

before, over 3,000 households were transitioned out of poverty.

And this is just a list of the types of programs that the CSGB funds can be used to administer. And I touched on it at the beginning of the presentation, but transportation, emergency services, health services, housing services -- there's quite an array of the services that can be supported by the Community Services Block Grant.

And these are a few more pictures of the -- one of our subrecipients who [inaudible] programs. And there's some additional information in the back of your packet, as I mentioned, that goes into more detail about the funding formula and the Weatherization Policy Advisory Council, and the use of the CSBG funds.

I'd be happy to take questions, if you have any.

MR. GERBER: I just have one last thing, and that is that, you know, sometimes we get lost on the housing side, and we forget that this really is the Department of Housing and Community Affairs. And these Community Affairs programs really make such important inroads in communities in providing additional support for that community's social services safety net. And it's

just some very innovative things that the action agencies have done, as well as our other partners. And so there's a lot of room for innovativeness.

And the goal of the division, I think, has been set to try to get as many Texans on -- who have come in for social services and move them to self-sufficiency. That's the overarching goal of it. So we have a 3,000 goal -- person goal now, up from 1500, you know, a year and a half ago. And the goal is going to be to continue to grow that number and get greater efficiency as they partner and do other innovative things.

But it's an area that has not typically had lots of board oversight. We've, as a team -- as a manager team, felt that the Board needed to have more oversight and see more of these plans and offer more comments about them. And so you'll be seeing more of these, and we'll just do some additional training.

But, probably, Mr. Conine, in your tenure here, how many of these -- I doubt you've seen very many of these --

MR. CONINE: I've read every one of them. Read every one of them. I promise you.

MR. GERBER: So get excited about more coming through to you all.

MS. OEHLER: Thank you.

MR. GERBER: The last thing I'd share is that Amy Oehler has been appointed, as of yesterday, as the new Director of Community Affairs, and so that's a very positive step for leadership.

(Applause)

MR. CONINE: All right. Well, thank you very much, Amy. You obviously did a good job, because there weren't very many questions. And good luck moving forward in your new capacity.

Yes, Counselor.

MR. HAMBY: I'm sorry. I have to do one -- board secretary stuff. I have to do one housekeeping thing. Since all of y'all spoke, I need everyone to sign a witness affirmation form unless you work for the Department. You have them all signed? Great. Everybody did it? We have one for Steve?

MR. GERBER: Before we go on to the bond discussions, I wanted to ask very quickly if Sandy Donoho, who is our internal auditor, would stand for just a moment, and just briefly touch on -- she is in the process of doing an audit that will benchmark where we are in Community Affairs. We've had some issues there that we've identified for the Board.

And, Sandy, if you'd just share where you are in two minutes or less. I know we'll have additional audit committee meetings and such [inaudible] the issues in more depth.

MS. DONOHO: Okay. We're currently working on an audit of Community Affairs. We're looking at the monitoring and [inaudible] processes, the Community Services Block Grant that Amy just talked about, as well as the Emergency Shelter Grant Program. We've previously audited the Energy Efficiency and LIHEAP programs that Amy also mentioned. I think that was last year. We're looking at the risk-assessment process that's used to select who is monitored by the Department. We're looking at the processes used to monitor the subrecipients. We're looking at the eligibility of the subrecipients for the Emergency Shelter Grant Program. And we're looking at subrecipient performance, not only the performance measures that we report to the legislature, but also the performance awards that are given out to the community action agencies.

We are also following up on 12 prior audit findings from previous audits in previous years. We originally targeted this to be done the end of February, but we've had some staffing changes and some delays.

Also, it's a much bigger program than we anticipated, so we expect to have the report out in late April. I'll be talking about it at the tentative audit committee meeting in May.

And the next audit we have up is the Office of Colonia Initiatives, the Border Field Offices and Bootstrap Programs, so you can look forward to those too.

And if anybody has any questions, I'll be happy to answer them.

MR. GERBER: We expect that that -- the audit of Community Affairs is going to present a number of management challenges that we're going to need to deal with, and so we'll have a lively discussion, I'm sure, in May about that.

MR. FLORES: Sounds like fair warning. Is that what it is?

MR. GERBER: Fair warning that that committee meeting is going to be probably a bit longer.

MR. CONINE: Okay. Thank you, Sandy.

Anything else, Counselor? You have that look on your face.

MR. HAMBY: Well, actually, Matt gave us ones for all the speakers, but everybody who introduced themself also needs to fill out a witness affirmation form

so their name can be spelled correctly for the transcript. So --

MR. CONINE: For Leslie's benefit, before you got here, we went around the room and introduced everybody. So if you're trying to figure out --

MS. BINGHAM ESCAREÑO: I'll just --

MR. CONINE: No. We're going to do it again.

MS. BINGHAM ESCAREÑO: Well, I mean, if they're going to sign forms anyway.

MR. CONINE: Since they're having to sign the forms anyway, we want to get it right.

MR. FLORES: Two forms.

MR. CONINE: Bill, start it off.

MR. DALLY: Yes, sir. Bill Dally, Deputy Executive Director of the Administration.

MR. MELVEAUX: I'm Mark Melveaux, Disclosure Counsel for TDHCA, with McCall, Parkhurst & Horton.

MS. RIPPY: Elizabeth Rippy with Vinson & Elkins, Bond Counsel for TDHCA.

MR. GERDES: Steve Gerdes with Vinson Elkins, tax lawyer.

MR. MORRIS: Ed Morris in Bond Finance.

MR. POGOR: Matt Pogor, Director of Bond Finance.

MR. MACHAK: Gary Machak, RBC Capital Markets, Financial Advisor to the Department.

MR. FLORES: Sonny Flores, board member.

MR. CONINE: We know who you are, Sandy.

MR. FLORES: So I don't have to sign an affirmation?

MR. CONINE: No.

MS. DONOHO: Sandy Donoho, Internal Audit Director.

MR. KIKER: Bobby Kiker, State Auditor's Office.

MS. GUTIERREZ: Cathy Gutierrez, Texas Homeownership Division.

MS. EVERETT: Sharon Everett, First Time Homebuyer Program.

MR. GOURIS: Tom Gouris --

MS. KING: Jackie King, Governor's Office.

MS. MEYER: Robbye Meyer.

MR. PIKE: I'm Eric Pike, Director of the Texas Homeownership Division.

MS. CRAWFORD: Kelly Crawford, Disaster Recovery.

MR. HOWELL: J.C. Howell with RBC Capital

Markets.

MR. ETTELDORF: Rob Etteldorf, RBC Capital Markets.

MR. WITHROW: Barton Withrow, RBC Capital Markets.

MS. CHERN: Lillian Chern, Swap Financial Group.

MS. BINGHAM ESCAREÑO: Thank you.

MR. CONINE: Again, thanks to everybody for doing it again for Leslie's benefit and for all of our benefit actually.

Gary, you going to lead this show? Or who's going to go first?

MR. MACHAK: We're going to start with Matt.

MR. CONINE: Matt's going to go first? All right. Let me give the group a little story.

Yesterday and -- or last two days, I've been in Washington, D.C., at something called a mortgage roundtable, which the Homebuilders puts on twice a year and that -- where we bring in all the greatest minds and a few dumb homebuilders in the mortgage industry to sit around a table and talk about it. And naturally, with the mortgage market in the current situation it's in, this was a meeting that I really wanted to attend. I enjoy this

side of the business anyway, but this one particularly I had an interest in.

And the guy who chairs this thing for us is a guy named Lou Ranieri, who some of the bond guys in the room might know. He's essentially the father of the mortgage-backed security. When he was with Salomon Brothers 25, 30 years ago, Lou put together the -- figured out how to put together the mortgage-backed security and essentially create the finance system that we have today.

And Lou essentially opened the meeting on Monday by saying that all the work we've done in the last 25 years on the mortgage-backed security has essentially gone out the window. And for someone of his stature to have said that really, you know, got to me.

And as we progressed through the meeting on Monday afternoon and Tuesday, it became apparent that the -- and we had people from Fannie there and Freddie and HUD and UBS and all the private mortgage insurers. We got -- the housing finance agencies are represented there. Everybody essentially was saying this market is really crazy. There's no economic reason for what's happening. We know the underwriting was a serious problem and a bunch of the sub-prime stuff, but even the Fanny and Freddie securities at that time, the spreads on them were just

going crazy.

And the next morning, he was -- everybody was doing the woe-is-me presentations that were part of this meeting, and about 9:30, Lou grabs his BlackBerry and looks at it and says, Oh, my God, I got to tell you guys this. The Fed has just announced that they're going to be $200 billion into the MBS market yesterday, which was a direct shot. And for the guy who created the thing, who the day before said that, you know, everything's been wiped out, to then mark the first time that the Fed has ever done anything like that, was kind of a surreal moment for me and might be for some of you bond guys around the room.

But suffice it to say, our mortgage market is upside down right now. I was talking to a mortgage guy I know in the multifamily arena today, and HUD 221(d)4 is quoting 6.78 percent interest rates this morning on a federally insured piece of paper. So it's glad and -- I'm glad and it's timely that we're having this discussion with our bond expertise. The Department plays a valuable role in providing first-time homebuyers' mortgages to their homes that they buy. And I got a feeling they're going to play a more valuable role as time moves forward, as the dearth of the market has left us and Congress

contemplates what to do and how to fix the liquidity in the mortgage market that is currently a problem. State housing finance agencies currently play a role in that. And I think, if we get the extra $10 billion that's been talked about in the Stimulus 2 Plan, will play an increasing larger role in providing low- to moderate-income citizens across this country the ability to get a mortgage.

So with that said, Matt, take it off. I just wanted to share that story with you. We're in a crisis, and tell us how it is.

MR. POGOR: Stole my thunder.

I guess before I really get started, what I want to do is do some housekeeping more than anything else. We've got some drinks and everything. There's some soft drinks, some water, cookies if you need to. Just make yourself at home. Also, if you need to go to the restroom, if you go out this door, on your right down the hall on your right is a restroom, if you need to use the facilities.

I guess before I get started, Ed -- first of all, what I'd like to do is thank Mike and Bill because without their help and support, none of these bonds would be -- really be brought to the Board, because none of this

has been in a vacuum. We have all professionals here that work together as a team. We bounce ideas off of Mike and Bill. We analyze things before we bring it to you. We want to make sure that it's brought to you as solid proposal.

So with that, we'll go ahead and get started. Anybody -- there are some books on the side here that we've prepared. I don't know if everybody's got one. If not, they're on the table. We can go get one for you. The first thing off, I want to make sure to give some kudos. We got -- RBC Capital Markets put this presentation together. Barton Withrow was the one that helped do this for us. So thank you, Barton, for all your help.

The index page, I think it tells you in which of those tabs you can find and going back into it in the next couple, three days, if you want to take a look at them in the next couple, three months, you can always have tabs to go there.

On the next page is like a -- more than a -- objectives of what we want to tell at this meeting with you, and that is the legal concerns and issues that are out there and how that relates to the Bond Review Board. You've heard that you approve the bonds, the Bond Review

Board -- Texas Bond Review Board also has to approve these bond structures.

Gary, I don't know if you could do anything better than what we did on the market overview, but good luck on that one, so --

(Laughter)

MR. MACHAK: It's changing daily.

MR. POGOR: We're also going to take a look at our financing team, how bond process actually works, trying to get you through that. Talk about swaps, cash flows, as well as some terms and conditions that we have in the very back. So once you leave this -- you're going to hear these terms today, but you'll be able to go back and look at those and see the definitions. So it should be of some help.

With that, I'd like to turn it over to Elizabeth Rippy to start off with the legal aspects of it.

MS. RIPPY: I'm just going to give a brief overview of the legal aspects of these transactions. I'm with Vinson & Elkins. This is my partner, Steve Gerdes, who is the tax partner that works on your account, and we are bond counsel to the Department. But what does that mean?

So you know, our client is the Department,

which basically means our client is the Board as a body. Not individual board members, but the Board as a whole is our client. That's who we represent on these transactions. And what we primarily do for you is draft the basic fiduciary documents for all of your bond transactions. And then our ultimate goal is to deliver two opinions. One is that your bonds are legal, valid and binding under state law. And then the second is that the interest on those bonds is exempt from federal income tax. That's primarily what our goal is.

We work extensively with the staff on the drafting of the documents and with the financial advisors and with the underwriting group to make sure that the terms of the deal are properly reflected in those documents. We also work with Kevin Hamby, your general counsel, who delivers an opinion on every one of your bond deals, as well as on things like the fact that you've met the proper posting requirements and those type provisions.

But it's very much a team effort. And that's kind of generally what we're doing. And we're involved just because we're specialists on the bond finance side of it.

And there's a couple of things that are just very different about governmental thinking, if you've done

a lot of work on the corporate side, but kind of the basic fundamental difference is generally that this board can't do anything unless the statute that creates the Board allows you to do that. And that's just the opposite of kind of the general rule in corporate America. Unless it's illegal or outside your articles and bylaws, you can do anything that promotes, you know, the possibilities and the purposes of the corporation. But it is really a different mind-set for governmental entities, and that's a big adjustment for people that work in the corporate world.

The first thing is that the bonds that you issue are revenue bonds, not general obligation bonds. That means we go out into the market, you borrow a pool of money, and you make loans. The only source for repayment of those bonds that you issue is the revenue from the loans that you originate. You can't just make a promise to pay in the future for money that comes in later from other sources, from appropriated funds. You just don't have that authority under state law.

There are state agencies that do, but it takes a constitutional amendment to allow you to issue that kind of debt with a general obligation pledge. In some ways that's great, because you know, at the time we close, that

the assets from this transaction are what's going to be used to repay the obligation, that there's not anything else that you have to look to. But it does limit the kinds of transactions that you can do. You can only help folks that ultimately are going to be able to repay their debts, because that's the only source to repay the money that you borrowed when you issued the bond.

So that's -- you know, it really has an effect on virtually every financing you do, the fact that you're going to revenue bonds.

And you gets lots of paper from us in your board package. You get a bond resolution, and there's a pretty significant board writeup that explains, you know, what's going on. And I think lots of times the Board looks around and says, Hey, we've got all this staff and all these professionals; what's all this stuff in here and what's going on? And the reason that most of that is in there, and the reason for virtually every word that's in the resolution is that the statute requires the Board to make certain determinations.

On your rated debt, the Board has to decide kind of a maximum interest rate on that debt and the maximum principal amount that you want to issue for a certain purpose and, you know, what the longest maturity

of that debt would be. And so all those terms are laid out in that bond resolution. And the Board writeup and all the material that's included is just intended to get the right information in front of you so that you can make that determination, with your professionals' advice, that the statute requires most of those determinations.

And another thing that you will see a lot of on the legal side is that both federal and state law require certain public notices for bonds that are issued, and that means that there's a lot of public comment on certain types of transactions. In general, for the single-family deals you do, not a lot of public comment. Everybody loves single-family homes, because the homes that you finance don't look any different from any other homes in the neighborhood, and they're dispersed throughout the state. They're not concentrated in any particular geographic area. We really do not get any push-back on the Single-Family Program.

But on the Multifamily Program, that's an entirely different issue. There's definitely community input on almost all of those projects at this point, and so you'll see you'll get a lot of public comment there, and that's going to be required by state law and federal law. So that will continue.

