

NEW ISSUE

This Official Statement has been prepared by the North Carolina Housing Finance Agency to provide information on the Series 40 Bonds. Selected information is presented on this cover page for the convenience of the user. To make an informed decision regarding the Series 40 Bonds, a prospective investor should read this Official Statement in its entirety. Unless indicated, capitalized terms used on this cover page have the meanings given in the Official Statement.



\$97,975,000
North Carolina Housing Finance Agency
Home Ownership Revenue Bonds, Series 40
(1998 Trust Agreement)

Dated: Date of Delivery

Due: as shown on inside front cover

<i>Tax Treatment</i>	In the opinion of Bond Counsel and subject to the qualifications described herein, interest on the Series 40 Bonds is not includable in gross income for federal income tax purposes, is exempt from all income taxes of the State of North Carolina, and will not be treated as a preference item for purposes of computing the alternative minimum tax imposed by the Code on certain taxpayers. See "TAX TREATMENT" herein for additional information including information regarding the tax treatment of the Series 40 Bonds.
<i>Redemption</i>	The Series 40 Bonds are subject to optional redemption, special redemption and mandatory redemption as described herein.
<i>Security</i>	The Series 40 Bonds are payable from and secured by a pledge of all Program Obligations, Revenues and Prepayments and certain other assets, on parity with outstanding Bonds heretofore or hereafter issued under the Trust Agreement. <i>The Series 40 Bonds do not constitute a debt, liability or obligation of the State of North Carolina or of any political subdivision thereof nor is the faith and credit or taxing power of the State of North Carolina or of any political subdivision thereof pledged to payment of the Series 40 Bonds.</i>
<i>Interest Payment Dates</i>	January 1 and July 1, commencing January 1, 2019 for the Series 40 Bonds.
<i>Denominations</i>	The Series 40 Bonds will be issuable in denominations of \$5,000 or any whole multiple thereof.
<i>Closing/Settlement</i>	November 14, 2018
<i>Bond Counsel</i>	Womble Bond Dickinson (US) LLP, Raleigh, North Carolina
<i>Underwriters' Counsel</i>	Bode & Harrell, LLP, Raleigh, North Carolina
<i>Trustee and Paying Agent</i>	The Bank of New York Mellon Trust Company, National Association, Jacksonville, Florida

The Series 40 Bonds are offered, when, as and if issued and received by the Underwriters, subject to prior sale and the opinion of Bond Counsel as to the validity, the tax treatment of interest on the Series 40 Bonds and certain other matters.

RBC Capital Markets

BofA Merrill Lynch

Citigroup

Raymond James

Wells Fargo Securities

The date of this Official Statement is November 1, 2018.

\$97,975,000
North Carolina Housing Finance Agency
Home Ownership Revenue Bonds, Series 40

MATURITY SCHEDULE

Series 40 Bonds
\$23,570,000 Serial Bonds

<u>Maturity</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Price</u>	<u>CUSIP[†]</u>
July 1, 2019	\$ 645,000	1.875%	100%	658207VE2
January 1, 2020	775,000	2.050%	100%	658207VF9
July 1, 2020	795,000	2.100%	100%	658207VG7
January 1, 2021	820,000	2.250%	100%	658207VH5
July 1, 2021	840,000	2.300%	100%	658207VJ1
January 1, 2022	865,000	2.400%	100%	658207VK8
July 1, 2022	885,000	2.450%	100%	658207VL6
January 1, 2023	910,000	2.550%	100%	658207VM4
July 1, 2023	935,000	2.600%	100%	658207VN2
January 1, 2024	960,000	2.700%	100%	658207VP7
July 1, 2024	985,000	2.750%	100%	658207VQ5
January 1, 2025	1,015,000	2.850%	100%	658207VR3
July 1, 2025	1,040,000	2.900%	100%	658207VS1
January 1, 2026	1,070,000	3.000%	100%	658207VT9
July 1, 2026	1,100,000	3.000%	100%	658207VU6
January 1, 2027	1,125,000	3.150%	100%	658207VV4
July 1, 2027	1,160,000	3.200%	100%	658207VW2
January 1, 2028	1,190,000	3.250%	100%	658207VX0
July 1, 2028	1,225,000	3.300%	100%	658207VY8
January 1, 2029	1,255,000	3.400%	100%	658207VZ5
July 1, 2029	1,290,000	3.450%	100%	658207WA9
January 1, 2030	1,325,000	3.500%	100%	658207WB7
July 1, 2030	1,360,000	3.550%	100%	658207WC5

\$8,980,000 3.800% Term Bonds maturing July 1, 2033 at 100% CUSIP 658207WD3[†]

\$18,585,000 4.000% Term Bonds maturing July 1, 2038 at 100% CUSIP 658207WE1[†]

\$11,305,000 4.100% Term Bonds maturing January 1, 2041 at 100% CUSIP 658207WF8[†]

\$35,535,000 4.250% Term Bonds maturing July 1, 2047 at 105.687% CUSIP 658207WG6[†]

[†] Copyright, American Bankers Association. CUSIP data herein is provided by CUSIP Global Services, managed by Standard & Poor's Financial Services LLC on behalf of The American Bankers Association. This data is not intended to create a database and does not service in any way as a substitute for CUSIP Global Services. CUSIP numbers are provided for convenience of reference only for the purchasers of the Series 40 Bonds. Neither the Agency nor the Underwriters assume any responsibility for the selection or accuracy of such numbers.

The Underwriters have provided the following sentence for inclusion in this Official Statement: The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their respective responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

No dealer, broker, salesman or other person has been authorized by the North Carolina Housing Finance Agency or the Underwriters to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or the solicitation of any offer to buy nor shall there be any sale of the Series 40 Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale.

The information set forth herein has been provided by the North Carolina Housing Finance Agency and other sources believed to be reliable. Quotations from and summaries and explanations of provisions of laws and documents herein do not purport to be complete and reference is made to such laws and documents for full and complete statements of their provisions. Any statements made in this Official Statement involving estimates or matters of opinion, whether or not expressly stated, are intended merely as estimates or opinions and not as representations of fact.

The information and expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the North Carolina Housing Finance Agency since the dates as of which information is given herein.

THE SECURITIES OFFERED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933 OR THE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. THE SECURITIES OFFERED HEREBY HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION, NOR HAVE ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF THIS OFFERING OR THE ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY MAY BE A CRIMINAL OFFENSE.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE SERIES 40 BONDS OFFERED HEREBY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

References to website addresses presented herein are for informational purposes only and may be in the form of a hyperlink solely for the reader's convenience. Unless specified otherwise, such websites and the information or hyperlinks contained therein are not incorporated into, and are not part of, this Official Statement for purposes of, and as that term is defined in, Rule 15c2-12 of the Securities and Exchange Commission.

The order and placement of materials in this Official Statement, including the Appendices, are not deemed to be a determination of relevance, materiality or importance, and this Official Statement, including the attached Appendices, must be considered in its entirety.

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OFFICIAL STATEMENT
OF
NORTH CAROLINA HOUSING FINANCE AGENCY

\$97,975,000
North Carolina Housing Finance Agency
Home Ownership Revenue Bonds, Series 40

(1998 Trust Agreement)

INTRODUCTION AND PURPOSE

This Official Statement (including the cover page and appendices hereto) has been prepared and is being distributed by the North Carolina Housing Finance Agency (the "Agency") in order to furnish information in connection with the sale of the Agency's Home Ownership Revenue Bonds, Series 40 (the "Series 40 Bonds"), being offered hereby in the aggregate principal amount of \$97,975,000 pursuant to the North Carolina Housing Finance Agency Act, being Chapter 122A of the General Statutes of North Carolina, as amended (the "Act"), a Trust Agreement, dated as of May 1, 1998 (the "Trust Agreement"), between the Agency and The Bank of New York Mellon Trust Company, National Association (hereinafter the "Trustee") and a Fortieth Supplemental Trust Agreement, dated as of November 1, 2018, between the Agency and the Trustee (the "Fortieth Supplemental Trust Agreement"), authorizing the issuance of the Series 40 Bonds.

