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# *Arkansas Development Finance Authority*

*Combined Financial Statements for the  
Year Ended June 30, 1998, and  
Independent Auditors' Report*

**INDEPENDENT AUDITORS' REPORT**

The Board of Directors of  
Arkansas Development Finance Authority:

We have audited the accompanying combined balance sheet of Arkansas Development Finance Authority (the "Authority") as of June 30, 1998, and the related combined statements of revenues, expenses and changes in fund balances and of cash flows for the year then ended. These combined financial statements are the responsibility of the management of the Authority. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such combined financial statements present fairly, in all material respects, the financial position of the Authority as of June 30, 1998, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed more fully in Note 1, the Authority adopted Statement of the Government Accounting Standards Board ("GASB") No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* for the year ended June 30, 1998.

Also, as more fully discussed in Note 10, the Authority has restated fund balance as of June 30, 1997, to more appropriately reflect the relationship of certain related entities in accordance with the provisions of GASB Statement No. 14, *The Financial Reporting Entity*. Additionally, subsequent to the issuance of the Authority's 1997 combined financial statements, management of the Authority determined that certain conduit debt obligations should be excluded from the combined financial statements at June 30, 1997, and accordingly, has restated the June 30, 1997, financial statements to reflect the exclusion of the conduit debt obligations.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 30, 1998, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

*Deloitte & Touche LLP*

October 30, 1998

# ARKANSAS DEVELOPMENT FINANCE AUTHORITY

## COMBINED BALANCE SHEET

JUNE 30, 1998

(DOLLAR AMOUNTS IN THOUSANDS)

	Single Family Mortgage Purchase Programs	Multi-Family Mortgage Purchase Programs	Development Finance Programs	Other Programs and ADFA General Fund	Memorandum Only Totals
<b>ASSETS</b>					
Cash and cash equivalents	\$ 83,228	\$ 50,701	\$ 33,563	\$ 50,160	\$ 217,652
Accounts receivable	2,993	239	9,992	6,715	19,939
Accrued interest receivable	3,198	495	1,075	1,496	6,264
Accrued rent receivable			1,145		1,145
Investments	681,719	8,435	47,152	69,742	807,048
Loans receivable, at amortized cost, net	136,450	35,632	182,846	146,275	501,203
Deferred charges	9,990	1,795	4,718	1,940	18,443
Direct financing leases			83,770		83,770
Capitalized assets, net				537	537
<b>TOTAL ASSETS</b>	<u>\$ 917,578</u>	<u>\$ 97,297</u>	<u>\$ 364,261</u>	<u>\$ 276,865</u>	<u>\$ 1,656,001</u>
<b>LIABILITIES AND FUND BALANCE</b>					
Bonds and notes payable, net of unamortized discounts and premiums	\$ 852,501	\$ 87,753	\$ 281,138	\$ 164,299	\$ 1,385,691
Accrued interest payable	20,621	2,096	3,358	2,037	28,112
Accounts payable, including loans in process	1,017	494	39,108	19,756	60,375
Deferred fees, advances, grants, and credits	7,959	141	26,233	4,887	39,220
Total liabilities	882,098	90,484	349,837	190,979	1,513,398
<b>FUND BALANCE:</b>					
Restricted for bond programs	35,480	6,813	14,424	52,674	109,391
Unrestricted				33,212	33,212
Total fund balance	<u>35,480</u>	<u>6,813</u>	<u>14,424</u>	<u>85,886</u>	<u>142,603</u>
<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<u>\$ 917,578</u>	<u>\$ 97,297</u>	<u>\$ 364,261</u>	<u>\$ 276,865</u>	<u>\$ 1,656,001</u>

See notes to financial statements.