And there's a really important concept that's different for revenue bonds than corporate debt is sovereign immunity. And what that -- the basic concept is is that you can't sue the sovereign unless -- which is the State, unless they've agreed to allow you to sue them. And your statute does not waive sovereign immunity. So basically, you can't be sued. The place, the jurisdiction -- they can't even file a lawsuit in the State of Texas against the Department. That, at least initially, seems like a great thing. You can't be sued. That's wonderful. We do see more and more push-back from investment providers and liquidity providers on this issue in particular. There was a Supreme Court case -- it's probably been two or three years now -- two years -- that is directly on point. There's nothing we can do about this. You have sovereign immunity, but we are seeing fewer bidders on both your investment agreements and your liquidity.

Now, there's a lot going on in the market that is causing that as well. It's impossible to determine whether sovereign immunity is the reason that they're not bidding or if it's really market conditions, and if market conditions come back, you'll have lots of bidders. But I think we're going to continue to see that issue come up

more and more on your transactions.

And Matt mentioned a couple of approvals that you get. There is -- every bond issue that's issued by a state agency in Texas has to be approved by the attorney general. That's part of what we do. We file a transcript with the attorney general of all your documents, and we work with them to make sure they give a legal opinion as well on every transaction you do on the state law issues. And we work with them to make sure that they're comfortable in delivering that opinion.

I think -- I'll take these next two together, the Bond Review Board approval and limits -- and state law limits on your mortgages. And you have a lot of authority to set your program guidelines in whatever ways you want, but there's certain restrictions that you have to meet. Your statute requires you, on every single-family issue you do, to set aside 30 percent of the proceeds for home loans for people at or below 60 percent of the area median income. So you will always do that. You could always set aside more than that 30 percent, but those limits are kind of minimum limits that you have to meet so that you're serving a target audience.

There is, in your statute, also a provision that talks about, if practicable, that you need to set

aside 40 percent of the proceeds of your transaction for people in geographically or economically underserved areas. And that was initially added to your statute to try to allow you to serve the sub-prime market. You have never made any sub-prime loans, and the way that you avoid doing that is each time you do a single-family transaction, the Board makes the determination that it's just not financially practical to make those kinds of sub-prime mortgages. And the Texas Bond Review Board has to agree with you on that determination.

Bond Review Board approves every bond issue that you do, and that entity is made up of a representative from the governor's office, the lieutenant governor's office, the speaker's office, and the comptroller's office. So those four offices have a representative that sits on that board.

There are some limited times when they can allow their executive director just to give that approval, and you don't have to appear before the Board, but in general, virtually every transaction goes to that board for approval.

You can now flip to the next slide.

MR. GERBER: And, Elizabeth, it's fair to say that in the last several years the focus has been less on

the merits of the project and more on the financial structure of the bonds. We have generally discouraged them from having a rehash of a neighborhood association's, you know, opposition to a development before the Bond Review Board. And the Bond Review Board has not bidden, at least in the last 18 months, on many multifamily deals. They've talked about the structure of the bonds and the nature of swaps and other things for single-family transactions, but they have generally let this policy-making board make its choice. Is that a fair --

MS. RIPPY: I think that's absolutely fair. And in the past, that's not been the case. There's definitely been some push-back and there's been a lot of community opposition --

I think they definitely have kind of changed the -- moved the focus.

MR. GERBER: And the community opposition might be the impetus for them calling a particular project in, but ultimately, when you get there, the questions --

MS. RIPPY: Tend to be. Now, in fairness, we haven't had nearly as many multifamily transactions in front of us --

MR. GERBER: True.

MS. RIPPY: -- especially in the last six or

eight months. You know, it's just a reality that they haven't been.

And this slide talks about volume cap. And that is a federal law idea, and basically the amount of bonds that can be issued in any given year for these types of projects is limited by the federal government. Because the interest is going to be tax exempt and that affects federal tax revenues, they want to limit how many of these are issued throughout the United States.

Texas gets about $2 billion in bond [inaudible] and in total in any given year, and that's based on population. This chart gives you an idea of how that money was spent. And this was for 2007. This is how the money is actually allocated. By the end of the year, this is how it is used. And if you look, for your single-family transactions, you got about $260 million total in single-family transactions that you did for 2007. And then your multifamily was another almost $88 million. So that's kind of the slice of the pie that you actually received for 2007.

And if you'll go to the next slide, 2008 Volume Cap, this is how the statute splits it out, at least initially. So for the $2 billion that Texas will get for 2008, at least for right now, we're authorized to pull

about $190 million for single family and about $90 million for multifamily. If some of the other issuers in the other categories don't use their money, then you'll get an opportunity later in the year, if you've got demand and you have need, to be able to use that money.

And the $10 billion that Kent mentioned, additional allocation, that would be above and beyond this allocation that you're already receiving. That would be a particular allocation for housing, and the State will have to decide how they will allocate that -- and then the state agency which is the Department, TSAHC, which is another state agency, and for local housing finance corporations. And Steve wants to make a point.

And with that, I'm going to turn it over to Steve Gerdes, our tax partner.

MR. GERDES: Because is Department is an agency and therefore an integral part of the State of Texas, its obligations, as they comply with tax law limitations, are, generally speaking, carry interest that is excludable from gross income, not subject to income tax. It is the case, however, that all the Department's bonds are subject to the alternative minimum tax, which has been much in the news in recent months. And that's just a fact of life for us that all of the bonds that we issue, whether they are

single-family or multifamily, are generally going to be subject to the alternative minimum tax.

There is a large body of tax limitations that are largely different for multifamily versus single-family, as you might expect. And they overlay the state law requirements. Sometimes they're more generous, in which case the state law limitations are the real limitations; and sometimes the tax law limitations are more limiting. For example, tax law generally limits you on how much you can charge borrowers, whether they're multifamily borrowers or first-time home borrowers, relative to the interest rate on your bonds.

For example, generally speaking, the interest rate on the developer loan, taking into account your fees, can't be more than 1-1/2 percent higher than the interest rate on your multifamily bonds. In addition, there are program-type restrictions that, as I say, kind of are molded in with -- into your documents with the state law limitations.

Our job as bond counsel is to work with your staff and make sure on the multifamily side we prepare documents and receive representations on certain occasions from the developers that ensure that the developers will comply both initially and on an ongoing basis with the tax

law requirements as well as the state law requirements. In addition, of course, you have a staff that makes sure, post closing, that that compliance is more likely to take place.

As a result, we don't really come to the Board for first-line representations and certifications in the same way on multifamily that we do on single-family. That is to say, these multifamily transactions are largely driven by what the developers promise they will do.

On single-family, we again have state law limitations, but also tax limitations. For example, 20 percent, generally speaking, of your bond proceeds has to be held for a year for origination in targeted areas, areas defined in the tax law and determined by HUD to be areas of chronic economic distress. As you know, that's been expanded for some time and for the next year and a half, I guess, to include the Rita GO zones. Money that you originate in the target areas, including the Rita GO zone, is exempt from certain of the federal law limitations, most significantly, first-time homebuyer limitation. First-time homebuyer limitation is a federal tax limitation.

Again, there is a limitation on how much you can pass along to first-time homebuyers as an interest

rate on their loans relative to the interest rate on your bonds. If you issue bonds at 5, generally speaking, that homeowner can't pay more than 6-1/8. It's a 1-1/8 limitation. And that's a hard limitation to work with your financial advisor and your investment banking team to make sure that the transactions in your programs are structured such that they will produce an interest rate to first-time homebuyers or others in targeted areas that is in compliance with this interest-rate limitation.

MS. RIPPY: Steve, make sure you don't make too much money.

MR. GERDES: But you are allowed to make some money on these things.

MR. CONINE: Steve, is this the -- would this be an appropriate time to talk about blending some taxables in with the nontaxables?

MR. GERDES: It is something that the Department has done in the past as a way to extend volume cap, which Elizabeth just talked about, inasmuch as you are limited to how much bond -- how much in the way of bonds you can issue on the single-family side. You could pair that, and you have in the past paired that, with some taxables to more or less blend the rate.

You then in effect provide to each homebuyer a

dual loan, part of which is funded with your tax-exempt bonds, reflecting a lower rate; part of which is financed with your taxable bonds, reflecting a higher rate. And they get a blended rate that is still better than market.

MR. FLORES: When's the last time we did that?

MR. GERDES: Gary, you have a better memory than I.

MR. MACHAK: I'm going to go back to --

MS. RIPPY: Gosh, it's been a long time.

MR. MACHAK: -- maybe as far as 2004, 2003?

MR. FLORES: It's been a while.

MR. MACHAK: Yes. And what's happened in the marketplace now with taxables -- we used to do taxable bonds. Now a lot of the issuers, when they are [inaudible] to extend their cap, do a synthetic fixed slot, and that helps out to really bring down the interest rate. Typically, what happens is that our tax-exempt bonds that we go out for are lower than taxable rates that are out there. Right now, that's not the case. Taxable rates are higher than -- are trading at a higher percentage. But if we need it, if we had a great demand for our product, that's one of the ways that we could leverage the cap that we have from the State every year in the taxable laws.

We'll get into this a little bit more, but one of the other ways that you leverage it is with a recycling program. And that's taking prepayments from loans in previous programs, and we're allowed to recycle that for ten years and bring it into a new program. And that -- we have -- we do that more, because that, we're allowed to issue on the -- as a tax-exempt basis.

MR. CONINE: Effectively, we have no taxable cap. Is that true?

MS. RIPPY: You can --

MR. MACHAK: Right.

MR. GERDES: One way to think of this as your 1-1/8 spread over [inaudible] certain amount of subsidy. And you can spread it over just that many homeowners or spread it over --

MR. CONINE: Sonny, remember it's like you used to put water in your ketchup and make your ketchup go further? It's the same sort of thing.

MR. FLORES: When I was a freshman at A&M we did a lot of things like that and much worse. And I'll tell you about it --

MR. CONINE: It wasn't ketchup, though, was it?

MR. FLORES: Yes.

(Laughter)

MR. WITHROW: There's one more part of it, too. Over the last few years, you've been able to go back in August and get additional cap that was left over. In times past, that got all gobbled up. And so it's always -- you know, it's cheaper to borrow, most of the [inaudible] tax exempt than taxables. We haven't needed to get the taxable ones to spread out the ketchup a little bit. We went back and got more ketchup.

MR. MACHAK: And the one thing, it's always one of the more difficult things that we look at, you know, when we price these, and that's a difficult process, but also targeting the rates. What rates do we want to make available to the homeowners and to the lenders, because those monies stay with you for a number of months, sometimes more than a year, and you always want that to be competitive to the conventional market, because that rate's fixed -- you're fixing that rate, currently with your programs, but the market that you're competing with moves up and down. So if you had taxable, it has the -- may have the ability to actually increase that and make your funds a little bit less --

MR. CONINE: Attractive.

MR. WITHROW: -- less competitive.

MR. GERDES: I'll just make two other tax

points quick. One is -- Gary mentioned swaps. As you might expect, there's a federal tax law group of rules that affects swaps. And generally speaking, swaps are taken into account in determining the rate that serves as your limit with this 1-1/8 cap on your spread. And generally what it means is that if the variable rate on the swap that you receive from the swap provider matches closely enough to the variable rate on your variable rate bonds, then you may treat the swap payments that you make or receive as something that can be taken into account in determining this 1-1/8 yield.

What that also means, however, is that if you have basis gain or less, which is to say if the swap counterparty variable rate is higher than your rate and you have gain, or if it's lower and you have loss, that is taken into account for purposes of determining compliance with this 1-1/8 limitation. I'm sure Gary will probably talk more about this later. But there is a tax aspect to the swaps.

Finally, sadly, the IRS is involved in enforcement activities in the single-family and multifamily area. I mean, you have had one of your single-family bond issues reviewed by the IRS. It was determined there was no need for change, so it was no big

deal, but part of what we have to anticipate moving forward is that there will, from time to time, likely be IRS reviews both of our single-family and our multifamily transactions. We expect it generally would be random. We have no reason to be concerned about them, especially on the multifamily.

You know, you're in a better situation than most issuers, because you have a staff that's been involved in oversight. And generally speaking, the developers should take care of those audits, but it could be on occasion that you will be reviewing materials relating to IRS audits. Don't expect it to happen very often.

MR. MACHAK: Just maybe a follow-up point on the 1-1/8. It's -- that is the allowed amount that we're supposed to -- we're allowed to earn over the bond rate, but it's not always a bad thing if we earn above that. And that happens even in traditional. That means that -- traditional municipal finance. That means we're maxing out the amount that we're allowed to earn.

If we earn above it, there are a number of things we could do. We could rebate, which we've done in the past. Or we can even, to some extent, create what we call zero percent mortgages. And that -- those we can put

in what we call like a bank or in a warehouse, and use those for a program in the future to bring that rate down.

So it's not necessarily a bad thing when we're looking at that 1-1/8, depending on market conditions, and depending upon the conventional market out there if we -- you know, if we are exceeding.

MR. CONINE: Steve?

MR. MACHAK: Okay. Let's see. What I'd like to do with this part of the presentation is just talk a little bit about the tax-exempt market. And I'll give you some background information on it.

We -- like Vinson & Elkins, we represent the Department, we represent the Board. When you sell these bonds in a tax-exempt market, we have an underwriting team. We may get into this a little bit later, but that underwriting team is really the middle person between the Department and the investors. We sit on your side of the table, because ultimately that underwriting team is looking to satisfy your needs, but they're also looking to satisfy the needs of their buyers too, because they don't -- they're going to buy these bonds from you, but they're not necessarily -- don't necessarily want to hold them in their inventory. If they do, because they have from time to time, when they have unsold balances, they

want to be able to resell those to investors very quickly. They're not in the business of investing; they're in the business of finding investors and marketing.

So we're representing you. We don't take place in that activity of selling, but we look at the transaction from a financial standpoint, from cost standpoint, and from other standpoints.

Historically, this is the general market in blue, with housing on top, and you can see the small percentage that housing has played and also the increase in the market. Just as a point of reference, our market now, just in the first two months of 2007 [sic], when you compare January and February of this year to January and February of last year, it's down about 30 percent. For the month of February, when you look at housing bonds, compared to February of last year, it's down about 60 percent. There are other categories that are down too. And some of them are up, but for the most part, the whole market is down.

MR. CONINE: Gary, what's the traditional split in the yellow called housing between single and multifamily?

MR. MACHAK: That, I think, is on the next page.

MR. CONINE: Sorry about that.

MR. MACHAK: That's okay. So you're looking at 7 percent. You can see the largest part of the market is general purpose and education. And, Kent and board members, that has changed over the years. Before we had caps, I think it was the '86 Tax Act, or maybe it was before that, '82, housing -- single-family housing made up a much larger percentage. And it was for a couple of reasons. Because housing was not subject to AMT. There was no -- the rates that they were able to get from these programs was a lot better than the conventional rates at the time, and so there was more demand for them.

As you can see the level that housing plays, and that -- you know, that comes in [inaudible] with investments too. One that has really come on, as you probably all know, is transportation, which has become larger and larger just over the last few years.

Okay. These pie charts break out some of the things that bond counsel was relating to earlier. Let's start down here in the lower lefthand corner, because we've covered that. You see, 31 percent are, again, obligation; 69 percent -- this is 2007. These have held true and probably over the years, over the last ten years, the percentage of revenue has increased, where it may have

looked like about 50-50 maybe ten years ago. And, of course, here in the blue, in the 69 percent.

Then we go up to the top lefthand corner, new money, refunding, and combination. Your percentage would typically be in either the new money or the combination. Usually you do not deal with refunding just by itself. A typical profile of an issuer that may do a refunding by itself, maybe like a school district or a city, that doesn't have new money needs until five years, because they're not building new schools. They're just going to go in and access the market to refinance and have savings on their bonds.