Except for bonds issued under the Trust Agreement that by the terms thereof are subordinate to the other bonds issued under the Trust Agreement, all bonds issued under the Trust Agreement will be equally and ratably secured by the pledges and covenants contained therein. All such bonds that are equally and ratably secured, including the prior series of bonds issued in the respective aggregate principal amounts and on the respective dates as described in "THE PROGRAM – Experience to Date Under The Program" herein, and the Series 40 Bonds are herein referred to as the "Bonds." Information descriptive of the Series 40 Bonds which is included on the cover page and inside cover page hereof is part of this Official Statement.

All capitalized terms used in this Official Statement which are defined in the Trust Agreement shall have the same meanings as are set forth therein (see Appendix C – "SUMMARY OF CERTAIN PROVISIONS OF THE TRUST AGREEMENT AND THE FORTIETH SUPPLEMENTAL TRUST AGREEMENT – Definitions"). The summaries of and references to the Act, the Trust Agreement and the other statutes and documents referred to herein and the description of the Series 40 Bonds which are included in or attached to this Official Statement do not purport to be comprehensive or definitive, and such summaries, references and descriptions are qualified in their entirety by reference to each such document or statute, copies of which are available from the Agency upon request.

The Agency is a body politic and corporate constituting a public agency and instrumentality of the State of North Carolina (the "State") which was created for the purpose of providing financing for residential housing for low and moderate income households. Pursuant to the Act, the Agency has established a housing program under the Trust Agreement (hereinafter referred to as the "Program") under which the Agency is authorized to enter into agreements for the purchase of mortgage loans, mortgage-backed securities and other obligations made for the purpose of assisting in providing housing to low and moderate income households in the State. Under the Act the issuance of bonds or notes by the Agency and the interest rate or rates, sale price or prices and manner of sale thereof must be determined by the State Treasurer and approved by the Local Government Commission (the "Commission") of the State.

The Trust Agreement authorizes the issuance of Bonds thereunder for the purpose of paying the costs of the Program and for refunding certain bonds of the Agency. Generally, Bonds issued to pay the costs of the Program are issued to finance the making or purchase by the Agency of "Program Loans" or "Program Securities." Under the Trust Agreement, and as used herein, a "Program Loan" is an obligation made or purchased by the Agency in order to finance or otherwise provide housing principally on behalf of households of low and moderate income, and a "Program Security" is an obligation representing an interest in a pool of Program Loans, which obligations are guaranteed or insured by a mortgage agency authorized by the Trust Agreement. As defined in the Trust Agreement and used herein, a "Program Obligation" is a Program Loan or a Program Security. Under the Trust Agreement and as used in this Official Statement, a "Series 40 Securitized Mortgage Loan" refers to a mortgage loan that is made to an eligible borrower to finance the purchase of a home, which mortgage loan is pooled into a Program Security that is purchased by the Agency with the proceeds of the Series 40 Bonds. See "Definitions" and "Program Fund" in Appendix C hereto.

The Trust Agreement further provides that the Supplemental Trust Agreement authorizing the issuance of a Series of Bonds shall direct whether the proceeds of such Series will be used to purchase Program Loans or Program Securities and, if Program Securities are to be purchased, the requirements therefor, including any insurance or guarantee requirements for the Program Securities that may be purchased. In the Fortieth Supplemental Trust Agreement, the Agency has provided that the new Program Securities that may be purchased with the proceeds of the Series 40 Bonds must be mortgage-backed securities issued by the Government National Mortgage Association ("GNMA") or Federal National Mortgage Association ("Fannie Mae"), representing mortgage loans financing single family residential housing for households of low and moderate income in the State. The Fortieth Supplemental Trust Agreement also permits the purchase as Program Securities of mortgage-backed securities issued by Federal Home Loan Mortgage Corporation ("Freddie Mac") representing mortgage loans for single family housing in the State. The Agency intends to begin to purchase Freddie Mac Certificates when its master servicer, ServiSolutions, a division of Alabama Housing Finance Authority ("ServiSolutions") obtains Freddie Mac approval. The Agency cannot predict at this time the amount of proceeds of the Series 40 Bonds, if any, it will utilize to purchase Freddie Mac Certificates. In addition to the purchase of Program Securities with proceeds of the Series 40 Bonds, new Program Loans will be purchased with proceeds of the Series 40 Bonds that will be non-interest bearing loans made to the borrowers of the related Series 40 Securitized Mortgage Loans to provide down payment assistance to such borrowers ("Series 40 DPA Loans"). Series 40 DPA Loans will be secured by a subordinate mortgage on the property purchased with the proceeds thereof, and the principal of such Program Loans will be forgiven if the borrower meets certain program requirements.

The proceeds of the Series 40 Bonds, and certain other funds as hereinafter described, will be used by the Agency to (a) purchase Program Securities as described herein, (b) purchase Series 40 DPA Loans as described herein, and (c) pay a portion of the costs of issuance of the Series 40 Bonds. For a more detailed discussion of the manner in which the Agency intends to apply the proceeds of the Series 40 Bonds and other funds, see "PLAN OF FINANCE" and "THE PROGRAM."

The Series 40 Bonds and the interest thereon are payable solely from the Revenues and other moneys and assets pledged therefor under the Trust Agreement. The Series 40 Bonds are additionally secured by a Debt Service Reserve Fund, as more fully described below in "SECURITY FOR AND SOURCES OF PAYMENT OF THE SERIES 40 BONDS – Debt Service Reserve Fund."

The Series 40 Bonds do not constitute a debt, liability or obligation of the State or any political subdivision thereof, nor is the faith and credit or the taxing power of the State or any political subdivision thereof pledged to payment of the Series 40 Bonds. The Agency has no taxing power.

PLAN OF FINANCE

The Series 40 Bonds will be issued as fixed rate serial and term bonds.

Purchase of New Program Securities

The Agency anticipates using approximately \$92.8 million of the proceeds of Series 40 Bonds, and \$20 million from amounts held in the Revenue Reserve Equity Account as hereinafter described, to fund the purchase by the Agency of GNMA Certificates and Fannie Mae Certificates, securitizing new mortgage loans for home ownership made to persons of low and moderate income in the State. Upon the purchase of such GNMA Certificates or Fannie Mae Certificates, whether the purchase is funded with the proceeds of the Series 40 Bonds or other funds, the GNMA Certificates and Fannie Mae Certificates so purchased will be deposited to the Series 40 Program Account and will be Series 40 Program Securities for all purposes of the Trust Agreement as that term is used in this Official Statement. The Agency also intends to begin to purchase Freddie Mac Certificates when its master servicer, ServiSolutions, obtains Freddie Mac Certificate approval. The Agency cannot predict at this time how many Freddie Mac Certificates, if any, it will purchase with the proceeds of the Series 40 Bonds.

Purchase of Series 40 DPA Loans

The Agency anticipates using approximately \$7.1 million of the proceeds of the Series 40 Bonds deposited to the Series 40 Program Account to purchase Series 40 DPA Loans. The program features associated with the Series 40 DPA Loans are being implemented in reliance upon the provisions of the Trust Agreement, which permits the Agency, in its discretion, to reduce the amounts collected under any Program Loan in order to comply with the requirements of the federal income tax laws applicable to the Series 40 Bonds.

Series 40 DPA Loans will be made to borrowers in connection with the making of a related Series 40 Securitized Mortgage Loan. Series 40 DPA Loans will be secured by the acquired real property by a mortgage that is subordinate to the related Series 40 Securitized Mortgage Loan and may be subordinate to other mortgages on the real property. Series 40 DPA Loans will be non-interest bearing loans and may be subject to automatic reductions in principal upon the occurrence of certain specified events, as appropriate to carry out the Agency's programmatic objectives to be accomplished through the Series 40 DPA Loans. Series 40 DPA Loans are not required to be insured or guaranteed pursuant to any federal or private mortgage insurance or guaranty program.