**ARKANSAS DEVELOPMENT FINANCE AUTHORITY**

**COMBINED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND BALANCES**

**YEAR ENDED JUNE 30, 1998**

**(DOLLAR AMOUNTS IN THOUSANDS)**

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	<u>Single Family Mortgage Purchase Programs</u>	<u>Multi-Family Mortgage Purchase Programs</u>	<u>Development Finance Programs</u>	<u>Other Programs and ADFA General Fund</u>	<u>Memorandum Only Totals</u>
<b>REVENUES:</b>					
Interest income:					
Loans and direct financing leases	\$ 13,144	\$ 4,208	\$ 14,489	\$ 6,535	\$ 38,376
Investments	48,604	617	4,246	5,620	59,087
Amortization of discounts on loans				8,368	8,368
Financing fee income	<u>2,027</u>	<u>101</u>	<u>984</u>	<u>2,879</u>	<u>5,991</u>
Total interest income	63,775	4,926	19,719	23,402	111,822
Net increase in the fair value of investments	10,683		58	3,891	14,632
Federal financial assistance programs				14,402	14,402
State of Arkansas financial assistance programs				1,000	1,000
Other income	<u>263</u>	<u>641</u>	<u>109</u>	<u>      </u>	<u>1,013</u>
Total revenues	74,721	5,567	19,886	42,695	142,869
<b>EXPENSES:</b>					
Interest on bonds and notes:					
Current interest	52,411	4,190	14,838	16,455	87,894
Accreted interest	<u>2,089</u>	<u>      </u>	<u>      </u>	<u>      </u>	<u>2,089</u>
Total interest on bonds and notes	54,500	4,190	14,838	16,455	89,983
Amortized bond and note discount:					
Amortized discounts and premiums on bonds and notes	2,010	414	133	114	2,671
Amortized bond and note issuance costs	<u>2,156</u>	<u>109</u>	<u>578</u>	<u>296</u>	<u>3,139</u>
Total amortized bond and note discount	4,166	523	711	410	5,810
Administrative expenses:					
Provision for losses				(108)	(108)
Federal financial assistance programs				8,546	8,546
Salaries and benefits expenses				2,759	2,759
Operations and maintenance expenses				1,116	1,116
Other expenses	<u>537</u>	<u>61</u>	<u>412</u>	<u>1,436</u>	<u>2,446</u>
Total administrative expenses	<u>537</u>	<u>61</u>	<u>412</u>	<u>13,749</u>	<u>14,759</u>
Total expenses	<u>59,203</u>	<u>4,774</u>	<u>15,961</u>	<u>30,614</u>	<u>110,552</u>
<b>EXCESS OF REVENUES OVER EXPENSES BEFORE TRANSFERS FROM (TO) OTHER FUNDS</b>	15,518	793	3,925	12,081	32,317

(Continued)

# ARKANSAS DEVELOPMENT FINANCE AUTHORITY

## COMBINED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND BALANCES YEAR ENDED JUNE 30, 1998 (DOLLAR AMOUNTS IN THOUSANDS)

	<u>Single Family Mortgage Purchase Programs</u>	<u>Multi-Family Mortgage Purchase Programs</u>	<u>Development Finance Programs</u>	<u>Other Programs and ADFA General Fund</u>	<u>Memorandum Only Totals</u>
OPERATING TRANSFERS FROM (TO) OTHER FUNDS	\$ (1,576)	\$ (166)	\$ 349	\$ 1,393	\$ -
EXCESS OF REVENUES OVER EXPENSES AFTER TRANSFERS	13,942	627	4,274	13,474	32,317
FUND BALANCE:					
Beginning of year, as adjusted (Note 10)	35,131	6,186	10,150	58,819	110,286
Residual equity transfer (Note 6)	<u>(13,593)</u>	<u>          </u>	<u>          </u>	<u>13,593</u>	<u>          </u>
End of year	<u>\$35,480</u>	<u>\$ 6,813</u>	<u>\$ 14,424</u>	<u>\$ 85,886</u>	<u>\$ 142,603</u>

See notes to financial statements.

(Concluded)

# ARKANSAS DEVELOPMENT FINANCE AUTHORITY

## COMBINED STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 1998

(DOLLAR AMOUNTS IN THOUSANDS)

	Single Family Mortgage Purchase Programs	Multi-Family Mortgage Purchase Programs	Development Finance Programs	Other Programs and ADF General Fund	Memorandum Only Totals
OPERATING ACTIVITIES:					
Excess of revenues over expenses after transfers	\$ 13,942	\$ 627	\$ 4,274	\$ 13,474	\$ 32,317
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:					
Amortization of discounts on loans				(8,368)	(8,368)
Amortization of deferred financing fees	(2,043)	(8)	(1,324)	(517)	(3,892)
Accreted interest	2,089				2,089
Amortization of bond and note discounts	2,010	414	133	114	2,671
Amortization of bond and note issuance costs	2,156	109	578	296	3,139
Provision for loan loss				(108)	(108)
Net increase in the fair value of investments	(10,683)		(58)	(3,891)	(14,632)
Changes in operating assets and liabilities:					
Accounts receivable	(1,643)	(225)	122	760	(986)
Accrued interest receivable	2,588	310	607	478	3,983
Accrued rent receivable			(378)		(378)
Interfund receivable	(584)		(613)	(4,845)	(6,042)
Other assets	11	(279)	(75)	(137)	(480)
Accrued interest payable	3,544	57	354	(64)	3,891
Accounts payable	113		11,004	1,624	12,741
Other liabilities	(6)	462	4,136	5	4,597
Interfund payable	<u>527</u>		<u>109</u>	<u>5,406</u>	<u>6,042</u>
Net cash provided by operating activities	12,021	1,467	18,869	4,227	36,584
INVESTING ACTIVITIES:					
Purchase of investments	(627,247)	(28,249)	(38,676)	(43,227)	(737,399)
Maturities of investments	570,917	29,787	39,700	47,658	688,062
Net (increase) decrease in loans receivable	30,396	16,708	(44,504)	16,559	19,159
Lease payments received			<u>3,355</u>		<u>3,355</u>
Net cash provided (used) by investing activities	(25,934)	18,246	(40,125)	20,990	(26,823)