Over in 2007 on the right-hand side, up on the right hand, competitive versus negotiated, this has to do with the method of sale. Basically, there are -- you see, there's three methods of sale, negotiated being the overwhelming larger part of that, and competitive 17 percent. I think the next chart, when we get to it, describes a little bit more about what the differences are between that.

And then short-term and long-term, you're in the short -- in the long-term market overwhelmingly.

MR. FLORES: Gary, before you move on --

MR. MACHAK: Yes, sir.

MR. FLORES: -- he was about to hit the trigger on here. It's been -- in negotiated, I thought we were in the government business and we couldn't do things like that.

MR. MACHAK: We are allowed to, and I think the next slide --

MR. FLORES: Good question, though.

MR. CONINE: He keeps saying, The next slide, but I don't know that -- you never did answer my single-family/multifamily question.

MR. FLORES: He's avoiding it.

MR. CONINE: I know.

MS. RIPPY: [inaudible] split.

MR. MACHAK: Oh, the split between single-family and multifamily? Okay. I thought it was housing versus general market. I'd say the split on that is probably about -- I'd have to take a look. I think it's probably 60-40, single-family.

MR. CONINE: That's what I would guess.

MR. MACHAK: Yes.

MR. CONINE: Okay.

MR. MACHAK: That upper right-hand pie chart with the negotiated versus competitive sales, we are, under state law, as are most issuers in the state of

Texas, allowed to issue under a negotiated method as opposed to competitive or private placement. Let's start with the competitive.

A competitive sale has to do with how you structure your bond issue, having it out in the marketplace and then having the underwriting teams bid on it and submit closed bids to us. And then we open those up and basically award it to that underwriter that gives us the best interest rate and the best price. That's very difficult to do with housing bond issues.

Typically, competitive sale is done on issues that are -- the credits are very simple for the investors to understand and very simple for underwriters to issue. For instance, Steve and I worked with the State of Texas, with the Comptroller's Office, on what they call a tax and revenue anticipation rate. It's a short-term borrowing that they go into the market for every year. It has the State GO rating, which for short-term is in the highest category, so they don't need any type of credit enhancement. It's a -- and so cash flow is basically the general obligation of the State. And it's for one year. There are no optional calls.

Our bond issues, as opposed to that, need a lot of optionality in it, because when the mortgages that

underlie our bonds prepay, we need to call -- be able to call those bonds up. The State does not need to do that. So typically, they have issued that on a competitive basis.

Now, that typically is usually a large issue. It ranges from $5 billion to, like, we've been up as high as $7 billion. They -- there may be needs -- they may have needs to actually go with a larger issue in the coming year. It has to do with the State finances and what they need to do for school districts. But they, because they are getting to a larger issue size, are now talking about possibly looking at also on negotiating sale. And that's because that size issue, when they get up into $11 billion, is a -- will play a large percentage of that short-term market.

So we go with a negotiating sale for a number of reasons. The reason is because we have not -- we have AMT bond issues. Now, it is a story credit. We have to explain the credit, because it's backed by mortgage loans. We have a lot of optionality, and we typically, you know, maybe layer in a bond -- an issue that has various call options, where prepayments are directed to certain bonds in that structure to call those bonds out more quickly.

As Kent said in the beginning, he referenced

Lou Ranieri. Those are some of the things that, when he first started doing collateralized debt, he started to work in some of those concepts like targeting prepayments with the payment of the underlying assets to certain classes of bonds, and those -- that's exactly what we're doing.

So we benefit from a negotiated sale because we have an unusual credit and we're able to pre-market that issue to investors. Our underwriting group knows that they're going to have this bond basically confirmed to them if they give us good rates and they're able to go out and generate interest -- investor interest before the issue.

It also gives us -- and this is something that you tend to lose in a competitive sale, too -- the flexibility of market timing. And this is very important too, because we're trying to -- basically our end product are the mortgages that are going to be competing other product that's out there. When a school district goes out and issues for school building or the State goes out and issues for cash flow, you know, there's really not -- they're really not competing with the product to use that money. We are, so the market timing -- and because the market has been very volatile -- is very important, and

the negotiating sale lends itself very much to that.

If it were a competitive sale, we may be in a market where we see rates go up very high that day and we may not want to go out there -- we would have to basically cancel that sale and come back and set another date. Whereas, on a negotiated sale, we could basically just inform the market that we -- although we thought we might be in the market that day, we may be putting it off.

Or what happened on our last issue is we had a very good market the day before we were planning on pricing. We were able, with the underwriters, to accelerate that and get into the marketplace, and we were able to save anywhere from five to ten basis points, 15 basis points, up and down the yield curve on that issue. So that, again, is a --

MR. DALLY: And we had a particular investor who wanted a certain feature, and we'd give and take in the negotiation. It was up to us to decide, yes, we'll --

MR. MACHAK: Yes.

MR. DALLY: -- we'll do a lockout feature for ten years on this particular --

MR. MACHAK: That's another --

MR. DALLY: -- particularly term bond.

MR. MACHAK: And whereas a competitive sale,

you don't have the flexibility to do that, and that is to tailor a certain bond for an investor that's willing to pay up for it and give you a lower rate in your overall [inaudible].

MR. FLORES: Okay. Don't go away. He didn't answer my question, so I'll ask you. The question is legal. It has to do -- is the State purchasing, all about, you know, the legal -- go purchase service throughout the state. Are we exempt from that? Is that allowed:

MS. RIPPY: The State purchasing law allows you to do negotiated sales.

MR. FLORES: So that's one of the --

MS. RIPPY: Absolutely.

MR. FLORES: -- things you pull out of there.

MS. RIPPY: Yes.

MR. FLORES: Because he's just referring to the process and so on, but he's telling me that I was this legally.

MS. RIPPY: You're acquiring -- it's financial services advice, and, yes, you are exempt from that competitive requirement.

MR. FLORES: Okay. But we have to comply with the company, it sounds like, you know, essentially, while

we're doing this. It sounds like this is out of the room for --

MS. RIPPY: There is room to --

MR. FLORES: -- you know, that's why the word's called negotiated, they negotiate terms.

MS. RIPPY: I mean, the statute says there's certain things the Board has to set parameters for and the team that's making the decisions at the pricing has to work within those parameters. But you are allowed to delegate certain pricing decisions under state law. You have to be selling bonds that are rated A or higher, and all of your single-family bonds are rated Triple-A right now, I think, the senior lien ones anyway.

MR. GERBER: S&P, yes.

MS. RIPPY: So you meet the requirements under state law that allow you to delegate.

MR. FLORES: And we set the parameters from each bond deal?

MS. RIPPY: You decide a maximum interest rate that you're willing to pay and that -- you know, and price range that you're willing to sell the bonds to the underwriters, and the maximum principal amount of bonds that you're going to issue. And you set those parameters, and then the pricing takes place, and those decisions have

to fit within those parameters.

MR. FLORES: So I don't have to worry about going to jail.

MS. RIPPY: You do not.

MR. FLORES: Okay.

MR. CONINE: You need to worry about it, but just on a different basis.

(Laughter)

MR. FLORES: Speeding --

MS. RIPPY: Not for this anyway. Right.

MR. MACHAK: And, Mr. Flores, it's not unlike the other state agencies and other issuers with our state. In fact, state law over the years, I think, has generally loosened the restrictions --

MS. RIPPY: Uh-huh.

MR. MACHAK: -- on issuers to do their bond issues on a competitive basis.

MR. CONINE: Well, the nature of the product is such that it's moving every minute, so you've got to have that kind of flexibility or you'd never sell --

MR. FLORES: Yes, but we're the government. Sometimes we don't move very well.

MR. CONINE: The nature of the product gives them that flexibility.

MR. FLORES: Yes, but all the other 50 states, obviously the majority are doing similar things like this.

MR. DALLY: If you have that short depth service and it's very fixed, then they can bid on a competitive bid, but because of the optionality and prepayments and things are going to come in and we've got to build in options and that kind of thing just lends itself to negotiate itself. It's supposed to.

MR. FLORES: I understand. I've just been on the General Services Commission too long, and we did everything inside the box and so on. You know, all of a sudden, you're doing something quite, quite different than the State purchasing rules.

MR. MACHAK: And the last one is the private placement. This -- we've used this with Fannie Mae. Fannie Mae, by their statute basically required that we privately place the portion of bonds that they would buy from us. And it's also used a lot on the multifamily side too. And so it's placed with one issuer -- with one buyer. The underwriter or financial advisor acts as the placement agent, and there's no -- there's nothing that the underwriting group basically takes any of the bonds in inventory and is at risk of bonds --

In both of the tops -- there's the top one and

the negotiated sale and the competitive sale, the underwriters, when they purchase the bonds from you, may have unsold balances. And basically part of what you're paying them for is to take that unsold balance and go at risk at the market for that, and to confirm to you at the end of the pricing date, a certain interest rate on each of your maturities.

Sometimes -- the other thing about negotiated sale, too, and we saw this, is that sometimes you will be -- have so much demand of a certain maturity that the underwriters can go back to those investors that are looking to purchase that bond and say, You know what, instead of a 4.5 percent, we have such demand from investors, we're going to lower that to a .45, so five basis points less. Some investors may drop, but the underwriters feel confident that enough will stay at the lower rate, and then you get the [inaudible]. So you're -- really, when you're looking at a negotiated sale, in some respects, you are -- you may be getting even a better view of the market.

We -- at our firm, we risk our capital. We are in the business of buying and selling those bonds, the bonds -- the types of bonds we sell, so we know what the market is, and we can advise you whether the underwriters

are placing a fair price and the price that they're getting from the investors is a fair price.

MR. CONINE: But you're not -- you don't buy and sell our stuff.

MR. MACHAK: We do not. As financial advisor, we act as your agent and not as your principal on the transaction.

Any other questions? That's a -- I mean, that is a very important part of the whole process, the negotiating.

Next page, you can see that overwhelmingly you're not alone in doing that. Over on the -- we talked about the whole market and what percentage is done negotiated, competitive, top by dollar amount, bottom by number of issues. On the right-hand side, you can see housing issues overwhelming go negotiated, for the reasons that we just talked about.

Just as a point of reference, there is no issuer out there that traditionally has done competitive bidding. And that's -- you may hear about it when you're in those boards where the national counsel state entities, but Virginia typically has done competitive issues.

UNIDENTIFIED SPEAKER: By law?

MR. MACHAK: I don't think it's by law. I

think it's been by choice that they've just traditionally done that. So they have different -- you know, they have different backing and [inaudible] issues.

Next page gives you kind of a cross-section of the investors that are there. Those are the institutions and retail investors that put their money up and buy your bonds, and so they break down in terms of national bond funds. Fannie and Freddie have been traditional buyers. They're out of the market right now. That has hurt us immensely in terms of rates. We talked about our rates being above taxable rates right now. One of the main reasons, I think, is because we're not getting the support of Freddie and Fannie, and so there's not that much demand out there among the investors right now because of the AMT and because of the optionality that's been there. And so they're not driving the market, and that lack of competitiveness, that lack of demand -- because we are a supply-and-demand market -- is hurting us.

Other buyers have been insurance companies, investment advisors. Local banks have been purchasers of your bonds, and then we do have -- typically, if we have enough time during a marketing and there's not a lot of volatility, we will have a period the day before our pricing to open up our bonds for retail investors, what we

call a retail orders period, so that we give priority to Texas retail investors and other retail investors out there after that. Typically, it doesn't count for a large portion of the purchases, maybe not even a million or two in an over a $100 million issue.

The -- basically the last part has to do with the investors and types of maturities that they're looking for. The serial bonds and the intermediate term bonds, right here, are typically the targets that sell. We talked about the underwriting group taking balances and underwriting bonds. Those are typically the bonds that go unsold, and they take [inaudible]. You can see those are the two that they work off usually through the retail branches. But institutional investors really make up the demand for all the other types of bonds that are out there.

Next page, this gives you a historical look at the holders of all of the municipal debt, and you can see the large role that funds -- the increasingly large role that the funds and the households have played in our market since -- going back all the way from 1984, and that basically the little bit of a -- the insurance companies go up and down. Most of those are casualty companies, so it ultimately depends on how they're going to be able to

reinvest their premiums or whether they need to pay out on their policies [inaudible] supply and demands on those bonds.

Next chart, this is right -- really targeting what we're talking about in terms of how -- the rates that we can get in the market right now are very high compared to conventional rates. The Bond Buyer G.O. Index would be where the City of Austin, Travis County, other general obligation issuers may be borrowing. You see that in the red.

The Ten-Year Treasury is really what we look at as maybe an indices of where, you know, mortgage product may be, so we are driven somewhat by that.

The revenue index is just non-AMT. Revenue bonds [inaudible] sort of systems, things like that, airport revenue. And then you'll see in the bright green the 30-year housing bond index that we put together at our shop. And you can see the divergence at the last few months between really the gray and the bright green.

MR. ETTELDORF: What I was mentioning to Gary is over the course of the last couple weeks -- and Chairman Conine referred to this earlier -- there's been a huge dislocation in the market in that you have tax-exempt -- municipal tax-exempt rates trading at levels

which are higher than taxable Treasury rates. So you have 30-year, Triple-A, G.O. debt -- City of Austin, Triple-A, G.O. sort of credits, trading at 112 percent of the 30-year Treasury rate. So tax-exempt income trading at 112 percent of taxable income. That's what's been happening in the municipal market over the course of the last three to four months.

MR. MACHAK: The next chart basically just breaks down what the yield curve looks like on housing bonds and G.O. issues. And on the short end they start out very low, and they -- around ten years out, they start to flatten out. And you can see the spread there.

The next chart has to do with the tax-free rates on bonds and why an individual or someone who's paying income tax or a corporate tax would be interested in buying them. And below, depending on the tax bracket, shows their after-tax return. So there's a lot of demand -- tends to be more demand when interest rates are higher in our market, because you can see that the after-tax yields go up. When you get lower rates they compress, and investors look at other alternatives too that will mirror, you know, closely or near our rates.

This chart here is the chart of the investment grade designations from the rating agencies. We mentioned

we have triple-A from S&P. We have double-A -- one from Moody's. We hope to get that upgraded from them soon. But these are the investment grade rating agencies. And actually, what's happened in our market, the municipal market -- and the rating agencies have come under pressure lately, and this has come up before too -- but if you look at these categories all the way down to about the A category, an A category municipal will [inaudible] less than a corporate triple-A. And recently, you've have California, Connecticut, New York, issuers from those states, go to the rating agencies and say, You're unfairly -- you've been unfair to us because investors are looking at us as an A credit or a double-A credit. When you compare us to corporate, we would be a triple-A bond. And so we're artificially paying more interest rate, because investors are looking at us as double-A.

Rating agencies are coming back and saying, We're not unfairly penalizing you, because the investors are asking us to give up -- give a gradation of the credits that are out there, and although your credits are better as single-A to a triple-A corporate, we still need to give the investor information between -- for that gradation. So it's a -- these have been in place for years, but there may be some change coming out.

And Moody's, a few years ago, actually did a study to confirm what some of those states and some of those issuers were saying with regards to the high credit worthiness of municipal bonds comparing to -- compared to the corporate bond rate.

One other thing about ratings and insurance companies, corporate credits -- they are fairly complex to analyze, but there aren't as many out there, so the investors typically would not seek municipal bond insurance. Municipal bonds, the number of credits are probably, oh, I'd say ten to 20 times the amount of credits that there are in the corporate world, and so analysts do not want to sit down and do an analysis on the bonds that they're buying for every credit that's out there, and that's why there's always been the heavily -- reliance on bond insurance in our market. And that is to basically blanket the market with triple-A and allow the investors not to do the type of credit analysis that they may have to do if they didn't have the bond insurance.