Initially, Series 40 DPA Loans will be made to each borrower in the amount of \$8,000. It is the intention of the Agency that no principal on the Series 40 DPA Loans will be due during the first fifteen years of such loan unless (1) the property purchased with such loan is sold during such period, (2) the Series 40 Securitized Mortgage Loan related to the Series 40 DPA Loan is refinanced, or (3) there is a default under the Series 40 Securitized Mortgage Loan related to the Series 40 DPA Loan. If the events described in the preceding sentence do not occur as of the applicable date, 20% of the original principal of the Series 40 DPA Loans will be reduced on each of the eleventh, twelfth, thirteenth, fourteenth and fifteenth anniversaries of the origination of the Series 40 DPA Loan.

Until the principal of a Series 40 DPA Loan is completely forgiven, the Series 40 DPA Loan will be a "Program Loan" for purposes of the Trust Agreement and will be subject to the pledge of the Program Loans to secure payment of the Bonds issued under the Trust Agreement. Any payments on the Series 40 DPA Loans (which would consist only of payments received if the principal of the Series 40 DPA Loan becomes due during the first fifteen years because the acquired property is sold, the related Series 40 Securitized Mortgage Loan is refinanced or there is a default and foreclosure on the Series 40 Securitized Mortgage Loan) will constitute "Prepayments" and will be applied as provided below under "SECURITY FOR AND SOURCES OF PAYMENT OF THE SERIES 40 BONDS."

SOURCES AND USES OF FUNDS

The proceeds to be received from the sale of the Series 40 Bonds, together with other available moneys, shall be applied approximately as follows:

Sources of Funds:

Principal Amount of Series 40 Bonds.....	\$97,975,000
Original Issue Premium of Series 40 Bonds	2,020,875
Transfer from Revenue Reserve Equity Account	20,000,000
Transfer from Other Available Agency Funds.....	<u>985,499</u>
Total Sources	<u>\$120,981,374</u>

Uses of Funds:

Series 40 Program Account*	\$119,995,875
Costs of Issuance**	<u>985,499</u>
Total Uses	<u>\$120,981,374</u>

* Of the amounts deposited in the Series 40 Program Account, approximately \$46.9 million[†] is expected to be used to acquire approximately \$46.3 million[†] in principal amount of GNMA Securities at a weighted average purchase price equal to approximately 101.3% of the principal amount thereof, and approximately \$65.9 million[†] is expected to be used to acquire approximately \$65.4 million[†] in principal amount of Fannie Mae Securities at a weighted average purchase price equal to approximately 100.8% of the principal amount thereof, and approximately \$7.1 million[†] is expected to be used to acquire approximately \$7.1 million[†] in principal amount of Series 40 DPA loans at a weighted average purchase price equal to approximately 100% of the principal amount thereof.

** Costs of Issuance includes underwriters' fee, legal fees and expenses, rating agency fees, printing costs, fees and expenses of the Trustee and other miscellaneous expenses.

[†] Preliminary, subject to change.

SECURITY FOR AND SOURCES OF PAYMENT OF THE SERIES 40 BONDS

Pledge Created Under the Trust Agreement

The Series 40 Bonds are special obligations of the Agency payable from the following moneys and assets of the Agency, which are pledged in the manner and to the extent provided under the Trust Agreement for the payment of the Bonds:

1. All Program Obligations, Revenues, Program Obligation Accrued Interest, Financing Fees and Prepayments (as such terms are defined in the Trust Agreement), and all moneys, securities and Funds and Accounts held or set aside pursuant to the Trust Agreement; and
2. All money and securities held by or on behalf of the Trustee in all of the funds, accounts or subaccounts established pursuant to the Trust Agreement, except those funds, accounts and subaccounts that are expressly pledged in a Supplemental Trust Agreement as security only for a specified Series of Bonds and a Special Debt Service Reserve Account (as defined in the Trust Agreement).

For further information, see the subcaptions "Pledge" and "Application of Revenues and Other Moneys" in Appendix C.

Series 40 Principal/Special Redemption Account and Disposition of Certain Funds

Pursuant to the Trust Agreement, the Agency has created, among other things, the Revenue Fund, the Bond Service Fund and the Redemption Fund, and the accounts thereof. In addition, the Trust Agreement provides that all Revenues (as defined in the Trust Agreement) are to be deposited to the credit of the Revenue

Fund and all Prepayments are deposited to the Special Redemption Account of the Redemption Fund for the Series of Bonds that provided the funds for the purchase of the Program Obligations to which such Prepayment relates. In order to facilitate the management of the Revenues and Prepayments derived from the Series 40 Program Obligations, the Agency has determined to combine (1) the amounts that would be deposited to the Revenue Fund representing payments of principal on the Series 40 Program Obligations and (2) the amounts that would be deposited to the Series 40 Special Redemption Account into one account designated the Series 40 Principal/Special Redemption Account.

The Fortieth Supplemental Trust Agreement has created a special account within the Bond Service Fund designated the "Series 40 Principal/Special Redemption Account." So long as no Event of Default has occurred and is continuing under the Trust Agreement, principal payments on the Series 40 Program Obligations, whether constituting scheduled principal payments or Prepayments, shall be deposited to the Series 40 Principal/Special Redemption Account. The Series 40 Principal/Special Redemption Account is established for the convenience of administration of the Trust Agreement and the Series 40 Bonds under the Trust Agreement and notwithstanding the creation of the Series 40 Principal/Special Redemption Account and the deposit and application of funds as provided therein, all amounts deposited and held in the Series 40 Principal/Special Redemption Account remain pledged for the benefit, security and protection of all present and future Owners of Bonds issued and secured under the Trust Agreement, without preference, priority or distinction as to lien or otherwise of any one Bond over any other Bond. See "AMENDMENT OF TRUST AGREEMENT" below for a discussion of an amendment to the Trust Agreement that would amend the Trust Agreement to make the provisions described above apply in all circumstances.

All payments of principal and interest on the Series 40 Program Obligations shall be collected by or on behalf of the Agency and deposited as received in the name of the Trustee. Unless an Event of Default shall have occurred and is continuing, upon receipt, the Trustee shall apply the amounts received as follows:

- (1) All amounts comprising the payment of interest on the Series 40 Program Obligations shall be deposited to the credit of the Revenue Fund.
- (2) All other amounts received shall be deposited to the credit of the Series 40 Principal/Special Redemption Account.

Amounts deposited to the Revenue Fund shall be applied as provided in the Trust Agreement.

Amounts deposited to the Series 40 Principal/Special Redemption Account shall be applied as follows, in the following order of priority:

- (1) An amount, if any, needed to increase the amount in the Series 40 Principal/Special Redemption Account so that the amount on deposit equals the principal of all Series 40 Serial Bonds maturing within the next six months shall be retained in the Series 40 Principal/Special Redemption Account, and such amount shall be applied on the principal maturity date to pay such principal.
- (2) An amount, if any, needed to increase the amount in the Series 40 Principal/Special Redemption Account so that the amount on deposit (in addition to the amount set forth in (1)) equals the amount, if any, needed to increase the amount in the Series 40 Principal/Special Redemption Account so that the amount on deposit equals the Sinking Fund Requirements of the Series 40 Term Bonds to be redeemed within the next six months pursuant to the Sinking Fund Requirement therefor specified in the Fortieth Supplemental Trust Agreement, and such amount shall be applied on the sinking fund redemption date to redeem such Series 40 Term Bonds pursuant to the Sinking Fund Requirement therefor.
- (3) To the Special Redemption of Series 40 Term Bonds maturing July 1, 2047 (the "Series 40 PAC Bonds") up to the amounts set forth in the Fortieth Supplemental Trust Agreement. See "REDEMPTION OF SERIES 40 BONDS – Special Redemption."

- (4) At the option of the Agency, as evidenced by an Officer's Certificate, to (a) redeem Series 40 Bonds; (b) redeem Bonds other than Series 40 Bonds, to the extent the Supplemental Trust Agreement authorizing the issuance of such Bonds allows for such Bonds to be redeemed from such amounts; or (c) to purchase additional Program Obligations that meet the requirements of the Fortieth Supplemental Trust Agreement.