(Continued)

# ARKANSAS DEVELOPMENT FINANCE AUTHORITY

## COMBINED STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 1998 (DOLLAR AMOUNTS IN THOUSANDS)

	Single Family Mortgage Purchase Programs	Multi-Family Mortgage Purchase Programs	Development Finance Programs	Other Programs and ADFA General Fund	Memorandum Only Totals
NONCAPITAL FINANCING ACTIVITIES:					
Proceeds from issuance of bonds and notes payable	\$ 261,915	\$ 32,892	\$ 51,491	\$ 1,833	\$ 348,131
Repayments of bonds and notes payable	(185,228)	(2,655)	(26,946)	(8,023)	(222,852)
Payments of debt issuance cost	(2,717)	(500)	(777)	(1,560)	(5,554)
Collection of financing fees	1,292		3,113	167	4,572
Net cash received in residual equity transfer	<u>(2,091)</u>	<u>          </u>	<u>          </u>	<u>2,091</u>	<u>-</u>
Net cash provided (used) by noncapital financing activities	<u>73,171</u>	<u>29,737</u>	<u>26,881</u>	<u>(5,492)</u>	<u>124,297</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	59,258	49,450	5,625	19,725	134,058
CASH AND CASH EQUIVALENTS:					
Beginning of year	<u>23,970</u>	<u>1,251</u>	<u>27,938</u>	<u>30,435</u>	<u>83,594</u>
End of year	<u>\$ 83,228</u>	<u>\$ 50,701</u>	<u>\$ 33,563</u>	<u>\$ 50,160</u>	<u>\$ 217,652</u>
Supplemental disclosure of cash flow information - Interest paid	<u>\$ 48,868</u>	<u>\$ 4,133</u>	<u>\$ 14,913</u>	<u>\$ 16,975</u>	<u>\$ 84,889</u>

Supplementary schedule of noncash financing activities -  
The Authority transferred approximately \$11,500 of investments (in thousands)  
in connection with the transfer of residual balances of refunded programs from  
the Single Family Mortgage Purchase Programs to the General Fund.

See notes to financial statements.

(Concluded)



# ARKANSAS DEVELOPMENT FINANCE AUTHORITY

## NOTES TO COMBINED FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 1998

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### 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Arkansas Development Finance Authority (the "Authority") was created May 1, 1985, by Act 1062 of 1985 (Arkansas Development Finance Authority Act) and is a public body politic and corporate, with corporate succession, separated and apart from the State of Arkansas. Pursuant to Act 1062, the Authority is authorized and empowered to issue bonds and various other debt instruments for the purpose of financing qualified agricultural business enterprises, capital improvement facilities, educational facilities, health care facilities, housing developments, and industrial enterprises.

Bonds and other debt instruments issued by the Authority are special obligations of the Authority, payable solely from and collateralized by a first lien on the proceeds, monies, revenues, rights, interests and collections pledged therefore under the resolutions authorizing the particular issues. The State of Arkansas is not obligated to pay the bonds and other debt instruments, and neither the faith and credit nor the taxing power of the State of Arkansas is pledged to the payment of the principal or redemption price of, or interest on, the bonds and other debt instruments. The Authority has no taxing power.

The major accounting principles and practices followed by the Authority are presented below:

***Basis of Accounting*** - The Authority uses the accrual method of accounting whereby expenses are recognized when the liability is incurred and revenues are recognized when earned.

***Fund Accounting*** - The Authority's accounts are organized as funds, each of which includes accounts for the assets, liabilities, fund balances, revenues and expenses of the Authority's programs and general fund.

The following describes the nature of the funds currently maintained by the Authority:

- (i) *Single Family Mortgage Purchase Programs* - Accounts for proceeds from single family mortgage purchase bonds, the debt service requirements of the bonds, and the related mortgage loans for single family owner-occupied housing in Arkansas.
- (ii) *Multi-Family Mortgage Purchase Programs* - Accounts for the proceeds of the multi-family mortgage purchase bonds, the debt service requirements of the bonds, and the related mortgage loans for HUD approved and insured multi-family housing in Arkansas.
- (iii) *Development Finance Programs* - Accounts for the proceeds from the sale of development revenue bonds and notes; the debt service requirements of the bonds and notes and related loans to developers, public and private institutions and government bodies within the State of Arkansas; and includes certain assets not owned and related obligations not owed by the Authority. To a limited extent and only when specified by a specific trust indenture, the payment of principal and interest on the obligations not directly owed by the Authority is guaranteed by the Authority (see Note 3).