It's been great business for the bond insurers. It isn't -- it is not the problem that the bond insurers are having now. The problem the bond insurers -- most bond insurers are having now has to do with the fact that they've diversified -- wanted to diversify out of that

municipal bond and into insuring other types of collateral debt obligations. That may have to do with some problem --

MR. DALLY: They've strayed from their home cooking.

MR. MACHAK: That's right. They've strayed from their old business plan. The good news is the -- we do have insured bonds out there. They are mostly insured by FSA, and FSA is -- has retained -- and their rating has been confirmed by the rating agencies, and they are not under a negative watch or pressure to be downgraded by some of the other bond insurers that may [inaudible] MBIA and MAC and Insurer Guaranty.

Next one, you've heard from bond counsel, you're hearing from us, you'll be hearing from Mark, disclosure counsel, that there are many other people that are involved in single-family financing and multifamily financing to put these -- this transaction together.

The next chart is for your reference, and if there's any questions about those roles --

This is a list of your investment banking pool. They became your investment bankers by responding to a request for proposal years ago. They were ranked by staff on their capabilities to issue your bonds, and we have

three rotating groups: one led by Bear Stearns, another by Citigroup, and another by UBS. On the issue we're working right now, it's UBS' turn in rotation, and you can see they also have co-senior managers and then co-managers.

And what you're looking to form in this syndicate or underwriting group is to be able to get the best penetration in the market from these investment banks. Morgan Keegan, Morgan Stanley may call on different investors than Lehman Brothers and UBS, and you want them working to be able to sell those bonds. They get paid basically from the bonds that they sell. If they don't sell our bonds, they typically will not make any money in the account.

They also are at risk for losing money too. Again, if they take bonds into their inventory and they can't sell them out at the rates, they have to sell them out at higher rates than what they paid for you -- to buy them from you.

Any questions there? You can see you're represented by large institutions, some regional institutions, and then some historically underutilized minority-owned institutions.

MR. GERBER: And, Gary, just because the three

senior managers have each had their challenges that have been well featured on the front page of the paper, we have gone back to each, but most recently to UBS, because they are front and center for this next upcoming transaction, to just explain the write-downs and other issues, and so if there was ever a question that board members would have about those, they're certainly available to discuss them and I think want to discuss them --

MR. MACHAK: That's right.

MR. GERBER: -- to assure us of their capacity.

MR. MACHAK: That's a great point. We're always making sure that they can perform for us. When they submitted those proposals, they were strong firms. They're still strong firms, and we want to make sure that they can represent this --

Yesterday I was on the phone with the Bear Stearns folks. There were rumors with regards to illiquidity at Bear Stearns, and I was talking to Peter Rice about those rumors. And he sent me some emails. They represent us in the market, and then as soon as -- we would depend on them after representing us for a number of things. One is to make a secondary market for those bonds, in case investors who bought our bonds want to resell them. But they're also, either as a bank, like

UBS, or a financial sub, which is separated and bankruptcy remote, is our counterparty on a lot of our financial props or swaps.

So -- and Rob can get into this a little bit more, but Bear Stearns, if something happened to their credit rating parent company, our long-term commitment with them on a swap is with a financial products company that they created that has a triple-A rating. That triple-A rating has been reaffirmed. It's actually rated higher than Bear Stearns itself. So that gives us assurance when we enter into swaps with these companies.

MR. FLORES: Gary, I still don't understand how -- these are teams, kind of. How do they go around spreading the welfare. I mean, they --

MR. MACHAK: Well, that's an interesting process that we go through. The senior manager is the leader of the group. Most of our communication is going to be with the senior manager. It's the senior manager's responsibility to communicate the direction of the sale, the term of the sales, to the co-managers. We do involve them on conference calls, but not necessarily every -- you know, every meeting and every conference call that we have.

When we go into the marketplace, the senior

manager announces to the group the bonds that are going to be available to be sold. For instance, we talked about a retail order period. What -- they'll tell the rest of the group is that, We're going to have a retail order period on -- you know, on Wednesday, the 12th, and we're going to have an institutional order period on Thursday, the 13th.

When that happens, those companies -- Merrill Lynch, Morgan Keegan, Morgan Stanley -- those firms especially who have large retail offices across the country, basically on every screen, every retail broker in their office can have access to your bonds and be able to sell those. And that's done with electronic information, and it's done with printed information in your offering document.

Any questions that they have will be filtered back to their desks, where the underwriters are, and then if those desks can't answer the questions, it will come back to the -- you know, to the senior manager to answer the questions.

Now, that when retail order period's over and we have -- you know, we've sold maybe a million or two of our bonds, the next day we'll have our institutional order period, and it will be very much the same thing, except those bonds will now be open to the mutual funds,

insurance companies, banks, to buy. They'll still be open for retail, but now retail will have to compete for those with the institutions.

But the way they get paid, the way they make money on these, again, is if they can sell bonds. And there's different priorities on the sales. And institutions usually come in for large blocks, so a lot of times they're given priority on their bond sale, because the underwriting group, again, their role is to get the market for your bonds. It's not to hold them in inventory.

So if a large institution comes in, that's better for you, because more of your bonds are going away -- what we call going away and being invested, not being held. And it's also better for the group too, because then they don't have balances that they have to underwrite. So they usually give those large blocks a priority.

MR. FLORES: But can all those guys participate?

MR. MACHAK: Well, for instance, on new financing, it'll be this group.

MR. FLORES: Oh, that's a group?

MR. MACHAK: That's a group.

MR. FLORES: Line 1, 2, and 3 we're looking at there?

MR. MACHAK: That's right.

MR. FLORES: Bear Stearns, UBS, Citigroup --

MR. MACHAK: UBS -- this is their co-senior, and these four firms are their co-managers.

MR. FLORES: Okay.

MR. MACHAK: The next one up would be -- we'll go back to Bear Stearns, and that would be that group. Then we just -- the last transaction will be completed with Citigroup.

MR. FLORES: Okay. You've got three teams. I thought maybe the senior managers could pick and choose underneath them.

MR. MACHAK: No.

MR. FLORES: They've got the teams already set up going in.

MR. MACHAK: That's right. They've got the teams set up. Sometimes we'll -- we may come back to you because a firm may have merged or there's been a name change, and so we may come back to you to approve the fact that this firm has merged. You still want it in the group, but they're now merged with another program. So you'll see that in between the time in which the decisions

were made to make these groups.

MR. FLORES: And we approve those, what, once a year?

MR. MACHAK: We approve those over a number of years. About -- oh, I'd say about two or three years ago -- five years ago?

MR. POGOR: '05.

MR. MACHAK: Okay.

MR. POGOR: In 2005 when [inaudible] RFP and we selected these group of teams, and we've been through Bear Stearns, Citi, UBS, Bear Stearns, Citi, and we're finishing up the second cycle with UBS.

MR. FLORES: So in 2010, you'll go through the cycle again on those selections?

MR. POGOR: No. Probably we'll go out and RFP next year to revisit --

MR. CONINE: 2009.

MR. POGOR: -- in 2009, to reselect our team of underwriters.

MR. MACHAK: If you don't mind me elaborating a little bit more about this, this -- as far as [inaudible] represents you as your underwriter ranges amongst the issuers of these types of bonds. Some issuers may just have one group, and every time they go out, that's their

group. They do not rotate. Other issuers may have more groups, may just have two. You actually reduced the size of your groups, I think, from four or five -- six? -- down to three?

MR. POGOR: Three, yes.

MR. MACHAK: Yes, the last time. So you've had -- you've worked with a number of these firms, and so we decided that having a lot of different groups was getting unwieldy. We really wanted -- we wanted these firms to understand our business better, and so we reduced it down to those that we thought were doing the best job the years previous to 2005.

Any other questions there?

MR. CONINE: I'm not going to say anything. Go right ahead.

MR. MACHAK: Okay. Let's see, next one. Okay. I think at this point, I'm going to hand it back to Elizabeth and to Mark, and they're going to talk a little bit about the documentation behind these bond issues.

MS. RIPPY: And given that we're all taking a little bit more time, I'm not going to talk a whole lot about the documentation here, but we will go over just the main financing documents.

The main document that we draft is a trust

indenture. And because you're doing revenue bonds, that trust indenture is kind of the key. There is an entity called the trustee that holds all the assets that you're going to put into your transaction, and they collect payments on the mortgage certificates that you purchase with your bond proceeds, and they make the payments to your bondholders. And so the trust indenture sets out all those mechanics and kind of lays out how the payments are going to be made. And that's just the name for that contract with the trustee.

Go to the next slide. And these, on single-family, kind of the -- you also hire a servicer that -- and that's a company that has expertise with single-family mortgage certificates. For your single-family transaction, that servicer is Countrywide on loans. And the document that we enter into the contract with them is an origination sale and servicing agreement. And then it talks about their duties and, you know, what they're going as far as pooling the mortgages and, you know, making sure that they get information to lenders about changes in interest rates or any changes in the program feature and that sort of thing.

So -- and it also has all the documentation you need in order to show that you've got tax compliance and

that you're making loans to the right lenders. There's all kinds of certificates that have to be executed by the borrowers when they sign up for their loan. We review all those certificates, make sure that we think they're going to get you into tax compliance, and those are attached to this agreement. And they tell Countrywide, Make sure the lenders get this from every borrower.

I think Mark's going to talk about the official statement, since he drafts that document.

MR. MELVEAUX: I'll try to make this as brief as possible, but this is one document where, Mr. Flores, that you can have criminal liability.

MR. FLORES: Oh. I guess I better --

MS. RAY: You better pay attention.

MR. FLORES: No kidding.

MR. MELVEAUX: As a result of the Great Depression, the -- one of the results of that was the Security and Exchange Commission was created. And the intent behind it was to make sure that investors, people like you, me, institutions, and other purchasers of these bonds, have as much and as accurate information as possible to make a determination of whether they're going to purchase bonds.

Corporations have to register their bonds in

almost every state when they issue debt and stocks, in almost every state. Under the [inaudible] memo, which was done decades ago, municipal issuers don't have to go through registration, but they do, when we issue bonds to the public and the public can buy, we have to provide them with a document that clearly, accurately, and fairly explains the transaction. So while you have all these people working on the transaction, from the bankers to lawyers, the document that is used by those bankers when they sell these bonds is the official statement. It provides the information on how the deal is structured. It provides information on the issuer. It provides information on the health and well-being of your revenue stream.

This is what I work on. To the extent there's any information in here that is material, that is incorrect, it's your responsibility actually. You can rely on your professionals. That's what you rely on me for. I provide you opinions saying that from my review of all the documents from the midst of the TDHCA and from reading all the federal securities laws, I believe that the information in this document is fair and accurate. But at the end of the day, the party that is responsible for the document is the Board. This is the Board's

document.

We get certain comfort from certain other individuals. Elizabeth Rippy and Vinson & Elkins would give comfort that certain sections of this document are accurate and fair. I will give comfort on this document that certain sections are accurate and fair. But at the end of the day, it's the Board's document. It's not staff's document. It's yours.

The good thing is you have disclosure counsel that -- we've doing this since, I think, 1993. Before that, one of the reasons why we retained -- the Department retained disclosure counsel because certain things happened in the late '80s that said we need someone who can actually spend time specifically on disclosure.

So we do this document. It's very thick. We probably -- when we try to -- we try to fall on the -- in terms of being conservative in terms of what we produce, so we'll probably over-disclose as opposed to under-disclose, to make sure that no potential investor can look at the document and say, Something was missing; You didn't tell me something accurately; you didn't explain something to me.

It's not going to be 300 pages, but what we try to do is give every material information, every material

fact any prospective purchaser would need. And this is what your investment bankers are using when they sell your bonds.

And if I can answer any questions regarding that, I'd be happy to. But I'm the guy who's usually in the boiler room, watching everybody else negotiate, but making sure at the end of the day it was disclosed as accurately and fairly as possible.

MR. MACHAK: The next two documents I'll speak to quickly. It's the bond purchase agreement and the agreement among underwriters. And these are -- first one you are party to. It's the document that controls the purchase of the bonds from you from the underwriting team. And the most important thing that's in -- the most important things that are in there are the interest rates that they're going to buy the bonds from you and also the price for the underwriting fee or discount that they're going to receive.

That underwriting fee, as I mentioned, or discount, is mainly composed of their compensation, their commission for their salespeople to sell. It also reimburses them for their expenses, and it also gives them a reimbursement for their time for cash-flow preparation and deal structure preparation.

The next document, called an Agreement Among Underwriters, and that document you're not a party to. But if you recall those teams that we had from UBS or Lehman Brothers, that's a document that really controls their financial agreement and their legal agreement on how they're going to sell the bonds and, if there are unsold bonds, how those are going to be divided up.

The important part of that document is what we call the liability. So the senior manager, if there are, you know, 10 million bonds unsold, they're not responsible, at the end of the day, for all 10 million. They may be responsible for 50 percent of those, and then the rest is divided up amongst the other underwriters, giving certain percentages. Co-senior manager usually gets, then, a larger percentage, somewhere around 20 to 25 percent. And then the co-managers get somewhere between 5 and 7 percent.

And that's important too, because, as I said, there's different priorities of sales. Some institutions will come in and say, I don't want to buy them from this firm directly; I don't want to buy them from UBS directly; I don't want to buy it from Lehman Brothers or Morgan Stanley directly. I want to buy it from the group as a whole, the whole underwriting group. Then that sales

commission will be divided up amongst those -- amongst the dealers in that group, similarly to the same percentages.

Sometimes -- we'll get into this a little bit later, but sometimes actually we give the investors the right to designate how many dollars they want to go to each institution. Again, they'll say, I don't want to give it just to UBS. I want to give it to three members in the group. And these members in the group have been basically -- have been taking care of my account with them. They've been making bids on my bonds in the secondary market. They've been showing me new product that other broker-dealers aren't showing. So I want to designate this bond sale to UBS, to Morgan Keegan, and to Estrada Hinojosa. And so that has to do, again, with how the underwriting team is working for you, and they're also in competition with each other to sell your bonds and get the best price.

MR. CONINE: Can I go back to the Countrywide -- this document for just a minute, and lay out a concept that may be helpful to you. And it's hard for me to always understand how we could issue a bond, essentially from the Department, but effectively from the State of Texas, and not put the State of Texas at risk, because those bondholders have to be paid, and we're

depending on payments coming in from a bunch of single-family homeowners who may or may not make their payment. And so let's make the assumption that somebody doesn't make their payment. Tell us how we make the bondholder paid that month.

MR. MACHAK: Are you going to cover that --

MR. POGOR: I'm going to cover that later, Kent.

MR. CONINE: Okay. You got it later?

MR. POGOR: Yes.

MR. CONINE: Great. Never mind.

MR. POGOR: Just 30 seconds. We -- there are guarantors we have that Countrywide was able to receive those mortgage payments in, and they will make whole on any payment that needs to be paid on a monthly basis. If a mortgage holder decides that, for some reason, he is unable to pay, Countrywide will step up to the plate and make whole on that loan. Okay? And so our bondholders are not dinged at all.

Now, if it comes to a point where it's 60, 90 days old, 120 days old, those guarantors will step in. And since Countrywide's been paying the last three or four months, Countrywide will tell those guarantors, Hey, I've been paying this note off for the last three or four

months. We need to either foreclose on this property -- and at that point the guarantors will pay Countrywide back for all their fees that they've been, you know, making whole for us. And then Countrywide will settle that -- try to go out and sell the market -- sell that house, foreclose on it, or whatever they need to do.