In the event that an Event of Default occurs and is continuing under the Trust Agreement, the Agency shall take such steps as shall be necessary or convenient to identify whether a payment of principal on the Series 40 Program Obligations is derived from a scheduled payment on the Program Obligation or a Prepayment. Thereafter, so long as the Event of Default is continuing, payments of scheduled principal on Series 40 Program Obligations shall be deposited to the Revenue Fund and Prepayments on Series 40 Program Obligations shall be deposited to the Series 40 Principal/Special Redemption Account. Upon such occurrence, transfers shall be made from the Revenue Fund to the Principal Account and the Sinking Fund Account to pay maturing principal and mandatory sinking fund redemptions of the Series 40 Bonds as otherwise provided in the Trust Agreement. See "AMENDMENT OF TRUST AGREEMENT" below for a discussion of an amendment to the Trust Agreement that would amend the Trust Agreement to make the provisions described above apply in all circumstances.

Debt Service Reserve Fund

The Trust Agreement creates a Debt Service Reserve Fund for the additional security of the Bonds issued thereunder. The Trust Agreement provides that each Supplemental Trust Agreement providing for the issuance of Bonds shall specify whether the Bonds authorized thereby will be entitled to the benefit of the Debt Service Reserve Fund and shall specify the portion of the Debt Service Reserve Requirement with respect to such Bonds. The Debt Service Reserve Requirement under the Trust Agreement is the sum of amounts established by each Supplemental Trust Agreement as the portion of the requirement with respect to the Bonds issued under that Supplemental Trust Agreement. The Trust Agreement does not provide a minimum requirement for the portion of the Debt Service Reserve Requirement in connection with a particular issue of Bonds. All Bonds secured by the Debt Service Reserve Fund will be secured equally and ratably by the Debt Service Reserve Fund, regardless of the amount of the Debt Service Reserve Requirement with respect to a particular Series of Bonds set forth in the Supplemental Trust Agreement authorizing the issuance thereof. As of June 30, 2018, there was on deposit in the Debt Service Reserve Fund \$4,474,000.

Prior to the issuance of the Series 37 Bonds, each Supplemental Trust Agreement had provided that the portion of the Debt Service Reserve Requirement related to the series of bonds authorized thereby be equal to two percent (2%) of the outstanding principal amount of such authorized bonds. **THE SUPPLEMENTAL TRUST AGREEMENT FOR EACH SERIES OF BONDS COMMENCING WITH THE SERIES 37 BONDS PROVIDES THAT SUCH BONDS ARE SECURED BY THE DEBT SERVICE RESERVE FUND AND SUCH SUPPLEMENTAL TRUST AGREEMENTS ALL FURTHER PROVIDE THAT THE DEBT SERVICE RESERVE FUND SHALL NOT BE INCREASED ON ACCOUNT OF EACH SUCH SERIES OF BONDS ISSUED COMMENCING WITH THE SERIES 37 BONDS.**

The Debt Service Reserve Fund consists of three accounts: the Proceeds Reserve Account, which is funded with the proceeds of Bonds, the Contribution Reserve Account, which is funded with the moneys attributable to appropriations by the State of North Carolina to the Agency, and the Equity Reserve Account, which is funded from funds of the Agency other than funds appropriated to the Agency by the State.

Under the Trust Agreement, moneys held in the Debt Service Reserve Fund may be used to pay when due principal of and interest on the Bonds if, at any time, the moneys otherwise available for such payment or retirement are insufficient for such purpose. Any deficiency in the Debt Service Reserve Fund may be made up from Revenues in excess of Revenues necessary to pay debt service on the Bonds and any other moneys available to the Agency for such purpose. Moneys in the Debt Service Reserve Fund in excess of the Debt Service Reserve Requirement due to a decrease in the Debt Service Reserve Requirement shall either be retained in such Fund or, except for amounts in the Contribution Reserve Account, transferred to the Optional Redemption Account or a Special Redemption Account, as shall be determined in an Officer's Certificate.

The Trust Agreement also provides that all or any portion of the Debt Service Reserve Requirement may be met by cash, Investment Obligations or a Reserve Alternative Instrument (See Appendix C – "Definitions").

The Trust Agreement also provides that any Supplemental Trust Agreement may provide for the creation thereunder of a Special Debt Service Reserve Account, which shall secure only the Bonds authorized by such Supplemental Trust Agreement.

Neither the Act nor any other statute provides for any appropriations or payments by the North Carolina General Assembly to restore moneys withdrawn from the Debt Service Reserve Fund to pay principal of or interest on the Bonds.

Revenue Reserve Fund

To the extent that Revenues are not needed for debt service, to fund or make up a deficiency in the Debt Service Reserve Fund or for the other purposes provided for by the Trust Agreement, they are required to be deposited to the credit of the Revenue Reserve Fund. As of June 30, 2018, there was on deposit in the Revenue Reserve Fund \$21,418,000 in cash and investments derived from revenues. Subsequent to June 30, 2018 and before the delivery of the Series 40 Bonds the Agency is expected to transfer approximately \$94.9 million to the Revenue Reserve Equity Account from the Revenue Reserve Refunding Account. Approximately \$20 million of this amount will be used to purchase Series 40 Program Securities. The Agency anticipates using the balance of such funds to purchase additional Program Securities in conjunction with future bond issues, but such funds are not restricted to this use.

In addition, the Trust Agreement provides that the Agency may from time to time deposit any money available to the Agency to any Fund or Account created under the Trust Agreement. Pursuant to this provision, approximately \$94.9 million of available funds of the Agency have been deposited to the Revenue Reserve Fund into a special account thereunder designated the "Revenue Reserve Equity Account." Amounts in the Revenue Reserve Equity Account are subject to all provisions of the Trust Agreement regarding the Revenue Reserve Fund, including the application of moneys in the Revenue Reserve Fund. In connection with the issuance of the Series 40 Bonds, the Agency will instruct the Trustee to transfer \$20 million from the Revenue Reserve Equity Account to the credit of the Series 40 Program Account of the Program Fund for purchase of Series 40 Program Obligations.

Moneys held in the Revenue Reserve Fund are pledged to secure the payment of the Bonds and may be used to pay when due the principal of and interest on the Bonds if at any time the moneys otherwise available for such payment or retirement, other than moneys held in the Debt Service Reserve Fund, are insufficient for such purpose. Any moneys so used can only be restored from Revenues in excess of Revenues necessary to pay debt service on the Bonds and not necessary to make up any deficiency in the Debt Service Reserve Fund.

Under certain circumstances, moneys in the Revenue Reserve Fund may be (i) used to fund any required payments under an interest rate swap agreement, including termination payments, in the event that the Revenues are not sufficient for such purpose, (ii) used to make any payments required to be made to comply with applicable covenants made by the Agency regarding the exclusion of interest on the Bonds from federal income taxation, (iii) transferred, at the option of the Agency, to a Special Redemption Account, (iv) used to pay Operating Expenses of the Program, (v) transferred to the Optional Redemption Account or any Special Redemption Account created by a Supplemental Trust Agreement, (vi) used to pay costs of issuance of a new series of bonds or to purchase additional Program Obligations, (vii) used for any other purpose authorized by the Trust Agreement or (viii) transferred to the Agency's General Fund. See the subcaptions "Application of Revenues and Other Moneys" and "Revenue Reserve Fund" in Appendix C.

In addition, the Agency has also deposited to the credit of the Revenue Reserve Fund additional funds and assets made available to the Agency from the refunding of Bonds of the Agency issued under other Resolutions or Trust Agreements, following the discharge of all obligations under such other Resolutions or Trust Agreements. Such funds and other assets are not pledged to secure payment of any Bonds issued under

the Trust Agreement, the amounts received thereunder do not constitute Revenues under the Trust Agreement and the Owners of the Bonds do not have any rights in respect thereto. While in the Revenue Reserve Fund, however, such amounts may be used for any purpose described in the preceding paragraph (including transfer to the Agency's General Fund), other than for transfer to a Special Redemption Account for the redemption of Bonds from surplus Revenues in the Revenue Reserve Fund. In addition, the Agency has established within the Revenue Reserve Fund a special account called the "TBA Loan Administration Account" to which the Agency may deposit or withdraw from time to time cash or investments of cash in connection with the administration by the Agency of the single family homeownership program being carried out by the Agency utilizing mortgage-backed securities issued by Fannie Mae and GNMA and sold in the secondary market. Cash or other assets held in the TBA Loan Administration Account are not pledged to secure payment of any Bonds issued under the Trust Agreement and the amounts received thereunder do not constitute Revenues under the Trust Agreement, and such cash and other assets do not provide security for the Bonds and the Owners of the Bonds shall have no rights in respect thereto.