- (iv) *Other Programs and ADFG General Fund* - Accounts for various sources and uses of funds in connection with the following:
- (a) *Section 8 Housing Assistance Payment Program* - Accounts for Section 8 housing assistance funds received in advance, housing assistance payment disbursements, and Authority fees and expenses related to the Section 8 Housing Assistance Payment Program.
  - (b) *Bond Guaranty Program* - Accounts for grants from the State Treasurer, guaranty fees collected, interest earned on deposits, and disbursements made in connection with bond guaranties provided by the Authority. The fund was created by Act 505 of 1985 which authorized a grant of \$6,000,000 from the State Treasurer for the purpose of enhancing and supporting the creditworthiness of bonds and other debt instruments guaranteed by the Authority. At June 30, 1998, the fund had cash and cash equivalents and investments totaling \$20,342,951 in the reserve account to collateralize Authority-guaranteed bonds and future issues under the bond guaranty program.
  - (c) *ADFG/ATRS Interim Loan Program* - Accounts for monies borrowed under the \$5,000,000 Revolving Loan Agreement with the Arkansas Teacher Retirement System and related loans to developers, public and private institutions, and government bodies within the State of Arkansas who are anticipating financing projects from proceeds of an Authority bond issue. At June 30, 1998, unused credit available to the Authority under the revolving loan agreement was approximately \$4,761,453.
  - (d) *GNMA/BMIR Loan Purchase Program* - Accounts for proceeds from the sale of GNMA Guaranteed Bonds, debt service requirements on the bonds, related below market interest rate mortgages purchased with bond proceeds, disbursements to program participants of excess loan prepayments, and the Authority's fees and expenses in connection with the program.
  - (e) *ADFG General Fund* - Accounts for money transferred from other funds to the extent such transfers are permitted by the resolutions establishing other funds and to account for income and expenses not directly attributable to a program. Administrative expenses are allocated to the programs based on projected receipts in excess of debt service requirements of each program. The receipt and disbursement of cash transferred from time to time between funds, to the extent that such transfers are permitted by the applicable resolutions, are recorded as residual equity transfers if the transfers are permanent or as interfund payables/receivables if the transfers are temporary. Also included are two loan programs, *Rural Economic and Community Development Service ("RECDs")* and *Police Home Ownership*. RECDs involves leveraging of funds through partnership with RECDs, a federal agency, and provides mortgage loans to low and moderate income homebuyers in rural areas. The Police Home Ownership Program is a partnership between the Authority and the City of Little Rock to help declining neighborhoods by providing stability and security. This objective is accomplished by offering low interest rate loans to police officers agreeing to purchase homes in specified areas.
  - (f) *Home Investment in Affordable Housing Program* - Accounts for federal financial assistance received from the Department of Housing and Urban Development for the purpose of developing and supporting affordable housing through tenant based rental assistance, rental rehabilitation, new construction, or assistance to homebuyers and homeowners.

- (g) *Capital Access Program* - The Capital Access Program was created by Act 733 and Act 886 of 1993 to provide public fiscal resources to assist Arkansas financial institutions in overcoming obstacles and constraints in meeting the full range of economically sound financing needs. Under the acts, the Authority contracts with Arkansas financial institutions who wish to participate in the program. The contracts provide for the creation of loan loss reserve accounts for the benefit of the financial institutions. The loan loss reserves are funded by fees paid by the borrowers equal to 1.5% to 3.5% of the loan amount. The financial institutions match the borrowers' fees; such match may be funded by netting the loan. The Authority provides a 100% to 150% match of the fees paid by the borrowers and the financial institutions. The monies deposited in the loan loss reserve funds are the property of the Authority and are pledged to the financial institutions for reimbursement of financial losses incurred as a result of default on a qualified loan made under the program. The Authority's liability to any financial institution is limited to the amount of money credited or on deposit in the loan loss reserve account of that institution.
- (h) *Community/Technical College Revolving Loan Fund* - Act 683 of 1989, as amended, established the College Savings Bond ("CSB") Program which is managed jointly by the Department of Higher Education and the Authority. Community colleges were eligible to participate in the original CSB Program. Act 171 of 1993 made technical colleges also eligible to participate. The Community/Technical College Revolving Loan Fund (the "Fund") was capitalized with interest earnings on the CSB proceeds. The Fund provides low interest loans to community and technical colleges for capital projects. Loan repayments will be returned to the Fund and will be used for subsequent loans. Each loan will be approved by the State Board of Higher Education. The Authority serves as financial manager of the Fund.
- (i) *Intermediary Relending Program* - The Authority received a \$3 million, 1% loan from RECDS for business and community development projects in rural Arkansas. A combination of Intermediary Relending Program, the Authority and/or private funds can be used as a method of leveraging resources and lowering the effective interest rates available through lenders and the Authority's existing loan programs.

***Combined Financial Statements and Memorandum Only Totals Columns*** - The combined financial statements contain the totals of the similar accounts of the several funds. The total column is captioned "memorandum only" to indicate that it is presented only to facilitate analysis. No consolidating or eliminating entries were made in arriving at the total column; thus, it does not present consolidated information in accordance with generally accepted accounting principles. Since the assets of the several funds are restricted by the related resolutions, the totaling of the accounts, including assets therein, is for convenience only and does not indicate that the combined assets are available in any manner other than that provided for in the resolutions for the separate funds.