MR. CONINE: And that guarantor is typically FHA or Fannie Mae.

MR. POGOR: Or Fannie Mae. Yes.

MR. CONINE: Those are the two main ones. So you can see how the money either comes from the family or FHA and Fannie Mae comes through us and over to the bondholders.

MR. FLORES: But Countrywide is the one that has to do all the work if somebody bellies up and doesn't pay.

MR. CONINE: Well, these guys would argue with you that they do a lot of the work, but you're right, Countrywide's got to some of the work.

MR. MACHAK: When those mortgages are in the portfolio, when they're your assets, they are doing the everyday management of that asset pool.

MR. WITHROW: Well, the Ginnie Mae/Fannie Mae, they guarantee unconditional, timely payment of the

interest on the bonds. The principal is a work-out situation, but the interest will come in on the 20th of the month. So you just won't prepay your bonds, but that's passed on through to the bondholders so that --

MR. CONINE: Well, and the Ginnie Mae guarantee is not a hundred cents on the dollar; it's 99, isn't it?

MR. WITHROW: I think -- on the NBS, as I -- I think it's -- they guarantee 100 percent.

MR. CONINE: But on the individual loans, I think FHA's a 99-cent deal. I don't know who eats the penny.

MR. MACHAK: Yes. FHA is -- may not be 100 percent. VA is certainly not 100 percent.

MR. CONINE: Right.

MR. MACHAK: But even though it's not 100 percent, Freddie, Fannie, and Ginnie, on the government-insured loans, will take those mortgages and securitize them and they'll be able to get a triple-A and will guarantee the payment. So they -- those guarantors may --

MR. CONINE: So the guarantors are eating it somewhere down the line.

MR. MACHAK: They may eat it. They may -- it depends. Sometimes they go back to whoever is responsible

for servicing or originating that loan, too --

MR. CONINE: Right.

MR. DALLY: And they'll do that because every month they get a guarantee fee off of -- when we talked about the 1-1/8 between what the bond unit was and what the mortgager paid, they take a portion of that as a guarantee fee off all performing loans. And then that way they're compensated in the sense -- so they can cover -- yes.

MR. FLORES: So the guarantee fee is kind of a little insurance policy.

MR. DALLY: A little insurance policy. Yes.

MR. FLORES: You don't use that term, but you can convert that sometimes down to my home mortgage and then I can understand it.

MR. MACHAK: And that has really reduced the cost for agencies, these guarantors in place. Before that, in the early 1980s when that was not available, we actually had -- we had pools of mortgages that had whole loans in them, and they weren't guaranteed by these triple-A entities. The way that we got those to be credit-rated and at a higher rating would -- we would go out and buy mortgage pool insurance for -- you know, up to 30 percent of the mortgage pool.

MR. CONINE: I'm afraid we're back to those days.

MR. MACHAK: We may be back to those days. That's the transformation that you were talking about.

MR. CONINE: Yes.

MR. MELVEAUX: Just a piece of information, just some data, since the inception of the Department's program, the Department's [inaudible] gone slightly over 3,000 mortgage loans and have an outstanding principal balance of about $158 million. As of June 30 and this deal, you only had mortgage loans under foreclosure for a little over $5,000, so it's not a common --

MR. FLORES: Wow.

MR. MELVEAUX: -- foreclosures are not common. That's because your standards for loaning are --

MR. CONINE: We use the FHA and Fannie Mae underwriting standard.

MR. MACHAK: You're not doing sub-prime loans.

Just maybe to finish up on this section here, Kent made a great point that our market is transforming, but there are still buyers out there, and there are still issuers out there. Just in this week in the marketplace and successfully completing bond issues has been the State of Iowa, the State of Maine, New York, and Rhode Island.

So there still is --

MR. CONINE: Describe successful for me.

MR. MACHAK: Well --

(Laughter)

MR. MACHAK: I was going to put another modifier in there.

MR. CONINE: Not from the standpoint that the bankers got their fee, but describe successful.

MR. FLORES: What was the percent?

MR. POGOR: If you're making a long-term bond, it's six maybe.

MR. MACHAK: Well, as Matt was just saying, we're -- the long-term bond right now is at -- for housing bonds, from the cash market, is 6 percent. And what a lot of these issuers have done is that they have used financial products on the long end to bring those rates down. What some of them do, like California, they have a lot bank of zero percent mortgages, although they've used them up over the last few years. But they'll use those to buy the mortgage rate down.

So when -- you know, when you hit some tough times like this, there are alternatives out there to look at. I think the Iowa transaction just went out with the serial bonds, the short-term bonds. On the complete long-

term piece of the bond, they did a financial product, because it lowered their rate.

And we'll get in later -- we just got -- if you want, we just got an update from our underwriters on our transaction. Let me go through this.

MR. CONINE: What's our transaction?

MR. MACHAK: Giving a snapshot of the market right now for our bonds, a cash deal, where we have all bonds going out with no financial products to layer in there, would give you a full-spread mortgage rate, meaning you're getting all the way up to the 1-1/8 that Steve talked about, of a 6.96 with -- five points? -- of down-payment of assistance and a 6.21 without any down-payment assistance. Now, compare that to a 100 percent -- because we've also done tests in between, where we've layered in some percentages -- but 100 percent with a financial product with a swap, that rate would be a 5.76 with five points in down-payment assistance, and a 5.01 with just -- with no down-payment assistance.

So you can see the difference there of what -- when you layer in the financial products. What we'll get into later is how to balance that, how to balance that competitive rate with layering of financial products and the risks of layering that in compared to a cash market.

MR. GERBER: We've probably got about 45 minutes to cover a lot of ground, and we brought poor Rob all the way down from the tundra in Minnesota to cover swaps, so --

MR. ETTELDORF: This is my spring break.

MR. GERBER: Great.

MR. FLORES: I thought you were telling me I'm going to get out of here at 7:00.

MR. GERBER: We're going to try our best to get out of here at 7:00.

MR. FLORES: At 6:00 I have to make a phone call.

MR. GERBER: Do you want to pause for --

MR. FLORES: Take five minutes?

MR. CONINE: Let's take a potty break.

(Whereupon, a recess was taken.)

MR. CONINE: Back to class.

MR. POGOR: Okay. This portion is called, Welcome to my world.

MR. CONINE: I'm not sure anyone wants to go there.

(Laughter)

MR. POGOR: I mean, the whole thing starts off with a market study, I guess. And Eric Pike and his

group, they go out and they survey, you know, 64 bankers, mortgage companies, 400 other institutions, and they come up with a demand. And with that demand, they also take a look at the target rate we want to set.

And while Eric's out there doing that, I'm out here doing a different thing. I'm out here looking at assumptions, trying to figure out how much down-payment assistance we may need with the structure, how much money we'll be putting into this bond structure from the Department. There's other assumptions that we take a look at with the underwriter.

We get together as a group. When I say we -- Bill Dally; Eric and his staff; my staff; all the underwriters; financial assistance; our financial advisor, Gary and his group; Elizabeth Rippy; Mark Melveaux and his group -- we all get together in a working group. And we discuss all these assumptions and go through any legal issues that may be coming forth from the legislature from the prior year. We take a look at everything possible.

And then we go out at that point, and I send financial information to the underwriters. Our underwriters, at that point, will come together with some scenarios that we just talked about. And these assumptions or these scenarios will -- they could give us

what the fixed-rate structure would be, what would be the 20, 30 percent swap rate be, what would -- if you did a 5 percent swap, what the mortgage rates would be.

So we take a look at all this, and we come back to the Board on a preliminary basis and ask for your approval for the underwriter, as well as ask for your approval to draw down the volume cap. Okay. Then we kind of go back and, before we come back to you, we finalize the structure, because before we may be looking at a whole different scenario. We're trying to finalized it, what we're going to come to with -- at that point, we will come to you. We'll also be working on a lot of different agreements, the disclosure agreement, the loan agreement, and so forth, trust indenture.

We'll come to you and ask for your approval at that point. After we do get that approval, then we have to go to the Bond Review Board, as Elizabeth talked about, and we get their approval. Once that happens, then our next step is to -- Mark sends out the official statement, and the pricing begins like a week later.

So at that point, I'm going to let Gary take it over from there, and he can run with it.

MR. MACHAK: Hey, Matt, Eric Pike to stand here for about 30 seconds. Just describe how you assess market

demands.

MR. PIKE: Sure.

MR. CONINE: Surprise.

MR. PIKE: Typically, before every new bond release, as Matt said, we contact a lot of our participating lenders. We've got about 60-plus organizations that participate in our program. That translates into about anywhere from 3- to 400 branch offices across the state. So we contact some of those larger producing lenders, especially some of the bigger builders that build here in Texas. Many of them -- some are located actually -- or headquartered here in Texas. Some are outside of the state. But I talk to them, and I find out, Well, what do you think your -- what do you think the housing market's going to be like? What do you think your sales projections are going to be for the upcoming six months or so?

So we try to gauge what type of the demand, and then as part of the bond documents that we send out to all of our lenders that participate in our program, they're required to also complete information that tells us that they think that they can originate, say, $10 million in targeted area loans, or they can originate, you know, $5 million worth of unassisted loans. So that helps us to

build a demand request.

And so, again, as Matt says, it's just a lot of basically telephone work from organizations that we've had some expertise with. We also talk to our servicer and some of the other professionals that we work with to see what some of the other local housing finance agencies might be -- what interest rates their programs might be offering at the current time, so that we know what our competition is.

So we try to look at a lot of things, and we've been real successful, real lucky, that we've always been able to go out with an attractive rate, at least in the last number of years that I've been with the program.

MR. MACHAK: These are concepts, actually in the last section, we talked a lot about. But again, they're involved in the bond sale, the maturities and redemption dates, fixed rate versus variable rates, and how we hedge those as we do a variable rate.

In the new transaction, some of this we will not have. We are not contemplating having taxable bonds, subordinating bonds or soft financings, but we are looking at the first two. We're looking at regular maturities and we're looking at possibly layering in a variable rate and hedging that variable rate. We talked about the methods

of bond sale.

Next chart, we look at the credit considerations. We are always looking at investment grade. It is very tough to find buyers for -- in our single-family bonds and in multifamily bonds, to buy anything except for investment grade. If it is something that we may not be able to get an investment grade on, then we would look to credit enhancement. And these are the credit enhancements that we typically use. Once in a while we will use [inaudible]

These are activities that happen after closing, after we've been in the market and sold the debt. We look at the investment of the proceeds, because what happens is if there's a mismatch in the timing, you're going to get $100 million from the underwriters on the closing date, but you're not going to have mortgages ready to be purchased. So you're going to have to have that money invested, and that money will be invested in what we call a guaranteed investment contract. Short name for it is a GIC. And that typically -- in certain markets, you earn above the rate that you're paying on your loans, but sometimes, like in today's market, it doesn't earn up to the rate that you're paying on your bond, so we have what's called the negative spread or negative arbitrage.

That makes the program a little bit less than -- a little inefficient and it is more costly to you.

At closing, Elizabeth is really the boss of the closing, because she's organizing all of the documents. We're making sure that the wires are coming in and any wires going out in terms of cash that you put into the transaction. And then all of the certificates and documents are signed, and they're signed in a way that they -- everyone is certified to the terms that satisfy the tax counsel and bond counsel, the underwriters, and the issuer, and us as financial advisor.

Post closing, after every closing you do a -- and we help to gather information, underwriters gather information on the bond issue. It gives them the final cost. It gives them how the bonds were sold to investors. And then sometimes later, many years later, we look at refunding opportunities, workouts, and credit substitutions.

Next chart. Program designs in the single-family assistance payments is something that's been very successful for you. We've done issues that have been 100 percent assistance. We have done others that have been -- not used any assistance at all. Right now we're doing a blending. We do part of it as assisted, as you heard

before, and part of it as unassisted. And assistance basically means that within the bond issue, we generate money from either -- from selling premiums usually on the bonds to provide down-payment assistance, five points, to certain investors.

Kent asked earlier, we talked about taxable bonds, how that can layer -- or actually expand your cap to give you more proceeds. But taxable bonds are also helpful when you're looking at a refunding, which is the next, because a lot of times if you can refund with a taxable bond, that may free up some of the money that can be earned from going from a high rate to a low rate if you're -- and that low rate is taxable. If you did it with a tax-exempt, you may be restricted with some of this money that you create with regard to that [inaudible] because of the tax dollars.

Let's see. I think that's it on that chart. And junior lien bonds we've used before. We haven't used those recently. It was used in the past to help design a program. And basically when you issue bonds, you issue them under what was called an open indenture. That means there's many different bond issues under the same legal term, the same open indenture. That helps you build up assets and build up excess cash.

Years ago we had excess cash in an indenture, and we issued junior lien to try and tap into and finance against that excess cash for a program.

We're going to talk about financial products later, and we'll talk about -- we talked about recycling a little bit earlier, too, from prepayments from prior mortgage loans, again to expand your cap. And you have a program in place, and we'll probably be back to you soon on a new program.

That's it on design. Matt, you want to take the next chart?

MR. POGOR: Just continuing with recycling and refunding techniques. Remember, for the first ten years, when you get -- release a bond, you can bring those repayments and prepayments that come in from the mortgage, and you can -- as they come in to us, we'll split the interest off and pay debt service. But principal, we can take those repayments and prepayments and warehouse them, is the term, into either a draw-down bond or a commercial paper program.

Since '94, we've had the commercial paper program, and due to the market constraints, we're moving into a draw-down bond. We'll be paying back here later on this year with that.

But as these come in, the money is sitting in there -- these prepayments and repayments sit there until we need them. And I'll be coming to you with this next structure, and I'll be using about $50 million of these bonds to -- refunding bonds, what we're going to do -- you get the refunding bonds, and they pay off the commercial papers. Okay? Once that's done, it releases the mortgages, or these repayments and prepayments, and you're able to loan that money back out. So that's how you're able to recycle your money.

Any questions?

MR. CONINE: It's a hard concept to understand.

MR. POGOR: Yes.

MR. CONINE: Very difficult.

MR. POGOR: Money comes in. It's housed here for a period of time, until we need it. Okay? When we issue the commercial paper, there's a bondholder -- or there's a commercial paper holder that actually gives us money for that paper. We pay off the principal-to-debt service. Okay? Those repayments and prepayments are still sitting here, and there's still a commercial paper holder. When we issue refunding bonds, the refunding bonds pay off that commercial paper holder. It releases these prepayments up to send out for new mortgages.

MR. CONINE: We can only do that through year ten, though. Correct?

MR. POGOR: For ten years. Correct.

MR. CONINE: And after the tenth year, federal law says you've got to start leaving them over in the debt service fund to pay everybody off eventually,

MR. DALLY: And that technique lets us go beyond the $189 million that we have in that cap and lets us extend that. But it's flexible in the sense of in a year when we need -- you know, we need to extend it, we can. If we don't, we can continue to warehouse it.

MR. POGOR: On the next chart --

MR. CONINE: It's kind of like watering the ketchup down again one more time. You get to use it --

(Laughter)

MR. POGOR: If you wanted to know what we've done --

MR. CONINE: You've got to explain this so Sonny can understand it.

MR. FLORES: I'm not as sleepy as you think I am.

MR. POGOR: '94 is when we started this commercial paper program, and in '95, we issued our first refunding bond. Okay? Over the years, we've accumulated

$470 million. That basically helps about 4 million families, which really -- 4,000 families. Excuse me. So we were able to go back with this refunding technique and help about 4,000 additional families using this refunding, recycling process. Okay.

This next one is, I think, one you're really going to enjoy. And that has to do with exactly how the flow of money works.