Insurance Reserve Fund

The Trust Agreement creates an Insurance Reserve Fund for the additional security of the Bonds issued thereunder. The Trust Agreement provides that each Supplemental Trust Agreement providing for the issuance of Bonds shall specify the Insurance Reserve Requirement with respect to such Bonds and the manner in which such requirement is to be funded. **The Fortieth Supplemental Trust Agreement provides that there shall not be any Insurance Reserve Requirement with respect to the Series 40 Program Obligations and losses with respect to any Series 40 Program Loans will not be funded from transfers from the Insurance Reserve Fund.**

As of June 30, 2018, there was on deposit in the Insurance Reserve Fund \$9,365,000.

1974 Appropriation Reserve Fund

In the Twelfth Supplemental Trust Agreement, the Agency created an additional fund under the Trust Agreement designated the "1974 Appropriation Reserve Fund" and deposited \$4,000,000 to the 1974 Appropriation Reserve Fund. The 1974 Appropriation Reserve Fund represents certain funds appropriated to the Agency by the North Carolina General Assembly in 1974. Pursuant to the terms of the Twelfth Supplemental Trust Agreement, the Agency may withdraw amounts in the 1974 Appropriation Reserve Fund for application for a number of purposes of the Agency, including the provision for reserves for Bonds of the Agency other than Bonds issued under the Trust Agreement. However, while funds are on deposit in the 1974 Appropriation Reserve Fund, such amounts are available to make up deficiencies in the Bond Service Fund. See "1974 Appropriation Reserve Fund" in Appendix C.

Additional Bonds

The Trust Agreement authorizes the issuance of additional Bonds by the Agency, under the circumstances set forth in the Trust Agreement. Such additional Bonds may be issued to finance additional costs of the Program, to refund outstanding bonds issued under the Trust Agreement or issued under other resolutions or indentures other than the Trust Agreement, or for other purposes set forth in the Trust Agreement. In order to issue additional Bonds under the Trust Agreement, the Agency must comply with the provisions of a Supplemental Trust Agreement executed in connection with the additional Bonds, which Supplemental Trust Agreement must be authorized by the Commission and must contain the terms and provisions of the additional Bonds. The additional Bonds must not materially and adversely affect the ability of the Agency to pay the principal of, Sinking Fund Requirements on account of, and interest on the Bonds then outstanding. Such additional Bonds, together with the Bonds issued and outstanding under the Trust Agreement, including the Series 40 Bonds, would be equally and ratably secured by the moneys and assets which are pledged for the payment of all of the Bonds issued under the Trust Agreement and would be entitled to the equal benefit and protection of the provisions, covenants and agreements of the Trust Agreement.

Investments

The Trust Agreement provides that funds held thereunder may be invested in investments permitted by the Trust Agreement. For a complete description of investments that are permitted, see the definition of "Investment Obligations" in Appendix C – "SUMMARY OF CERTAIN PROVISIONS OF THE TRUST AGREEMENT AND THE FORTIETH SUPPLEMENTAL TRUST AGREEMENT."

Historically, the Agency utilized investment agreements and repurchase agreements for the investment of a significant amount of Program Funds, Revenues and Prepayments and Reserve Funds under the Trust Agreement. More recently, on account of current market conditions, the Agency has been unable to enter into such agreements that provided for rates of return and other provisions acceptable to the Agency. Funds held under the Trust Agreement are currently invested in other investments, principally consisting of Government Obligations and a commingled short-term Investment Fund maintained by the North Carolina State Treasurer.

Should market conditions result in a return of investment rates to more attractive levels, the Agency may return to a broader use of investment and repurchase agreements permitted by the Trust Agreement.

DESCRIPTION OF THE SERIES 40 BONDS

General

The Series 40 Bonds will be dated November 14, 2018. The Series 40 Bonds will bear interest (computed on the basis of a 360-day year consisting of twelve 30-day months) from their date until payment thereof, such interest to the maturity thereof being payable on January 1, 2019 and semiannually thereafter on July 1 and January 1 in each year. Interest payable on the Series 40 Bonds on each Interest Payment Date shall be paid to the registered owner thereof as of the close of business on the Record Date for such Interest Payment Date, which shall be the fifteenth day of the calendar month preceding such Interest Payment Date (whether or not such day is a business day).

The Series 40 Bonds will be issuable only in book-entry form as fully registered bonds and will be subject to the provisions of the book-entry-only system as described in Appendix D — "BOOK-ENTRY-ONLY SYSTEM." Purchases of the Series 40 Bonds will be made in the denominations of \$5,000 or any whole multiple thereof.

The Trustee, The Bank of New York Mellon Trust Company, National Association, Jacksonville, Florida, will perform, with respect to the Series 40 Bonds, the fiduciary duties for the Owners, such as maintaining the Funds and Accounts established under the Trust Agreement. In addition, the Trustee shall perform the duties of bond registrar, including the keeping of the registration books, the authentication of the Series 40 Bonds upon original issuance and upon subsequent exchange or transfer, the exchange and transfer of the Series 40 Bonds, and the payment of the principal or redemption price of and interest on the Series 40 Bonds subject to the provisions relating to the book-entry-only system, as described in Appendix D.

REDEMPTION OF SERIES 40 BONDS

The Series 40 Bonds shall not be subject to prior redemption except as provided in the Fortieth Supplemental Trust Agreement and the Trust Agreement.

Optional Redemption

The Series 40 Bonds are subject to redemption prior to their maturity, at the option of the Agency, either in whole or in part on any date on or after January 1, 2028 at a price of par, plus accrued interest (except the Series 40 PAC Bonds which will be redeemed at a premium as described below).

Any such optional redemption shall be from any moneys on hand held for the credit of the Optional Redemption Account on or before the date fixed for redemption, including, without limitation, the proceeds of

any Refunding Bonds issued pursuant to the Trust Agreement, upon receipt of an Officer's Certificate as provided in the Trust Agreement, in such manner as the Agency in its discretion may determine, and upon notice as provided in the Trust Agreement at a Redemption Price equal to the principal amount of the Series 40 Bonds to be redeemed, plus accrued interest to the redemption date (except that the Series 40 PAC Bonds will be redeemed at the principal amount thereof to be redeemed plus accrued interest to the date fixed for redemption, plus a premium that maintains the same yield to the optional redemption date as the initial reoffering price thereof, calculated based on the assumption that the Series 40 PAC Bonds are redeemed in each semiannual period such that the amount outstanding following each such redemption equals the related Series 40 PAC Bonds Outstanding Amounts as set forth in the Target Outstanding PAC Amount in "REDEMPTION OF SERIES 40 BONDS – Series 40 PAC Bonds" below).