***Cash and Cash Equivalents*** - Cash and cash equivalents include all cash balances and highly liquid investments with a maturity at acquisition of three months or less.

***Investments*** - Effective for the fiscal year ended June 30, 1998, the Authority adopted Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* ("GASB 31"). GASB 31 requires that certain investments be reported at fair value and that changes in the fair value of investments be reported as a

component of investment income. Beginning fund balance has been adjusted for the cumulative effect of implementing GASB 31. The cumulative effect as of July 1, 1997, was to decrease fund balance and decrease investments by \$10,696,000 (see Note 10).

***Direct Financing Leases*** - The Authority sells revenue bonds to provide financing of correction facilities and office space for the State of Arkansas but does not maintain or operate the facilities. Arrangements of this type are accounted for in the various funds as financing arrangements in accordance with the provisions of Financial Accounting Standards Board Statement No. 13, *Accounting for Leases*. Unearned income on net investment in direct financing leases is recognized using the interest method over the life of the lease.

***Loans Receivable*** - Loans are recorded at cost, adjusted for any discount or premium prorated to maturity and an allowance for losses. The loans are not valued at the lower of cost or market because it is the Authority's intention to hold the loans to maturity. However, the borrower may prepay the loan or foreclosure may become necessary.

An allowance account for uncollectible interest on loans is established based upon management's periodic review of loans contractually past due. The allowance is established by charges to income. Income is subsequently recognized only when cash payments are received or when, based upon review of the loan, it appears the borrower's ability to make payments has been restored, in which case the loan is returned to accrual status.

***Deferred Charges*** - Costs related to issuing bonds and notes and discount on sale of bonds and notes are capitalized and are amortized over the term of the bonds and notes based on the balance of bonds and notes outstanding. Early retirement of bonds results in proportionate amounts of amortization of bond issuance costs and discounts. Capital appreciation on bonds represents accrued interest to be paid at maturity.

***Deferred Fees, Advances, Grants, and Credits*** - The Authority receives commitment fees from lenders for earmarking funds and financing fees from borrowers. Deferred commitment fees which are nonrefundable are amortized into income ratably over the term of the respective programs based on the balance of mortgage loans outstanding.

***Provision for Losses*** - Provision for losses on loans and property acquired by foreclosure has been established by management based on amounts outstanding and historical experience. Provision for losses includes charges to reduce the recorded balance of loans and property to their estimated net realizable value. Such provisions are based on management's estimate of the net realizable value of the collateral or property, as applicable, considering current and anticipated future operating or sales information which may be affected by changing economic and/or operating conditions beyond the Authority's control, thereby causing these estimates to be particularly susceptible to changes that could result in a future adjustment increasing the provision for losses and, consequently, decreasing fund balance. Improvements in these factors and unforeseen recoveries may reduce the estimated allowance level and recover some of the previously provided allowance.

***Use of Estimates*** - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## 2. DEPOSITS AND INVESTMENTS

The following is a reconciliation of the carrying amounts of cash and investments at June 30, 1998 (in thousands):

As presented in the Combined Balance Sheet:

Cash and cash equivalents	\$ 217,652
Investments	<u>807,048</u>
Total	<u>\$1,024,700</u>

As presented in (a) and (b) below:

Deposits	\$ 6,785
Investments	<u>1,017,915</u>
Total	<u>\$1,024,700</u>

(a) *Deposits* - At year end the carrying amount (in thousands) of the Authority's deposits was approximately \$6,785 and the bank balance (in thousands) was \$7,451. Of the bank balance, \$500 was insured by federal depository insurance, \$3,004 was collateralized by collateral held in a Federal Reserve pledge account, and \$3,947 was collateralized by collateral held in the pledging bank's trust department in the Authority's name.

(b) *Investments* - In accordance with Governmental Accounting Standards Board Statement No. 3, *Accounting and Financial Reporting for Deposits with Financial Institutions, Investments and Reverse Repurchase Agreements*, the Authority's investments are categorized to give an indication of the level of credit risk assumed. Category 1 includes investments that are insured, collateralized or registered, or for which the securities are held by the Authority or its agent in the Authority's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent but not in the Authority's name.

Investments at June 30, 1998, by security type and level of credit risk (in thousands):

Security Type	Category			Reported Value
	1	2	3	
Categorized -				
U.S. Government Securities	<u>\$ 621,649</u>			<u>\$ 621,649</u>
Uncategorized:				
Investment Agreements				\$ 185,398
Mutual Funds				<u>210,868</u>
Total uncategorized				<u>\$ 396,266</u>
TOTAL INVESTMENTS				<u>\$1,017,915</u>

Under the investment agreements noted above, monies held by the trustees of the respective issues are invested at guaranteed rates for predetermined periods of time. The investments are backed by noncollateralized promissory notes of the lending institutions; therefore, the collectibility of such investments is dependent in part on the ability of the institutions to repay the promissory notes. As discussed in Notes 1 and 5, bonds issued by the Authority are payable solely from and collateralized by a lien on the proceeds, monies, revenues, rights, interest, and collections pledged under the resolutions authorizing the particular issues; consequently, any loss from investments impacts the particular related bond fund.