(Phone rings.)

MR. CONINE: Thank you for that $100 for the Housing Trust Fund, Mark.

(Laughter)

MR. POGOR: The bondholders basically give up some proceeds, and that goes to the trustee. Our trustee holds onto that money until it's needed. I'll leave it at that point, because as bond proceeds come into us, we sold our bonds, and the money resides here. What happens next in the process is that -- excuse me. It's over 64 banks and mortgage companies with 400 branch offices. But your mortgage lender and your first-time homebuyer, they get together.

Completely separate from this, after we do our bonds, Eric's out there publicizing, We've got money, we've got money. But lenders take a look at all this and

they work with first-time homebuyers. When that loan is closed, that mortgage lender understands that our master servicer is Countrywide. He will actually sell that mortgage to Countrywide. Okay? At that point, Countrywide will accumulate or pool several of these loans and work with Ginnie, Fannie and Freddie, our guarantors. The guarantors will take a look at it and make sure all the underwriting criteria meets their needs and will issue a certificate to the master servicer, who in turn turns the certificate over to the trustee. At that point is when the trustee sends the money over to Countrywide, our master servicer, because they have already paid for the mortgages originally. And then the master servicer has already paid the mortgage off with the mortgage lender.

So that's the process of the bonds, how it all works. But your first-time homebuyer, when they make their first payment of every month, the first payment comes in and goes to the master servicer. And here's the fun part, because the master servicer takes a look at it and they service these loans. They send out statements every month, and we pay them a fee. They strip off a portion of that fee for their services. They will send the rest of that balance down to the guarantors, and they strip a little bit of that money out for their services.

These two together is 50 basis points. It could be 25-25; it could be a different split. It depends on the agreements we have. Ginnie, Fannie or Freddie, when they strip off their amounts, they send the P&I over to the trustee. The trustee at that point will, at the appropriate time, based on letters from the agency and based on the bond documents, when the bondholder needs that service payment or interest payment, so payments would be made at that point in time. So that's really the cycle of the money, how it flows through and goes back out.

MR. WITHROW: There's also a little bit of a strip-off from the trustee to you.

MR. POGOR: We'll get to that in a minute.

(Laughter)

MR. POGOR: The trustee gets a little strip of this money. I'll go through that strip-off in a second.

Next chart, please. This is a little bit about the -- some of the application process we have in our organization. One thing we do is take a look at the housing indenture. Every month we get -- financial services gives us some information. We take a look at all the data, and we compile it in some nice, complete little report that gives parity.

Parity is nothing more than comparison of your assets and liabilities. You always want more assets than your liabilities. In our case, you see 102.8 percent for single-family. Our other indentures we haven't talked about yet. These are residential mortgage revenue bonds, and then there's collateralized homeowners revenue bonds, and then there's multifamily. So in all these indentures we have, the parity is over 102, which is very key to a rating agency, because they are the ones that have that as a mark to give us the ratings that we have currently right now.

And the next chart is just letters that we get Standard & Poors and Moody's that gives us their rating on our bonds. And this happens with every structure we put together.

The next chart covers basically bond compliance and disclosure. In my section I have two individuals. One individual does compliance work. And what that individual does, looks at the single-family as well as the multifamily, these indentures and covenants that are in these documents. They read through those and extract key elements within that that says, okay, we owe bondholders on X-given date, we owe them interest on this given date. There's certain fees that are paid. That person goes

through that on an annual basis to make sure that is being done properly and accurately. So that's one thing that that person does on the compliance side.

MR. CONINE: By the trustee.

MR. POGOR: By the trustee, yes.

Now, the other portion of this is the -- is disclosure. Ed Morris, you met earlier, he works with the disclosure portion of it. He sets up our website for disclosure, as well as he works with Mark Melveaux on the Security and Exchange Commission Ruling 15c2-12. That came into effect in 1994, and we put together -- there's eleven events that if they were to happen we must disclose that to the public. So all this is maintained by Ed in his function right there. So those are a few of the areas.

The next item, we [inaudible] our website. We're kind of proud of this thing -- Bill'll probably want me to take something off of here, but I just can't get rid of it. And that is, you have -- if you go with the program for our website and you pull down bond finance, you will see on there it has our investment policy, our swap policy, it has all the disclosure stuff we talked about that Ed puts on there.

And the reason I'm bringing this up, because

back in 2000 -- I know it's kind of old and dated, but I just can't get my hands off of it -- the agency was recognized by the National Federation of Financial Analysts, that we had the best practice on our website. So I believe that was something that really is the kind of thing that's [inaudible] for us to go and have still. Even when I got to [inaudible] and go to the disclosure sessions, every once in a while they talk about and [inaudible] about this. I have been receiving phone calls from Florida like three months ago, about our website, from Arkansas about three months ago. So I'm kind of proud of this section right here.

The next item we talk about is -- I think this is Eric's little baby right here, but we'll do it real quick. If you want to know what a first-time homebuyer -- first-time homebuyer may not have owned a home within the last three years. Okay? It must be a principal residence. Okay? And there are target area exceptions as well as there's no refinancing with this type of structure.

Also you're looking at purchasing price limits. Purchase price limits, non-targeted areas is $237,000 and targeted areas is $289-. Don't let that scare you, because I'll show you some data in a little bit, but we

don't even get near this. Okay?

You know how it is in income limits, your income for your family. If you're up to a 115 median income, you can use one of our bonds, okay, for a family of three or four; a hundred percent for a family of one or two, and targeted areas are 140 to 120.

There's other -- Elizabeth talked a little bit about this type of requirement, 20 percent of our proceeds. If we had a $100 million bond structure, $20 million of that $100 million bond structure must go to targeted areas and it must sit there for at least 12 months. That money usually has been hard to move, but with the GO zone, the Gulf Opportunity Zone being a targeted area. And that was brought in in 2005 with Hurricane Rita. That will go through 2010.

In 2006 we had specific structures that identified the Rita GO zone. And that money kind of flew out the door, because we had people in the Houston area, Orange County, Beaumont area, that utilized those funds. Some of it was, you know, taken advantaged of, I would say, but I'll talk little bit of that in a minute.

The other two items are state requirements, and that is 30 percent of our proceeds, or another $30 million that gets set aside, and that's money that must be there

for families with income of 60 AMFI -- up to 60 AMFI.

The reason that we have a state requirement that says, okay, you must pay down-payment assistance to families with up to 80 AMFI, this is making it a little harder to structure my bonds, because we're giving more assistance. When you took a look at this last year, what we did in 2007, 58 percent of our bonds were out to families with 80 AMFI or below. So that's why I said earlier, don't worry about this right here, because we're not meeting that target at all. We're meeting a lower income, which we should be, but just a little more difficult to structure our bond deal.

The next slide we've got is loan income range. And if you take a look at this, loans -- these three areas, the $30,000 to 60,000, that's like about 68, 69 percent of all our loans have gone to -- into that income range, between $30- and 60,000.

Take that next slide, you'll see that -- and this is where it's a little bit skewed, because if you take a look at the home purchase price, because that is the 2004 to 2007. It's look like we're issuing loans from $120- to 140,000. That seems like a lot. Well, it is. If you just take a look at this 2007, we're back to where we normally were in the past to $115,000 or so, on

average. Okay. So it's a little bit skewed on this data. I just wanted to bring that to your attention.

MR. CONINE: Why?

MR. POGOR: Because of Rita. When you -- with Houston, that was targeted area, even though you may have had some damage, if you wanted to sell your house, you could and go get one of our loans at a nice rate, and you didn't have to be a first-time homebuyer.

MR. CONINE: So they bought a little more house.

MR. POGOR: Yes, right.

MR. CONINE: Okay. Got it.

MR. DALLY: In an affected area.

MR. POGOR: Next chart, I'm going to kind of run these and I'll let you take a look at them, but we're running short of time. It talks about the top 15 cities -- if you want to ask me questions real quick -- talking about those counties and ethnicity as well.

I'm going to keep on trucking. Let me kind of run through this very quickly, in that -- and these are two structures we had in 2006 and 2007. We normally come to you twice a year. Okay? In 2006, the reason I'm going to take a look at this, we've got Programs 66, 68, 69. What happened to 67? Okay. Well, Program 67's an MCC.

I'll talk to you about that a little more about that in a second. But whatever program we issue, for accounting purposes, we need to keep track of our programs and [inaudible] MCC as well as our bond programs.

Also with this, you see that, depending on the tax matters, that we may issue bonds that are several series, and we may issue other bonds just under one series of bonds.

Next slide. Ah, here's a good one. Here's the one that kind of builds up exactly who gets paid and how they get paid. If our bond yield -- and this is what Gary was talking about earlier. If we had like a lot of series, a lot of terms, we got a lot of different types of bonds, but the average -- the yield for that is a 5 percent bond yield. The most we can go out to our market with is a 6.125, according to tax law. Okay?

Now, what happens is that, you've got your mortgage -- you've got your master servicer, and you've got your guarantors, and they will strip off 50 basis points like we talked about earlier. The trustee will take off 1-1/8, okay, or 1.8. TDHCA, we pay for our lights and this nice building, we strip off 35 basis points.

Why are you laughing, Mike?

(Laughter)

MR. POGOR: And then there could be some residual. Okay? So that's how this whole process works, as for getting a bond yield up to a one-on-eight.

MR. DALLY: The building doesn't explain it. It's the salaries.

(Laughter)

MR. CONINE: And by the way, in that last slide, the starting rate down there at 5 percent?

MR. POGOR: Yes.

MR. CONINE: Gary and the boys have already been taken care of in that number, Elizabeth and everybody.

MR. POGOR: Yes.

MR. MACHAK: And it's -- this is a good demonstration as to why it's good to have -- I mean, it's -- there's some risks involved in issuing bonds. We've tried to mitigate those risks with different techniques. But it's good to have the assets on the books, because if you have any assets, you're getting ongoing income, and then when you get to some of the call dates in those programs, you've built up equity into those programs that you may be able to tap out.

MR. DALLY: We kind of missed it, but I want to

fill in one more little detail. And when we do our application, our bond application to Bond Review Board, we lay out what's call the cost of issuance, and that's the underwriter fee, the bond counsel fee. So that's laid out in the print what everybody's getting paid off of the deal.

MR. FLORES: Before it's --

MR. DALLY: Before it's approved. Yes. Before it's approved.

MR. FLORES: Or we'll get in trouble.

MR. MACHAK: Full transparency. The cost of issuance is even broken out in the -- it's broken out as a line item in the offering document, too, to investors.

MR. POGOR: Okay. The next talks about MCCs. MCCs were established by the U.S. Congress as an alternative to the issuance of a single-family bond --

MR. CONINE: Pay attention. We'll see this tomorrow.

MR. POGOR: And what I'm going to do, instead of trying to paraphrase all this, I'm just going to tell you what the MCC actually does. Okay? To me, that's a whole lot easier to understand.

A homebuyer can go to a lender, but he cannot use our tax-exempt mortgage revenue bond. He must use

another structure, another method for financing.

MR. CONINE: FHA, normal FHA --

MR. POGOR: Normal FHA --

MR. CONINE: -- normal Fannie Mae --

MR. POGOR: Yes.

MR. CONINE: -- just a normal loan.

MR. POGOR: Now, when the first-time homebuyer is working with the lender, the lender may say, You can get an MCC here, which will help you. And they say, Well, how? So this is how it works. Okay. If you were to get this MCC, or this certificate, mortgage credit certificate, you can take that certificate to your employer. And remember when you filled out your W-4, Withholding? You went there and you checked off, Married, four kids, and they start making deductions. Well, you can take that certificate to your employer and say, Okay, I want to change my W-4. And what happens, you've got a maximum of $2,000 you can use, or $167 a month. So what happens after you go to your employer and get that changed, the next month, you've got an extra $167 in your pocket that you can go and pay some more bills with, buy a car, do whatever you want to do with it, okay, put the money in your pocket.

MR. CONINE: Well, in theory, what you're doing

is you're compensating on the rate between the nontaxables you could have gotten with us if we had issued some bonds and the ultimate rate we'd be charging on the mortgage and a normal, conventional mortgage. That -- in theory, what Congress decided is that would make up the gap between the two, in their infinite wisdom.

MR. FLORES: How did they make it come out so nice and neat?

MR. CONINE: I don't know. $167 is a really neat package. They capped it, so that's why.

MR. POGOR: Yes. And let's say you get the certificate, at the end of the year when you do your income tax and you itemize, okay, you're doing your taxes and you're looking at itemization, you get your statement from your mortgage lender, and it says, okay, you paid $6,000 in interest this year. You can still itemize. You can deduct that $2,000 from that 6- and use the remaining of that 4,000 for an itemization. So you can use it on both ends, on a monthly basis as well as at the end of the year for taxes.

MR. DALLY: But the $2,000 is a dollar-for-dollar credit you get first, and then the remainder of your interest for the month. It goes like a regular itemized deduction. So you're getting both. Pretty good

deal.

MR. FLORES: Well, we're learning a lot about the tax rules around here.

MR. CONINE: The fallacy of this program, as I understand it, is that the families do it the first couple of years and then they either quit itemizing -- they have a bad year and they quit itemizing, or they forget about it, and so the certificates kind of go away pretty quick. So the cost to the federal government isn't near what they compute it to be.

MR. DALLY: Oh, sort of like the rebates that you don't take or you don't mail in.

MR. CONINE: Yes.

MR. FLORES: Exactly.

MR. CONINE: You look at the annual historical usage of these, the families just quit using them.

MS. BINGHAM ESCAREÑO: They go to the easy tax --

MR. CONINE: Or they quit itemizing or something.

MS. BINGHAM ESCAREÑO: They don't itemize. Yes. Get their fast cash.

MR. POGOR: If you take a look at the bottom part of this, in '90 -- in '85 we issued our first MCC,

and we haven't done anything until 2003. We have one we issued back in June of '06 that we're just about completed. We've only got like a couple more loans and it should be done.

We've had a company that has been managing this for us, but we believe we have the expertise in the house, and Eric has stepped up to the plate and says that he's willing to do this. And we're wanting to -- we're coming to the Board tomorrow for an approval to basically bring this in house with a new MCC program.

What happens with this program, it also takes a look at your -- you have to draw down your volume cap. So we not only draw down $60 million of volume cap, okay -- the way it works, you get -- making it one for four -- so you only can use $15 million of authority. Okay. So with the $15 million of MCC authority, you're going to use $60 million of volume cap. That's still going to leave us, 100-and-let's-say-90 million dollars. That's still going to leave us, you know, enough volume cap, as long as -- and with the other commercial paper we talked about, we could have close to another $180 million or so if we needed it, between now and the end of the year, for bond programs.

MR. CONINE: When Congress -- again, when

Congress gave us the municipal bonding authority to do the mortgages, they created this MCC program to be the alternative when the credit markets are exactly the way they are right now. They're upside down. You can't sell a muni and get a competitive rate because, you know, a normal FHA loan is out at a very competitive rate, or Fannie or Freddie. So we can do these certificates and bypass -- we can still use our bonding capacity for the year in a turbulent credit market and get these certificates out to these people in lieu of using our bond cap, or instead of.

MR. POGOR: With that I'll turn it over to Robbye with Multifamily.

MS. MEYER: I'll try and make this short and sweet. Multifamily -- the difference is most of what you've heard so far is single-family. So multifamily, if you'll put it on a little bitty scale on an individual basis, that's what you're going to see on a monthly basis from multifamily. You're going to see an individual multifamily transaction. And all of this single-family stuff that you see going on is actually done outside with all the professional on a multifamily transaction.