Mandatory Sinking Fund Redemption

The Series 40 Term Bonds maturing on July 1, 2033 are subject to mandatory sinking fund redemption by lot on January 1, 2031 and on each July 1 and January 1 thereafter, in the principal amounts set forth below from moneys deposited to the credit of the Series 40 Principal/Special Redemption Account, at a Redemption Price equal to 100% of the principal amount of the Term Bonds to be redeemed, plus accrued interest to the redemption date:

<u>Date</u>	<u>Amount</u>
January 1, 2031	1,400,000
July 1, 2031	1,435,000
January 1, 2032	1,475,000
July 1, 2032	1,515,000
January 1, 2033	1,555,000
July 1, 2033*	1,600,000

*Maturity

The Series 40 Term Bonds maturing on July 1, 2038 are subject to mandatory sinking fund redemption by lot on January 1, 2034 and on each January 1 and July 1 thereafter, in the principal amounts set forth below from moneys deposited to the credit of the Series 40 Principal/Special Redemption Account, at a Redemption Price equal to 100% of the principal amount of the Term Bonds to be redeemed, plus accrued interest to the redemption date:

<u>Date</u>	<u>Amount</u>
January 1, 2034	\$1,645,000
July 1, 2034	1,685,000
January 1, 2035	1,735,000
July 1, 2035	1,775,000
January 1, 2036	1,830,000
July 1, 2036	1,880,000
January 1, 2037	1,925,000
July 1, 2037	1,985,000
January 1, 2038	2,035,000
July 1, 2038*	2,090,000

*Maturity

The Series 40 Term Bonds maturing on January 1, 2041 are subject to mandatory sinking fund redemption by lot on January 1, 2039 and on each January 1 and July 1 thereafter, in the principal amounts set forth below from moneys deposited to the credit of the Series 40 Principal/Special Redemption Account, at a

Redemption Price equal to 100% of the principal amount of the Term Bonds to be redeemed, plus accrued interest to the redemption date:

<u>Date</u>	<u>Amount</u>
January 1, 2039	\$2,140,000
July 1, 2039	2,260,000
January 1, 2040	2,320,000
July 1, 2040	2,390,000
January 1, 2041*	2,195,000

*Maturity

The Series 40 Term Bonds maturing on July 1, 2047 are subject to mandatory sinking fund redemption by lot on January 1, 2041 and on each July 1 and January 1 thereafter, in the principal amounts set forth below from moneys deposited to the credit of the Series 40 Principal/Special Redemption Account, at a Redemption Price equal to 100% of the principal amount of the Term Bonds to be redeemed, plus accrued interest to the redemption date:

<u>Date</u>	<u>Amount</u>
January 1, 2041	\$245,000
July 1, 2041	2,455,000
January 1, 2042	2,520,000
July 1, 2042	2,590,000
January 1, 2043	2,665,000
July 1, 2043	2,730,000
January 1, 2044	2,810,000
July 1, 2044	2,885,000
January 1, 2045	2,960,000
July 1, 2045	3,045,000
January 1, 2046	3,125,000
July 1, 2046	3,210,000
January 1, 2047	3,295,000
July 1, 2047*	1,000,000

*Maturity

Special Redemption

General. The Series 40 Bonds may be redeemed pursuant to an Officer's Certificate in whole or in part on any date at a redemption price of 100% of the principal amount thereof, except as hereinafter provided with respect to the Series 40 PAC Bonds, plus accrued interest to the date of redemption, from (i) unexpended proceeds of the Series 40 Bonds, (ii) amounts deposited in the Series 40 Principal/Special Redemption Account as provided in the Fortieth Supplemental Trust Agreement, (iii) excess Revenues transferred from the Revenue Reserve Fund pursuant to the Trust Agreement, (iv) moneys withdrawn from the Proceeds Reserve Account of the Debt Service Reserve Fund in connection with an excess over the Debt Service Reserve Requirement and (v) prepayments on Program Obligations held under the Trust Agreement that were financed by the proceeds of Bonds other than the Series 40 Bonds. Notwithstanding the foregoing, in the event that any Series 40 PAC Bonds are redeemed from unexpended proceeds pursuant to the Fortieth Supplemental Trust Agreement, such special redemption shall be at a redemption price of the principal amount thereof, plus accrued interest, plus the unamortized premium thereon as determined by the Agency by an effective interest rate amortization of the original issue premium on the Series 40 PAC Bonds between the date of issue and July 1, 2028 on and after which date there shall be no redemption premium.

Unexpended Proceeds. Unexpended proceeds of the Series 40 Bonds may be transferred, pursuant to the Trust Agreement, from the Series 40 Program Account to the Series 40 Principal/Special Redemption

Account and applied to the special redemption of Series 40 Bonds on any date directed by the Agency. In such event, the Series 40 Bonds to be so redeemed shall be selected pro rata by maturity in proportion to the principal amount of each maturity outstanding, unless the Agency files with the Trustee prior to the date of redemption, a notice of intent to redeem such Series 40 Bonds on other than a pro rata basis, together with a Cash Flow Certificate indicating the proposed form of redemption and prepared assuming that the Series 40 Bonds to be redeemed are selected in the manner proposed by the Agency.

Series 40 PAC Bonds. Amounts deposited to the Series 40 Principal/Special Redemption Account as described under "SECURITY FOR AND SOURCES OF PAYMENT OF THE SERIES 40 BONDS – Series 40 Principal/Special Redemption Account and Disposition of Certain Funds" during each semi-annual period ending January 1 or July 1 (or longer period for the period ending July 1, 2019) and not used to pay maturing principal or mandatory sinking fund redemptions on the Series 40 Bonds on the next January 1 or July 1 shall be applied on one or more days during the period to the special redemption of the Series 40 PAC Bonds, provided that after giving effect to such redemption and giving effect to the payment at scheduled maturity or mandatory sinking fund redemption of Series 40 PAC Bonds on the next January 1 or July 1, the aggregate principal amount of Series 40 PAC Bonds on a redemption date or January 1 or July 1 shall not be less than the related Target Outstanding PAC Bond Amount of Series 40 PAC Bonds set forth in the table below:

<u>Semi-Annual Period Ending</u>	<u>Target Outstanding PAC Bond Amount</u>
Date of Issuance	\$35,535,000
July 1, 2019	35,425,000
January 1, 2020	34,570,000
July 1, 2020	33,075,000
January 1, 2021	30,980,000
July 1, 2021	28,335,000
January 1, 2022	25,400,000
July 1, 2022	22,575,000
January 1, 2023	19,890,000
July 1, 2023	17,345,000
January 1, 2024	14,935,000
July 1, 2024	12,655,000
January 1, 2025	10,505,000
July 1, 2025	8,480,000
January 1, 2026	6,580,000
July 1, 2026	4,810,000
January 1, 2027	3,150,000
July 1, 2027	1,615,000
January 1, 2028	195,000
July 1, 2028	-

In the event that the amounts deposited to the Series 40 Principal/Special Redemption Account are insufficient during any period set forth to permit the special redemption of the Series 40 PAC Bonds in the amount described, unless the Series 40 PAC Bonds are called for special redemption from other permitted sources, the amount of Series 40 PAC Bonds exceeding the Target Outstanding PAC Bond Amount shall continue to be subject to special redemption from future amounts when deposited to the Series 40 Principal/Special Redemption Account.

In addition, after the amount of Series 40 PAC Bonds required to be redeemed during any period as described above have been called for special redemption in any semiannual period, if additional amounts deposited in the Series 40 Principal/Special Redemption Account are required pursuant to the requirements of clause (iv) of Section 143(a)(2)(A) of the Code to be used to redeem Series 40 Bonds (sometimes referred to as

the "Ten Year Rule"), such amounts may be applied to redeem the Series 40 PAC Bonds if at the time there are no Outstanding Series 40 Bonds other than the Series 40 PAC Bonds.

If the Series 40 PAC Bonds are redeemed from unexpended proceeds as described above, or pursuant to a special redemption on account of the Ten Year Rule, the Target Outstanding PAC Bond Amount for each semiannual period will be reduced on a proportionate basis.

Projected Weighted Average Lives of the Series 40 PAC Bonds. The "projected weighted average life" of a security refers to the average amount of time that is projected to elapse from the date of delivery of such security to the date of projected payment to the investor of each dollar paid to reduce the principal of such security (assuming no losses). The projected weighted average life of a security is determined by (a) multiplying each projected reduction, if any, of the outstanding amount of such security by the number of years from the date of delivery of such security to the related redemption date or maturity dated, (b) adding the results and (c) dividing the sum by the initial outstanding amount of such security.

The calculation of the projected weighted average lives of the Series 40 PAC Bonds requires the making of certain assumptions (collectively, the "Portfolio Assumptions") with respect, but not limited, to the future financing and prepayment of Program Obligations as well as certain assumptions (collectively, the "Agency Option Assumptions"), with respect, but not limited, to the future use by the Agency of its options under the Trust Agreement related to: (a) the repayments and Prepayments on the new Series 40 Program Securities; (b) the application of repayments, Prepayments, and excess revenues related to other Series to the redemption of Series 40 Bonds; and (c) the optional redemption of all or a portion of the Series 40 Bonds on January 1, 2028 from any source.