### **3. LOANS RECEIVABLE**

***Single Family Mortgage Purchase Programs and Multi-Family Mortgage Purchase Programs*** - All mortgage loans purchased under the single family and multi-family mortgage purchase programs are collateralized by first liens on real property. All mortgage loans purchased by the Authority under the FHA/VA Single Family Mortgage Purchase Programs are FHA insured or VA guaranteed mortgage loans. Loans purchased under the Conventional Single Family Mortgage Purchase Program are insured up to an aggregate limit for each issue by supplemental mortgage insurance. Private mortgage insurance is required to the extent that individual loans purchased under the Conventional Single Family Mortgage Purchase Program exceed 80% of the appraised value of the property.

***Development Finance Programs*** - Loans to private companies for financing the acquisition or expansion of industrial facilities are collateralized by liens on and security interests in collateral granted by the companies and by guaranty agreements between the Authority and one or more guarantors. To a limited extent and only when specified by a specific trust indenture, the payment of principal and interest on the bonds is guaranteed by the Authority under the ADFA Bond Guaranty Act (Act 505 of 1985). At June 30, 1998, the Authority reported in its combined balance sheet (dollars in thousands) \$50,056 nonrecourse loans to private companies and \$59,879 in related bond issues which are guaranteed by the Authority. Nonrecourse loans to private companies of \$69,158 and related bond issues of \$69,877 are not reported in the combined financial statements at June 30, 1998, as these issues are not guaranteed by the Authority and are considered to be conduit debt obligations.

Also included in the Development Finance Program are financing activities with educational institutions and other various state agencies. At June 30, 1998, the Authority reported loans of \$132,790, direct financing leases of \$83,770, and bonds outstanding of \$221,259 related to the financing arrangements with these institutions and agencies.

Loans to educational institutions for financing the cost of equipment and other capital improvements have been approved by the bond insurer, Federal Guaranty Insurance Company, which has issued a bond insurance policy to insure payment of the principal and interest on the bonds when due.

***Other Programs and ADFA General Fund*** - Each loan purchased under the GNMA/BMIR Loan Purchase Program was made pursuant to the FHA program for below market interest rate mortgage loans and is insured by the FHA pursuant to Section 212(d)(3) of Title II of the National Housing Act.

The stated interest rates on the loans and loan servicing fees charged to the Authority are as follows:

	<b>Stated Interest Rate</b>	<b>Loan Servicing Fee Rate</b>
Single Family Mortgage Purchase Programs	7.125 to 14.00%	0.125 - 0.5%
Multi-Family Mortgage Purchase Programs	8.20 to 10.25%	0.125%
Development Finance Programs:		
1985 Higher Education Capital Access Program Bond Fund	Variable	None
1986 Capital Asset Finance Program Bond Fund	Variable	None
Economic Development Revenue Bond Funds	Rate on Bonds	None
Prison Construction Trust Fund	Rate on Bonds	None
Arkansas Department of Computer Services	Rate on Bonds	None
1992 Series A State Agencies Facilities Revenue Bonds (UAMS Project)	Rate on Bonds	None
Other programs and ADFA General Fund:		
ADFA/ATRS Interim Loan Program	Variable	None
ADFA/ADPC&E Waste Water Treatment Facilities Revolving Loan Fund:		
1991 Series A	3.50 to 4.0%	None
1992 Series A	2.50 to 3.0%	1%
1993 Series A	2.50 to 3.0%	1%
1995 Series A	2.50 to 3.0%	1%
1996 Series A	2.50 to 3.0%	1%
GNMA/BMIR Loan Purchase Program	3.00 to 3.875%	0.125%

#### 4. NET INVESTMENT IN DIRECT FINANCING LEASES

The Authority is the lessor under various direct financing capital leases whereby the Authority issued bonds for the acquisition or construction of certain facilities and then leased the facilities to other state agencies. At the end of the lease terms, these leases either transfer ownership to the other agencies or contain bargain purchase options. Future minimum lease payments receivable under these leases which begin expiring in 2007 are as follows (dollar amounts in thousands):

Year ending June 30:	<b>Lease Payments</b>
1999	\$ 8,632
2000	8,624
2001	8,628
2002	8,606
2003	8,625
Thereafter	<u>81,855</u>
Total minimum lease payments receivable	124,970
Less amount representing interest	<u>41,200</u>
<b>PRESENT VALUE OF MINIMUM LEASE PAYMENTS RECEIVABLE</b>	<b><u>\$ 83,770</u></b>