The borrower you'll actually see in person at our board meetings, and they have a choice on multifamily

transactions to pick and choose their underwriters, the trustee, from an approved list that you will see from time to time. We will bring underwriters to you, trustees to you, get providers and need approving on a two-year basis. And so you'll see those -- on multifamily transaction, most of the things are done on the outside, by the borrower and professional bond counsel and as such.

We do have a few precautions that we have in place, and I'll go through them here. We do require our bonds on multifamily transactions to be fully amortized over the financing period, and we also have a traveling investor letter, and we actually require physical bonds on anything that is A rated or lower.

And now on private placements, we limit the sale to institutional investors and that -- ends that slide.

The one thing that's in your packet, we use the word NIMBY, and normally you won't hear that word come out of staff, but it's "not in my backyard." Multifamily transactions do tend to receive quite a bit of public comment. And that's probably where you would see most of -- a large board meeting from the outside. And we have an extensive notification process, not only from the applicant's perspective, but also from the staff

perspective and the Department's perspective. We do extensive notifications. We hold public hearings on the individual transactions. So we have individual -- or we have the public that's actually commenting on one individual transaction.

And these are some of the concerns that they bring up. The Board considers these concerns as well as information that staff is providing them, and that's market study, which -- Mr. Gouris and his group gives you an underwriting report for each deal. You'll see that on an individual basis for each individual deal. It will go into the location of that development, what's needed in that area. It has -- we don't normally do impact to schools, that is something that you will hear quite often, that people are [inaudible] how it's going to impact the school district or a neighborhood in general or the infrastructure in a particular area. But those are the things that you're going to hear on the multifamily transaction.

And the next slide has to do with our public hearings on each individual transaction. We do have -- different from the Housing Tax Credit Program, we have consolidated hearings and we do all of the applications in the competitive process, which I explained to you last

month. We do those on a larger scale. This is on an individual basis. So those tend to get a little bit more public comment than the competitive process.

We have public meetings where -- TDHCA meetings, also the Bond Review Board, we are in their process. Those are public meetings also and the public can show up at those. And then we have a notification process that [inaudible].

That's short and sweet. Any questions?

MR. ETTELDORF: Well, we spent a lot of time talking about bonds and bond process, and now we're going to talk about something that's not debt. A swap is not debt. It's not a security. It's a contract. It's a contract between two entities to exchange interest payments. It's starting to sound a little bit like debt. Right? Except the key here is that there's no principal amount exchanged. So when you talk about interest rate swaps, the term that you're going to hear is notional amount. It's a conceptual amount. It's the basis on which the interest stream is generated.

From your perspective, what's the notional amount of your swap? It's the [inaudible] amount of the bonds that you're swapping. Okay? So from your perspective, the swap is a component of a debt financing.

All right?

Now, when you do interest rate swap, one party is generally going to be making a fixed payment. The other party is going to be making a variable rate payment. Again, this is just interest. There's no principal. So a lot of times when people look at this diagram and they say, All right, this swap provider is telling me that if I pay him fixed, he'll pay me some variable amount, a percentage of LIBOR or the SIFMA index, some other rate, and one of the first things that goes through people's mind is, He knows that the fixed rate that I'm going to be paying him is going to be greater than the variable rate that he's going to pay me, or why would he enter into this transaction?

We're not that smart. Just like you, as an entity, are using this swap to hedge another box that's not showing up here, but it's your variable rate bonds. You've got another variable rate line that goes down goes to my book. You're using this swap to say, This swap is a tool. This swap is a better method for me to get fixed rate exposure that I want, because I've got these bonds down here, the swap provider can pay me variable. I'm going to make a variable payment to my bondholders. I hope these two things offset each other. What are you

left with? You're left with this fixed payment. You just created synthetic fixed rate debt. All right?

Why don't you go to the next one. What are the risks? Well, you've got several. And there are more than this. And you should know, as board members, you have a swap management policy that has a number of risks. It lays out the risks that you are going to evaluate and that staff evaluates, that we evaluate, before you actually enter into one of these transactions. But these are sort of the -- maybe the key four.

Prepayment mismatch risk. What happens when you do a bond transaction? You go out, mortgages are issued, prepayments come in. If you've entered into a swap that has a set amortization schedule of the notional amount, which matches up with your bonds, and you get prepayments that come in faster, you don't -- you have a potential mismatch. Conversely, what happens if you don't get prepayments on the same speed and the swap amortizes off, you have more variable rate bonds outstanding than you have swap hedging that. Okay?

So how do you address this risk? You buy optionality on the swap. As part of the structure in the swap transaction, it has a scheduled amortization that you buy additional amortization [inaudible] to be able to

terminate some, all -- you know, a portion of the transaction at various points in time. When you're buying optionality, that's something that's going to increase your fixed pay rate.

Basis risk. Your obligation is to pay your bond debt service. The swap provider's obligation is to make a variable payment to you based on the index that was chosen. Those two won't match up necessarily, and Lillian's going to address that when she goes through her section.

Tax risk. Your bonds are tax exempt. If you do a percentage of LIBOR swap, it's based on a taxable instrument. It's unaffected by what happens to marginal tax rates. If marginal tax rates were to go down, the value of tax-exempt interest is lessened. Correct? So if you're receiving 67 percent of LIBOR taxes and interest, and all of a sudden there's no income tax [inaudible], variable rate -- tax-exempt variable rate bonds are going to trade at LIBOR. You're receiving 67 percent of LIBOR under the swap contract that you entered into. You're now paying 100 percent of LIBOR effectively on your bonds. That's a basis risk.

Counterparty risk. You're entering into a contract with another institution. Just as they're

relying on your ability to make payments to them, you're relying on their ability to make payments to you. So how do we address these risks? There are terms in the ISDA documentation -- ISDA documentation is International Swap Derivatives Association -- that allow for different times when the counterparty may have to post collateral to you. You may have to post collateral to the counterparty at certain rating trigger levels, whether or not you can terminate the trade, whether or not they can terminate the trade.

On the additional termination events, it's your option, if the counterparty goes under, to terminate the trade. You don't have to. You can assign it to somebody else, but you don't have to terminate the trade. It's not an automatic termination.

Next page, please. What we tried to lay out here are three different structures: traditional fixed rate bonds, synthetic fixed -- so issuing floating variable rate bonds, swapping to fixed -- and unhedged floating. Okay?

Simple, relatively speaking, relatively low risk. You sell fixed rate bonds, you take them out to the marketplace, the investor owns the risk. What's the -- from your perspective, what's the negative? Depending on

the market -- and this is the point that I was trying to bring up earlier when you saw the separation that was happening and you're still in the marketplace. Tax-exempt bonds may not produce a mortgage that works.

Unhedged floating rate debt, that's going to be your lowest [inaudible]. What's the risk? You've got the whole interest rate risk and what's going to happen in the market on short-term interest rates.

A middle ground, perhaps, is a combination of all of these, but these transactions all have certain risks or certain benefits and negatives to them.

Next page, please. When Lillian gets up, you're going to see a bunch of different swap structures on the page that she shows. And you've seen 67 percent of LIBOR. You've heard 100 percent of LIBOR. This is 68 percent of LIBOR, and the question is, where does this -- from where does this come?

Well, if you were to look at marginal tax rates at 35 percent, this is just looking at history. Where would you expect, you know, tax-exempt -- short-term, tax-exempt rates to be? Well, it would be 1 minus the marginal tax rate. So somewhere around 65 percent, there's some efficiency in the market, so we're putting issues in the market, and that's why we tend to see, you

know, over a historical period of 1990 to today or '94 to today, that on average, the relationship of BMA, or now SIFMA, a tax-exempt index, and LIBOR has been about 67, 68 percent. But when you look at this line, this blue line, which is BMA divided by one-month LIBOR, you know, it's really never been 67 percent on a static basis. Right? It moves around. Things change. It's -- that's the average number, but when rates were incredibly low from 2002 to 2004, because the money market rates couldn't go any lower because of the fees that they had, you had BMA trading at 80, 90 percent of LIBOR during that period of time. So some of the transactions that you've done have been structured with a LIBOR formula which isn't just a straight percentage, but it's a percentage that gives you a higher effective rate when interest rates are low to try to offset or insulate you from the exposures in SIFMA --

Next page, please. [inaudible] said before, the build up to your rate, this is the build up of the risks. So you could do unhedged floating rate debt. It's going to be your lowest cost-to-capital, BMA, plus some at the time we did it was very -- this analysis was very low. You've got 5 basis points for AMT and something built in there for liquidity and remarketing fees. Low cost of capital but high risk.

Now you layer on an interest rate swap. You take it to synthetic fixed, you still have some risks, but your rate's higher than the variable loan, but lower than a fixed rate deal. Now you go with a BMA swap or a SIFMA swap today, you've gotten rid of some more risks, but you're paying a higher rate. And then if you go to fixed rate bonds, you've gotten rid of most of the risks, but now your rate is markedly higher than most of the alternatives.

So, again, the point that I'm trying to make here is swaps and variable rate debt are a tool that's available to the authority to be able to accomplish the borrow programs that it needs to have to be able to provide the mortgages.

Next. So this is just an overview of what happened on your 2006H transaction. You did a swap on about 27 percent of the total series -- total size of the deal. On the portion that was swapped, the 2006H bonds, the interest cost or the rate was about 71 basis points lower than it would have been in a fixed rate market. What that ended up doing is, overall lowering your rate by about 9 basis -- 19 basis points programmatically.

We structured this particular swap as a 64 percent of LIBOR plus 30 basis points. Again, it's a

vehicle that in a low rate environment should protect you a little bit. And on that transaction, UBS was the swap counterparty.

And then Lillian's going to walk through the programs that you currently have in place and sort of the structures on those transactions.

MS. CHERN: Just by way of background, swap financial group focuses exclusively on swaps and we're responsible for monitoring your swap portfolio. That means that we provide mark to market values amortization values on your swaps, as well as keep tabs on counterparty ratings. That falls under counterparty risk analysis [inaudible] earlier and why that's a bargain.

And here is a summary of your current swap portfolio, and you see that you have five swaps with three different counterparties. As was mentioned earlier, Bear Stearns [inaudible] is actually Bear Stearns Financial Products, which is a special purpose vehicle triple-A rated by both Moody's and S&P currently.

Goldman Sachs is guaranteed by Goldman Sachs Company, which is currently rated [inaudible]. And UBS is rated triple-A, double-A-minus, which is actually currently [inaudible].

And that's important because, because of the

counterparty risk that we discussed earlier, where what happens if the counterparty that you've entered into a swap with can't make payments or for some reason the swap is terminated and they owe you money. There's certain provisions in your swap agreements that will help mitigate this risk, but it's good to keep tabs on what the [inaudible] distributions on in case those distributions [inaudible].

Recent swaps, you'll see there's -- in fact a date when the swap kicks in. TDHCA pays a fixed rate in exchange for receiving the variable rate. And you see these formulas, as Rob was discussing, it's what we refer to as a compound formula which is a percentage of LIBOR plus a constant. And that helps to mitigate the compression risk.

The formula for the Goldman Sachs and the two Bear Stearns swaps seem a little complicated, but basically what it boils down to is when LIBOR is below a certain level, you know, [inaudible] a little bit of math. If LIBOR is below 1.02 percent, you're paying 100 percent of LIBOR, and that's because when rates are low, you know, SIFMA or BMA tends to trade at a higher percentage of LIBOR. When it's in the range of about 1.2 percent to 5 percent, you are paying 56 percent of LIBOR plus 45 basis

points. And when LIBOR is over 5 percent, you are paying 65 percent of LIBOR.

Now that formula, though it's a little bit more complicated, it -- you know, it basically is the same idea as the -- what's seemingly simpler, 63 percent of LIBOR plus 30 basis points. And just to give you some numbers and illustrate how it helps alleviate compression risk, if we just set -- say what if LIBOR were 1 percent. Under this formula, that would give you -- that would equate to you paying 93 percent of LIBOR. Under this formula, when LIBOR's 1 percent, that equates to, as I mentioned, 100 percent of LIBOR.

Now, if LIBOR were, say, 5 percent -- or shall I say, to make the math a little bit easier, say 3 percent, in this case, you know, 30 basis points being 10 percent, that your -- that equates to you paying 73 percent of LIBOR under that formula. And under this formula, you'd be paying 56 percent plus 45 basis points, which equates to 71 percent of LIBOR. And, you know, so you can see that as rates go up, the LIBOR percentage goes down.

With respect to one of the other risks that Rob was mentioning, in terms of a prepayment risk, all these swaps have a means of mitigating that. A couple, which

include the UBS and Goldman Sachs swaps, include a bid option, meaning that the TDHCA has bought the options from the counterparty to terminate a portion -- at least a portion of a swap on a specified date to manage a prepayment risk.

The Bear Stearns swaps are what -- are -- include what we refer to as matched amortization, meaning that the swap amortizes in accordance with the bonds as they prepay.

I think you can turn to the next page. And then you -- as I mentioned, we provide mark to market values, which you'll see under -- in the Fair Value columns. You know, we assist you with Gasby reporting requirements and if you have any questions from your auditors on why those fair values change. And it's really what the current market environment is at that time that we are valuing in the swaps.

If you look under the Hedge Effectiveness column, you'll see that that's really a measure of what you're receiving under the swap, that percentage of LIBOR plus the spread, versus what you're paying out on your bonds. And you'll see that that's -- it's not -- you know, it's pretty rare to have a perfect match, because that percentage of LIBOR formula was developed to

approximate what your floating rate bonds pay, but it's not going to be a perfect match.

MR. ETTELDORF: So part of the use of an interest rate swap is also the issuance of variable rates demand. And I feel like I'm coming almost full circle to the beginning of the meeting today in terms of Conine's comments about liquidity in the marketplace and what's going on. And when you do variable rate demand bonds, one of the services that you have to get is something called a liquidity facility. And what is a liquidity facility?

If you are an investor of variable rate demand bonds that reset every seven days, the security that you just purchased gives you the right to put that security back on a relatively short notice. Well, if an investor has the right to put the bonds back, somebody's going to have to buy that bond. Right?

Now, what's happened -- what traditionally happened in the past is that the remarketing agent, your investment banker, your underwriter, that is remarketing the bonds, was typically more than willing and able to provide liquidity and just say, I'll buy those bonds. I'll hold them. I'll find somebody else to buy them.

Over the course of the last six months, there has been a lot of demand on liquidity at financial

institutions. Some entities don't have the liquidity and aren't willing to take them on, and they're tendering bonds. And typically now -- before you get scared about that, I'm going to say that's typically with respect to transactions that have what I would say -- you know, insurers that people are concerned about or that are from clients or issuers who don't have strong underlying ratings. Okay.

The most common form of liquidity support is either a standby bond purchase agreement or a liquidity facility, or a letter of credit. And these instruments are typically, you know, several years' agreements that you have with highly rated banks. And periodically, you will have to renegotiate or solicit new requests for a liquidity facility on your programs. And, in fact, I think tomorrow you're going to be seeing this as well. But, you know, they've gone out for [inaudible] liquidity and have come back with a recommendation --

So what happens if the remarketing agent cannot find another buyer for the bonds? An investor comes, says, I don't want these bonds; take them back. If the remarketing agent can't find them and is unwilling to hold them, okay, then they will be tendered to the tender agent who then turns to the liquidity facility, and that

liquidity facility steps in and provides the funds to buy those bonds.

Once the liquidity facility is drawn upon, those bonds become what's called bank bonds. And bank bonds are subject to, you know -- there are a lot of quotes in here -- "bank rate." All right? So it's a rate that's stipulated in the standby bond purchase agreement that says if the bonds are tendered, the rate goes from what the normal remarketing rate would have been to a higher rate.