Set forth in the table captioned "Projected Average Lives (in years)" (the "Table") are projected weighted average lives for the Series 40 PAC Bonds under a number of different scenarios, each such scenario representing a unique combination of assumptions, as described below. Both the Portfolio Assumptions and the Agency Option Assumptions are hypothetical in nature and are provided only to give a general sense of how the weighted average lives for each of the Series 40 PAC Bonds might behave as such assumptions are varied. The actual characteristics and the performance of the Program Obligations (including, without limitation, prepayments thereof) will differ from the Portfolio Assumptions utilized in constructing the Table, and the actual use of options under the Trust Agreement by the Agency will differ from the Agency Option Assumptions utilized in constructing the Table.

Any difference between such Portfolio Assumptions and the actual characteristics and performance of the Program Obligations or between the Agency Option Assumptions and the actual use of such options will cause the actual weighted average lives of the Series 40 PAC Bonds to differ (which difference could be significant) from the projected weighted average lives in the Table. Accordingly, the Agency makes no representation as to the reasonableness of any of such assumptions and makes no representation that the projected average lives set forth in the Table will reflect the actual course of events. The Agency Option Assumptions are not necessarily consistent with the current or historical approach of the Agency to recycling and selecting Bonds to be redeemed, and they are not binding upon or necessarily indicative of future actions of the Agency with respect to the redemption of the Bonds.

All of the scenarios represented in the Table with respect to the Series 40 PAC Bonds are based on the assumptions that the Series 40 Program Securities will consist of approximately \$46.3 million of GNMA Certificates and \$65.4 million of Fannie Mae Certificates each securitizing loans with a weighted average interest rate of approximately 5.450% and a weighted average remaining term of approximately 360 months. Such amounts include GNMA Certificates and Fannie Mae Certificates purchased with amounts transferred to the Series 40 Program Account from the Revenue Reserve Equity Account as described above. In developing the scenarios represented in the table, no principal payments or Prepayments of the approximately \$7.1 million Series 40 DPA Loans are assumed.

Each of the scenarios represented in the Table is based on an indicated prepayment assumption, in each case expressed as a percentage of the PSA Prepayment Model. As used in the Table, for example, (a) "0%"

assumes no prepayments of the principal of the applicable Program Loans, (b) "50%" assumes the principal of the applicable Program Loans will prepay at a rate one-half times as fast as the prepayment rates for one hundred percent (100%) of the PSA Prepayment Model, (c) "200%" assumes the principal of the applicable Program Loans will prepay at a rate twice as fast as the prepayment rates for one hundred percent (100%) of the PSA Prepayment Model, and so on.

The computation of the weighted average life of the Series 40 PAC Bonds under each of the scenarios represented in the Table is based on the assumption that, with respect to the fulfillment by the Agency of its obligations pursuant to the redemption provisions described under "Special Redemption," the Agency will redeem the Series 40 PAC Bonds on each Interest Payment Date commencing on July 1, 2019. In addition, the Table is based on the assumption that the Agency will not redeem the Series 40 Bonds from any other source.

The computation of the weighted average life of the Series 40 PAC Bonds under each of the scenarios represented in the Table is based on one of two sets of indicated assumptions about the exercise of the Optional Redemption provisions under the Trust Agreement:

(a) In the case of scenarios labeled "Optional Call Exercised," it is assumed that the Agency will exercise its right to optionally redeem all Outstanding Series 40 Bonds on January 1, 2028.

(b) In the case of scenarios labeled "Optional Call Not Exercised," it is assumed that the Agency will not exercise its right to optionally redeem the Series 40 Bonds.

Investors owning less than all of the Series 40 PAC Bonds, as applicable, may experience redemption at a rate that varies from the projected weighted average lives shown in the Table.

Series 40 PAC Bonds Projected Average Lives (in years)		
PSA	Optional Call Not Exercised	Optional Call Exercised¹
0	25.6	9.1
25	17.0	7.9
50	10.1	6.8
75	5.9	5.7
100	5.0	5.0
150	5.0	5.0
200	5.0	5.0
300	5.0	5.0
400	5.0	5.0
500	5.0	5.0

¹ Assumes 1/1/2028 Optional Call date.

See the information set forth in "Appendix G — PROJECTED PERCENTAGES OF INITIAL PRINCIPAL BALANCE OUTSTANDING AND PROJECTED WEIGHTED AVERAGE LIVES OF THE SERIES 40 PAC BONDS" attached hereto.

Additional Amounts Deposited to Series 40 Principal/Special Redemption Account. After the amount of Series 40 PAC Bonds required to be redeemed during any period as described above have been called for special redemption in any semiannual period described in Series 40 PAC Bonds above, any additional amounts deposited in the Series 40 Principal/Special Redemption Account during the period may be applied by the Agency to redeem Series 40 Bonds other than the Series 40 PAC Bonds. In such event, the Series 40 Bonds to be so redeemed shall be selected pro rata by maturity (excluding the Series 40 PAC Bonds) among such Series 40 Bonds in proportion to the principal amount of each maturity outstanding, unless the Agency files with the Trustee prior to the date of redemption, a notice of intent to redeem such Series 40 Bonds on other than a pro

rata basis, together with a Cash Flow Certificate indicating the proposed form of redemption and prepared assuming that the Series 40 Bonds to be redeemed are selected in the manner proposed by the Agency.

Excess Revenues. Revenues transferred from the Revenue Reserve Fund pursuant to the Trust Agreement may be applied to the special redemption of the Series 40 Bonds at the option of the Agency. The Series 40 Bonds to be redeemed shall be selected in any manner directed by the Agency, provided that the Series 40 PAC Bonds may not be redeemed from such transfers except as provided in "Special Provisions for the Series 40 PAC Bonds" below.

Excess Debt Service Reserve Funds. Moneys in the Debt Service Reserve Fund in excess of the Debt Service Reserve Requirement may be withdrawn from the Debt Service Reserve Fund, as provided in the Officer's Certificate pursuant to the Trust Agreement and applied to the special redemption of the Series 40 Bonds. The Series 40 Bonds to be redeemed shall be selected in any manner directed by the Agency, provided that the Series 40 PAC Bonds may not be redeemed from such transfers except as provided in "Special Provisions for the Series 40 PAC Bonds" below.

Cross Call Redemption. Non-Series 40 Prepayments may be used to redeem Series 40 Bonds, provided that the Agency will deliver to the Trustee a Cash Flow Certificate with respect thereto. The Series 40 Bonds to be redeemed shall be selected in any manner directed by the Agency, provided that the Series 40 PAC Bonds may not be redeemed from such transfers, except as provided in "Special Provisions for the Series 40 PAC Bonds" below.

Special Provisions for the Series 40 PAC Bonds. Except as described herein, the Series 40 PAC Bonds may not be redeemed from excess Revenues, excess moneys in the Debt Service Reserve Fund or Non-Series 40 Prepayments. The Series 40 PAC Bonds may be redeemed from such sources at any time to the extent necessary to preserve the exclusion of interest on the Series 40 Bonds from the gross income of the owners thereof for purposes of federal income taxation. In addition, if the amount deposited to the Series 40 Principal/Special Redemption Account during any period specified in the table set forth above under "Special Redemption – Series 40 PAC Bonds" is less than the amount required so that the amount of Outstanding Series 40 PAC Bonds at the end of the period will be more than its Target Outstanding PAC Bond Amount, then the Agency may redeem Series 40 PAC Bonds from excess Revenues, excess moneys in the Debt Service Reserve Fund or Non-Series 40 Prepayments in amount sufficient to achieve the Target Outstanding PAC Bond Amount.

Ten Year Rule. As discussed under the heading "FEDERAL TAX REQUIREMENTS – Other Requirements," the Agency is required to apply certain repayments and prepayments on Series 40 Program Obligations funded with proceeds of the Series 40 Bonds to the payment of principal on the Series 40 Bonds. Prepayments and repayments on new Program Securities and Series 40 DPA Loans funded with proceeds of the Series 40 Bonds will become subject to this requirement beginning ten years after the issuance of the Series 40 Bonds.