## 5. BONDS AND NOTES PAYABLE

Bonds and notes payable at June 30, 1998, were as follows (dollar amounts in thousands):

Total Single Family Bonds Payable, with interest rates ranging from 3.7-11.42% and final maturity at varying dates through 2030	\$ 848,416
Plus unamortized premium	1,996
Plus capital appreciation	<u>2,089</u>
Total Single Family Mortgage Purchase Programs Bonds Payable, net	<u>852,501</u>
Total Multi-Family Bonds Payable, with interest rates ranging from 4.15-9.4% and final maturity at varying dates through 2027	87,811
Less unamortized discount	<u>(58)</u>
Total Multi-Family Mortgage Purchase Programs Bonds Payable, net	<u>87,753</u>
Total Development Finance Programs Bonds Payable, with interest rates ranging from 3.5-10.6% and final maturity at varying dates through 2030	283,346
Less unamortized discount	<u>(2,208)</u>
Total Development Finance Programs Bonds Payable, net	<u>281,138</u>
Total Other Programs Bonds Payable, at interest rates ranging from 4.0-9.75% and final maturity at varying dates through 2019	165,355
Less unamortized discount	<u>(1,056)</u>
Total Other Programs Bonds Payable, net	<u>164,299</u>
<b>TOTAL ALL PROGRAMS BONDS PAYABLE, Net</b>	<b><u>\$1,385,691</u></b>

A summary of scheduled bond and note maturities and sinking fund redemptions for the next five fiscal/bond years ending June 30 follows (dollar amounts in thousands):

	1999	2000	2001	2002	2003
Total Single Family Mortgage Purchase Programs	\$ 21,580	\$ 10,205	\$ 12,130	\$ 12,310	\$ 12,650
Total Multi-Family Mortgage Purchase Programs	720	425	460	505	545
Total Development Finance Programs	12,476	13,901	16,165	15,576	15,469
Total Other Programs and ADFA General Funds	<u>8,848</u>	<u>9,768</u>	<u>10,679</u>	<u>11,583</u>	<u>12,542</u>
<b>TOTAL BOND AND NOTE MATURITIES AND SINKING FUND REDEMPTIONS</b>	<b><u>\$43,624</u></b>	<b><u>\$34,299</u></b>	<b><u>\$39,434</u></b>	<b><u>\$39,974</u></b>	<b><u>\$41,206</u></b>



Future amounts required to pay interest on bonds and notes for the next five fiscal/bond years ending June 30 are as follows (dollar amounts in thousands):

	1999	2000	2001	2002	2003
Total Single Family Mortgage Purchase Programs	\$ 53,024	\$ 53,511	\$ 52,867	\$ 52,345	\$ 51,609
Total Multi-Family Mortgage Purchase Programs	3,218	2,148	2,128	2,106	2,081
Total Development Finance Programs	13,998	13,293	12,558	11,730	10,906
Total Other Programs and ADFa General Funds	<u>15,687</u>	<u>14,803</u>	<u>13,828</u>	<u>12,765</u>	<u>11,611</u>
TOTAL INTEREST	<u>\$ 85,927</u>	<u>\$ 83,755</u>	<u>\$ 81,381</u>	<u>\$ 78,946</u>	<u>\$ 76,207</u>

The remaining balance of bonds and interest totaling approximately \$1,187,154 and \$942,529, respectively, for all funds combined is due after June 30, 2003.

Under the bond resolutions, the Authority has the option to redeem bonds at premiums ranging up to 5.60%. Generally, the redemption option cannot be exercised prior to the time the bonds have been outstanding for six to ten years. Certain special redemptions, at par as governed by the bond resolutions, are permitted or required prior to such time.

The bonds and notes are collateralized, as described in the applicable bond and note resolutions, by the revenues, monies, investments, mortgage loans, and other assets in the funds and accounts established by the respective bond and note resolutions.

As of June 30, 1998, the remaining principal amounts outstanding on issues defeased in previous years are as follows:

<u>Issue</u>	<u>Date of Defeasance</u>	<u>Principal Outstanding</u>
1979 Series A Single Family Conventional Bonds	September 1988	\$ 59,080,000
1982 Series A 2023 Multi-Family Term Bonds	August 1990	8,251,379
1988-1 Compound Accretion Bonds	December 1992	11,047,388

## 6. TRANSFERS

Operating transfers during the year ended June 30, 1998, to (from) the various bond programs were as follows (dollars in thousands):

	Transfers
Single Family Mortgage Purchase Programs	\$(1,576)
Multi-Family Mortgage Purchase Programs	(166)
Development Finance Programs	349
Other Programs and ADFa General Fund	<u>1,393</u>
Total	<u>\$ -</u>

For the year ended June 30, 1998, the Authority transferred residual equity balances of refunded programs from the Single Family Mortgage Purchase Program ("Single Family") to the General Fund. The net effect of such transfer was to decrease the Single Family fund balance and increase the fund balance of the General Fund by \$13,593,000.