Under liquidity facility, there are certain conditions in which the bank will not be obligated to advance funds. This is one of the things that is going on in the market right now. If an insurer's rating fell out of investment grade category, a number of liquidity facility agreements said that was an automatic [inaudible] termination from the liquidity providers. So holders of bonds that had that provision in it looked up and said, These ratings on some of these insurers are dropping fairly fast; I'm not holding these bonds anymore. And that was one of the issues that's happened in the marketplace.

Under a letter of credit, you typically don't see those types of provisions in those letters.

A lot of things going on in the marketplace right now with option rate securities, and you've gone out and where you've perhaps in the past been able to get your liquidity for 9 to 12 basis points, the results that you got this time, the trade number, I think, was 27 to 32, so it's a pretty big jump. This won't make the pain any easier for you, but I have two stories for you.

One of the top ten largest issuers in the country went out for -- I think it was $5 billion of liquidity requests. They got responses back on 2 billion.

A county in Arizona recently went out -- an A-rated county in Arizona recently went out and solicited 26 requests for liquidity and letters of credit. They received zero response.

I know this number is higher than what you've seen, but relatively speaking -- and the cost has probably gone up from what it is here.

MR. CONINE: Who pays for that, Rob?

MR. ETTELDORF: Who pays for the liquidity facility?

MR. CONINE: Yes.

MR. ETTELDORF: We do.

MR. CONINE: We do. So when we run the numbers on a bond indenture, we calculate some payment back to the

liquidity provider based on historical averages in the past?

MR. MACHAK: We actually put that liquidity fee in the build up of the rate that you pay.

MR. CONINE: Okay.

MS. RIPPY: But when the cost goes up, it eats into your spread. You know, you've built in some profit --

MR. CONINE: Right.

MS. RIPPY: -- for the Department. If your costs go up, you're making less money.

MR. DALLY: The theory is, over time, you can get a lot of wealth in your indenture. This is going to eat away at it, some of it, just because it's --

MR. CONINE: And it -- but if we had a market where no one was turning them back in, we'd make whatever we built in for.

MR. MACHAK: And we have the right, after two years, I think, on this one --

MR. FLORES: On this one, yes.

MR. MACHAK: -- to go back and look at the liquidity again and, you know --

MR. ETTELDORF: But it's still better than we would have done if we had not done this structure and just

done fixed rate bonds at the time --

MR. CONINE: Believe me, I'm all over that. I just was trying to figure out where this guy got his [inaudible]. I think I got it.

MR. FLORES: Before you sit down, your name is --

MR. ETTELDORF: Rob.

MR. CONINE: Rob.

MR. FLORES: -- Rob. Who are these guys with such financial muscle that essentially they can guarantee these deals? Who are these liquidity --

MR. ETTELDORF: Who are the liquidity providers?

MR. FLORES: Yes.

MR. ETTELDORF: You're generally looking at banks, large banks, foreign banks --

MR. FLORES: Warren Buffet?

MR. ETTELDORF: Well, Warren Buffet's kind of got his hands full with some other options right now.

MR. FLORES: But they're foreign entities --

MR. ETTELDORF: Yes.

MR. FLORES: -- that actually come play the game, Abu Dabai people that have got excess --

MR. ETTELDORF: [inaudible]

MR. MACHAK: So a French bank and an Irish bank and, you know, some German banks.

MR. FLORES: Well, the euro was almost 1.53 yesterday, yes.

MR. ETTELDORF: That's right.

MR. WITHROW: I know it's late, and I'm sure you're tired of hearing about cash flows and so forth, but what I'm going to do is not talk about specifics on cash flow, but really just kind of run through, you know, what is it and why is it important, so basically who, what, when, where, and why. And just even before we get into the whats and so forth, why is it important to you.

One is -- I would say, is that when people -- when we come to you and say, This is what we recommend. Here is the structure. And we're sitting here, and you've got your board book and it's based on all these assumptions. Ultimately, you can have confidence that the -- that it's being based on -- recommendations are being based on numbers that are accurate.

Now, they're only as good as the assumptions that go in, so if they're based on assumptions that liquidity's going to be 12 basis points for the next 30 years and there's no margin of error, cash flows will say it will work. All right? Obviously, the assumptions you

use are going to be important, but the numbers -- it's the integrity of the numbers that's really doing that.

And also the cash flows are important because they give you the ability to do for cash and budgeting and planning. But you really need to question, again, the assumptions on that. All right?

So basically, on the what question, you know, the cash flow is basically the connotative engines that models the real-world cash flows. You know, if an indenture that's out there and it has -- it's about this thick and it has lots of definitions and waterfalls of when the dollars come in and do this and that, and that sounds good, but what you have to do is take a model that will -- under various circumstances, will take what's said in the indenture and model it out under all kinds of various scenarios to say, then, under are all these different scenarios, you're going to come out -- it's going to work.

And then the why question, as to why do you do the cash flows -- that's more of a when question -- but the why question, why you do the cash flows is two things. One is for sufficiency and the other is for tax compliance. Those are the main two reason why you do it.

This kind of goes back to the -- more of the --

go to the next slide. I'm sorry.

This is the when. Primarily, you'll do them for the -- first to new issues and then a refunding that would affect prior issues. If you don't originate fast enough, you have to do an extension to show that there is sufficiency to do one slower than you originally were doing.

When we do indenture cash flows, like we just completed for you on your RMRB indenture, found up to $6 million of cash that could potentially be released or used for other programs or to retire bonds. But we'll have to -- it's a very involved process of doing the cash flows on that, but if you want to take your money out, you've got to do the cash flows to show the indenture works. And then in some other instances, you may want to do a restructuring.

Basically, again, we're looking for sufficiency to cash flow. Parity is your assets to your liabilities. And there are -- you know there's variations. These are your main variables, you know, when and how much you originate, how fast you can get your money back, are there going to be any delays, and does any money default.

And finally the yield. Fortunately, they only look at one case. So you run the cash flows that generate

a set number. We do the numbers and show that under tax guidelines that you're in your one a day spread.

And a tax issue there -- but this doesn't change. It doesn't matter what actually happens. It's based on your expectations at the time that you show that there's compliance.

MR. CONINE: When do you do that?

MR. WITHROW: That's done at closing.

MR. CONINE: At closing.

MR. WITHROW: At closing, yes. And it's delivered to tax opinion, Steve says it's good, and that's what he bases -- as a matter of fact, we talked about relying on the numbers. Steve is very careful to base his opinion on the numbers he is given, he's basing it on that. He's not saying that the numbers are right. So again, integrity is important to the cash flow, to the people that are doing it know what they're doing, experienced and trained, and they're also -- there's one, arguably two, softwares out there that do the major amount of the crunching, but it's very complex, and you have to have experienced people that understand the numbers and understand the software and can produce that. And ultimately everybody relies on the output of that.

MR. MACHAK: Just a quick addition to that,

Kent. Those are delivered and everybody kind of signs off on them at closing. But really those cash flows, all the cash flows, and the yield cash flows, run prior to the pricing, to when we go into the marketplace, because we want to make sure that the structure we're going out in the marketplace is as yield compliance.

MR. CONINE: Right.

MR. WITHROW: Now, the cash -- in cash flow basically you have a who or the who-cares question. You've got bondholders, you got rating agencies, you got insurance companies, bond and tax counsel, and, of course, TDHCA.

Just some examples of structures that you can use and the variables that will change the cash flows based on functions and -- and rating agencies, very important. They're going to give -- they have guidelines and criterions that they use. Say, for this type of a structure, you need to show -- demonstrate sufficiency within these types of stresses.

And they're always going to look at the worst-case scenarios, like the last day of origination, no loans originated. They're going to look at super-fast prepayments. If you're doing some sort of a structured deal where you have bonds pay off at a certain point, and

you've got two different loan rates, they're going to assume that the highest loans pay off faster than [inaudible] zero percent thereafter and a low rate, then you're -- you know, can you sustain it under all those crazy scenarios that would never happen.

But they look at the pressure points, and it spits it out and shows that you can. If it doesn't, it's not a static thing. It adapts to the structures. That's how you structure a bond deal is you go through it -- and that's -- when you get these numbers that say, Here's the loan rate; you've got to put this much money in, that's what's happening.

And then the wording of the indenture needs to model what the -- you know, the assumptions are being used to [inaudible].

After the fact -- everything said today, up to that point, it has to do with you doing a new bond issue. But something else that's very important is when you have -- particularly with an open indenture, you will periodically want to, you know, look at or have the ability to look at, okay, at this point in time, we're going to do some projections.

How much money are we going to get? Is there a more efficient way of calling bonds? Can we do some

forecasting? We need to do budgeting because our new money issues are down, so we might need to take some money over there to pay for this nice building or to fund another program or use down-payment assistance in another program. So where can you get your money out of?

Well, by doing -- matter of fact, we just completed doing for you the RMRB open indentures and identified up to $6 million of funds that could be better used or used -- or many of those that we'll determine today on a conference call, that we'll be able to use to buy down a rate in the single-family program.

But, you know, all of these -- for instance, this right here will be the next phase that we'll do. Is there any better way to do bond calls? So that you're using your money within the constraints of the indenture and every individual subsidiary within that, can you call bonds, and when it's going to increase your network and your cash flows. And then, of course, this is going to be -- need to be submitted to the rating agencies to get their approval and ultimately to a report to you all.

And again, the bottom line is that you can reduce errors, reduce your liability, improve -- it also prevents mixups that might cause problems if word gets out on the market, you know, short -- deficiencies that you

weren't planning on. You can monitor these cash flows and make sure there's not any holes.

We've seen cash flows before where everything was close together, but there was something messed up. And trustees all the time will say you're supposed to do something in a certain order, and it doesn't -- they don't do it that way. And going back and monitoring, we can see the -- why is it that we're projecting this much cash and we only have this much? Oh, the trustees were calling this series [inaudible] the wrong way or were transferring in these six months later than they should have.

That's the -- and ultimately [inaudible] lower homeowner rates for your constituents and higher fees and residuals to you all.

MR. CONINE: Barton, during the ten years you've been playing with these things, historically, how many times have you run cash flows on one of our programs?

MR. WITHROW: For an open indenture?

MR. CONINE: Yes.

MR. WITHROW: Well, typically, principally, we'll be getting out of the RMRB is we'll be looking at it annually. You know, basically, a check. If you go into the doctor --

MR. CONINE: Right.

MR. WITHROW: -- every year, you get a checkup on that. When you have an indenture like the single-family indenture, every time the underwriters -- the rotating underwriters, they start and they start with new numbers. So they don't do a real in-depth analysis on that, but they do start with balances and -- both for the cash investments on the loans, and they use those as of to some date close to the time that you're issuing a new series, to say whether or not that single-family indenture will support the new deal. So you're getting that done on a single-family for the purposes of new bonds --

MR. CONINE: Yes.

MR. WITHROW: -- so you're not -- totally, it's not as in-depth, because that's not the purpose to go in and look at all the far issues, but it's enough that if there's some big gaping hole, you know, a fund that's supposed to have $20 million in it doesn't have any, we're going to catch that right off the bat. And they're not going to structure something -- and there's enough cushion in there -- and ultimately --

MR. POGOR: They do a consolidating cash flows, so they do a standalone for that particular series we're doing now. Then they take a look at the complete single-family structure and do a consolidated cash flow. So it's

two things they do for us.

MR. WITHROW: Exactly.

MR. POGOR: For the RMRB, we have not done that. We have not come back to the RMRB indenture. I meant to tell you about that earlier. The RMRB and single-family [inaudible] RMRB? Those two indentures we have not used in a while, and what we're trying to do is kind of bleed those down and let them just kind of like go away.

They're costing us, like anything else. If you've got a bank account, they're going to charge you for the savings account, they're going to charge you for the checking account. Trustees do the same thing. So the single-family indenture is a good indenture. We will continue with that, but kind of bleed off the other one and get rid of some of our expenses. So that's the reason why RBC was doing the RMRB indenture for us.

And this $6 million he talked about, about 1.3 we're able to use hopefully for this next deal to buy down the rate, since we're trying to get it from -- what was it, 6? -- 6 percent down to something a little bit lower. And the balance of that we'll be calling bonds with on the RMRB indenture. So both of those will go away quicker.

MR. POGOR: And credits due, we work very closely with Steve and Elizabeth to come up with a methodology. It's probably taken about three months now to work that through, come up with a methodology to be able to do -- it's a fairly novel idea, and [inaudible] signed off on it was to be able to use the money from the RMRB indenture in single-family. That's not done too often, because nothing in the tax code that I was aware of at the time prevented it, and Steve agreed. So instead of having this money trapped in an indenture that's not being used, we're forcing you to do a new indenture, an indenture that you're really trying to phase out, we're going to pick it up and put it in a new indenture.

That's just one example. There are others, but --

MR. MACHAK: Okay. I know we've run over our time. So let me just tell you that the last two sections are there as reference. They're definitions, things we've talked about in terms of underwriting and things like that. I'd be happy at a later time to go through those, but at this point let me wrap it up and say I want to thank you very much for your time. It's a lot of time and there's a lot of -- a lot to talk about, a lot to chew on, multidimensional. You can tell -- thank the staff and

everybody else. There's a lot of gray matter that goes into these transactions. They're very complicated, but you have a very accomplished staff, and you have a team that has a wealth of experience with this. And as problems come up, it's very likely that they've dealt with it before.

MR. POGOR: And as we say, this is not done in a vacuum. I guarantee you. With all the questions we've got, we lean on them hard.

MR. MACHAK: So, again, it's rare that we have this opportunity. We, as working for you, if you ever want to do it again, don't feel like it's an imposition for us. We would love to do it again. We talked about transparency on bond transactions. It is actually very helpful for us to go through this process and to make this as transparent as we can to you.

MR. CONINE: This is my third time in ten years, and I'm still learning.

MR. GERBER: We'll also probably, when we bring the transactions to you all, we'll -- unlike past years, past transactions, we will probably take that time, and we'll probably do a little more -- we want you to understand what's in there and make sure that you have a chance to ask questions. And this is a good background

for what's coming, so thank you, Gary. And thanks to your team and those of you who came a long way.

MR. CONINE: Yes. Thanks a lot for coming.

(Applause)

MR. CONINE: Any questions from the Board? While you've got them captive, you might as well --

MS. RAY: It's a lot to chew on.

MR. CONINE: It is.

MS. RAY: It's a lot -- now the swap guys, you guys confused me. I told Gary, I thought --

MR. MACHAK: It's intentional.

MR. CONINE: Just think of them as a bookie.

(Laughter)

MR. CONINE: You're taking your variable rate and you're swapping it for fixed rate, a guaranteed deal. And then they're taking it and laying if off somewhere else. They just want the juice in the middle.

MR. MACHAK: That's right. Somebody made money on the over and the under in the Super Bowl this year.

MR. CONINE: That's right.

MR. MACHAK: Somebody's making money on the --

MR. CONINE: Okay. Again, thanks to everybody here. We really appreciate it. And we'll see everybody at 9:30 in the morning.

(Whereupon, at 7:45 p.m., the workshop was concluded.)

C E R T I F I C A T E

IN RE: Board Workshop

LOCATION: Austin, Texas

DATE: March 12, 2008

I do hereby certify that the foregoing pages, numbers 1 through 160, inclusive, are the true, accurate, and complete transcript prepared from the verbal recording made by electronic recording by Penny Bynum before the Texas Department of Housing and Community Affairs.

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(Transcriber) (Date)

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