## **7. CONCENTRATIONS OF RISK IN LENDING AND LOAN RECEIVABLE INSURANCE**

The Authority, through its normal lending activity, originates and maintains loans receivable which are substantially concentrated primarily in Arkansas. The Authority's policy calls for collateral or other forms of repayment assurance to be received from the borrower at the time of loan origination. Such collateral or other form of repayment assurance is subject to changes in economic value due to various factors beyond the control of the Authority, and such changes could be significant.

Additionally, the Authority is heavily dependent on private insurers for recovery of loan principal should a borrower or borrowers not pay the principal and should any collateral prove to be insufficient in value to provide for full recovery of principal and accrued interest. This dependency is concentrated in a limited number of insurers and the Authority's ability to monitor closely the insurers' financial condition is limited.

## **8. RETIREMENT PLAN**

The officials and employees of the Authority participate in a state-wide, multiple-employer public employee retirement system administered by the Arkansas Public Employees Retirement System (the "System"). There is no legal obligation imposed upon the member agencies relative to the operation of the System other than the payment of a percent of the gross salaries of eligible employees participating in the System as an employer contribution. State law provides that Authority contributions for all covered state employees are to be based on 10% of gross payroll. All contributions required of the Authority were made for the year ended June 30, 1998. For the year ended June 30, 1998, the Authority's covered payroll and total payroll for all employees amounted to approximately \$2,224,555.

The contributory plan has been in effect since the beginning of the System, and is available to all persons who became members before January 1, 1978. The noncontributory plan was effective January 1, 1978, and applies automatically to all persons hired January 1, 1978, or later in System covered employment. Employees joining the System prior to July 1, 1997, are vested after ten years of employment. Beginning July 1, 1997, the vesting period for new members will be reduced to five years. A member covered by the contributory plan can elect to be covered by the noncontributory plan, and the change will be effective January 1, 1978, regardless of when the election was made. The System is audited separately, and included therein is financial data and trend information which gives an indication of the extent to which the system is accumulating sufficient assets to pay benefits when due.

## **9. CONTINGENCIES**

The Authority participates in numerous state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the Authority has not complied with the rules and regulations governing the grants, refunds of any money received may be required, and the collectibility of any related receivable at June 30, 1998, may be impaired. In the opinion of the Authority, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying combined financial statements for such contingencies.

**10. CHANGES IN ACCOUNTING AND REPORTING PRACTICES**

Fund balance at June 30, 1997, has been adjusted as follows (in thousands):

	<b>Single Family Mortgage Purchase Programs</b>	<b>Multi-Family Mortgage Purchase Programs</b>	<b>Development Finance Programs</b>	<b>Other Programs and ADFA General Fund</b>
Fund balance as previously reported	\$ 45,751	\$ 6,186	\$ 10,450	\$ 162,923
Change in accounting principle	(10,620)			(76)
Removal of conduit debt obligations			(300)	
Removal of ADPC&E Revolving Loan Fund Program	_____	_____	_____	(104,028)
Fund balance at June 30, 1997, as adjusted	<u>\$ 35,131</u>	<u>\$ 6,186</u>	<u>\$ 10,150</u>	<u>\$ 58,819</u>

***Change in Accounting Principle***

Effective July 1, 1997, the Authority implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The effect of this adoption has been reflected as a restatement of fund balance for all programs as of June 30, 1997.

***Removal of Conduit Debt Obligations***

Interpretation No. 2 of the GASB, *Disclosure of Conduit Debt Obligations*, discusses the accounting treatment and reporting requirements relevant to issuers of conduit debt obligations. Such interpretation requires only that disclosures include 1) a general description of the conduit debt obligations, 2) the aggregate amount of all conduit debt obligations outstanding at the balance sheet date, and 3) a clear indication that the issuer has no obligation for the debt beyond the resources provided by related leases or loans. There is no requirement to report the debt as liabilities on the balance sheet along with the related assets. In addition, the Interpretation does not forbid the continued reporting of liabilities and assets related to conduit debt obligations, if those obligations are the same as those already being reported. In previous years, the Authority has included these conduit debt obligations in their combined balance sheet along with the required disclosures. During the year ended June 30, 1998, management determined that the removal of the assets and liabilities related to the conduit debt obligations would more accurately reflect the financial position of the Authority. As a result, these programs have been removed from the combined financial statements as of June 30, 1997.

***Removal of ADPC&E Revolving Loan Fund Program***

Management of the Authority has restated fund balance of the General Fund by approximately \$104 million to remove the ADFA/ADPC&E Waste Water Treatment Facilities Revolving Loan Fund Program (“ADPC&E”) from the combined financial statements. Removal of the ADPC&E program more appropriately reflects the relationship of the Authority and ADPC&E in accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*.

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