Redemption Notice for the Series 40 Bonds. At least thirty (30) days but not more than sixty (60) days before the redemption date of any Series 40 Bond, whether such redemption shall be in whole or in part, the Trustee shall cause a notice of any such redemption to be provided to The Depository Trust Company ("DTC"), New York, New York as the Owner of the Series 40 Bonds in accordance with the procedures of DTC for notices of redemption. If there is no securities depository, then notice shall be mailed, postage prepaid, to all Owners of Series 40 Bonds to be redeemed at their addresses as they appear on the registration books maintained by the Trustee, but failure to mail any such notice to one or more Owners or any defect in such notice shall not affect the validity of the proceedings for such redemption with respect to any other Owner. Each such notice shall set forth the CUSIP numbers of the Series 40 Bonds to be redeemed, the interest rate of the Series 40 Bonds to be redeemed, the dated date of the Series 40 Bonds to be redeemed, the date fixed for redemption, the Redemption Price to be paid, the maturities of the Series 40 Bonds to be redeemed, in the case of Series 40 Bonds of any maturity to be redeemed in part only, the portion of the principal amount thereof to be redeemed, the address and phone number of the Trustee, the date of the redemption notice, that on the redemption date the Series 40 Bonds called for redemption will be payable at the principal corporate trust office of the Trustee and that from the redemption date interest will cease to accrue and be payable.

Any notice of redemption at the option of the Agency may state that the redemption to be effected is conditioned upon the receipt by the Trustee on or prior to the redemption date of moneys sufficient to pay the principal of and premium, if any, and interest on the Series 40 Bonds to be redeemed and that if such moneys are not so received such notice shall be of no force or effect and such Series 40 Bond shall not be required to be redeemed. In the event that such notice contains such a condition and moneys sufficient to pay the principal of and premium, if any, and interest on such Series 40 Bonds are not received by the Trustee on or prior to the redemption date, the redemption shall not be made and the Trustee shall within a reasonable time thereafter give notice, in the manner in which the notice of redemption was given, that such moneys were not so received.

So long as DTC or its nominee is the owner of the Series 40 Bonds, the Agency and the Trustee will recognize DTC or its nominee as the registered owner of the Series 40 Bonds for all purposes, including notices and voting. Conveyance of notices and other communications by DTC to Participants and by Participants to beneficial owners will be governed by arrangements among them, subject to any statutory and regulatory requirements as may be in effect from time to time. Any failure on the part of DTC or failure on the part of a nominee of a beneficial owner (having received notice from a Participant or otherwise) to notify the beneficial owner so affected shall not affect the validity of the redemption.

General Provisions as to Purchase or Redemption of Series 40 Bonds

Any Series 40 Bonds or portions of Series 40 Bonds to be purchased or redeemed other than by operation of the Sinking Fund Account shall be purchased or redeemed by the Trustee only upon receipt by the Trustee of an Officer's Certificate determining the following: (a) the Series from which the Series 40 Bonds are to be purchased or redeemed; (b) the maturities within such Series from which the Series 40 Bonds are to be purchased or redeemed; (c) the principal amount of Series 40 Bonds or portion of Series 40 Bonds within such maturities to be purchased or redeemed; and (d) if any of the Series 40 Bonds to be purchased or redeemed are Term Bonds, the years in which Sinking Fund Requirements are to be reduced and the amount by which such Sinking Fund Requirements are to be reduced. Pursuant to the Trust Agreement, the Agency shall not cause Series 40 Bonds to be purchased or redeemed unless, after such purchase or redemption, there shall be no material adverse effect on the ability of the Agency to pay when due the principal of and interest on the Series 40 Bonds then Outstanding. If less than all the Series 40 Bonds of a single maturity shall be redeemed, the Series 40 Bonds shall be redeemed by lot.

So long as DTC or its nominee is the owner of the Series 40 Bonds, if less than all of the Series 40 Bonds of any one maturity shall be called for redemption, the particular Series 40 Bonds or portions of Series 40 Bonds of such maturity to be redeemed shall be selected by DTC and its Participants in such manner as DTC and its Participants may determine. If a Series 40 Bond is of a denomination in excess of \$5,000, portions of the principal amount in the amount of \$5,000 or any whole multiple thereof may be redeemed.

THE AGENCY

Organization and Purposes

The Agency was created in 1973 by the Act as a body politic and corporate and as an instrumentality of the State. It is positioned within the Office of State Budget and Management for financial reporting and budgetary purposes, and it is managed solely by its Board of Directors (the "Board"). The Executive Director is appointed by the Board subject to the approval of the Governor. The Executive Director appoints all other employees subject to an organization chart which is approved by the Board. All employees of the Agency are exempt from the State Personnel Act, but they are considered State employees for certain purposes. They receive the State employee benefits package and participate in the Teachers' and State Employees' Retirement System of North Carolina.

The Agency, like all other State agencies, is required to submit its operating budget to the Office of State Budget and Management. Appropriations, if any, from the North Carolina General Assembly to the Agency are credited to the Agency by the Office of State Budget and Management.

The Agency makes available annual audited financial statements to the Governor, the State Treasurer, the State Auditor, the Finance Committee of the Senate, the Finance Committee of the House of Representatives, the Commission, the Advisory Budget Commission, and the Office of State Budget and Management.

Board of Directors

The Board is constituted with thirteen members. The General Assembly appoints eight directors, four upon the recommendation of the Speaker of the House of Representatives (at least one of whom has had experience with a mortgage-servicing institution and one of whom is experienced as a licensed real estate broker), and four upon the recommendation of the President Pro Tempore of the Senate (at least one of whom is experienced with a savings and loan institution and one of whom is experienced in home building). The Governor appoints four of the directors of the Agency (one of such appointees is required to be experienced in community planning, one in subsidized housing management, one in public housing policy, and one in the manufactured housing industry). The twelve members so selected elect a thirteenth member. The Governor designates a chairman from among the members of the Board. Members of the Board and officers of the Agency continue in office until their successors are appointed.

The current members of the Agency's Board are the following:

<u>Name and Position</u>	<u>Term Expires</u>	<u>Occupation</u>
R. Gene Davis, Jr., Chairman	6/30/2021	Attorney, Raleigh
Patricia G. Garrett, Vice Chair	6/30/2019	Retired Businesswoman, Surf City
Michael P. Ayotte	6/30/2019	President/CEO, Morganton Savings Bank, Morganton
Leigh T. Brown	6/30/2019	Realtor, Broker/Owner, RE/MAX Executive Realty, Concord
Joseph D. Crocker	12/09/2019	Director, Poor & Needy Division, Kate B. Reynolds Charitable Trust, Winston-Salem
Marc Isaacson	6/30/2022	Partner, Isaacson Isaacson Sheridan Fountain & Leftwich, LLP, Greensboro
Paul S. Jaber	6/30/2019	Executive Vice President, First South Bank, Washington, NC
James C. Kearney, Sr.	6/30/2019	Retired Businessman, Mortgage Servicing Representative, Rocky Mount
Paul L. Kennedy	6/30/2019	Retired Sr. Vice President, Carolina Bank, Shallotte
M. Charles Mullen	6/30/2019	President, Mullen & Company, Inc., Rocky Mount
James W. Oglesby	6/30/2019	Owner, Oglesby Insurance, Asheville
Christopher C. Parrish	6/30/2021	Co-Owner, Parrish Manor, Inc., Raleigh

<u>Name and Position</u>	<u>Term Expires</u>	<u>Occupation</u>
Tom E. Smith	6/30/2019	Berkshire Hathaway Homeservices York Simpson Underwood Realty, Raleigh

Agency Staff

The Agency currently employs approximately 124 persons. The following persons have been appointed as the principal staff of the Agency:

<u>Name and Position</u>	<u>Experience</u>
Scott Farmer Executive Director	Executive Director, North Carolina Housing Finance Agency, January 2017 to present, Director of Rental Investment, 2005 to 2016, Manager of Rental Development, 2001-2005, Debt Restructuring Specialist, 1999-2001; REO/Commercial Asset Supervisor, CDSI Mortgage Services, 1998-1999, Commercial Asset Manager, 1996-1998; Problem Loan Specialist, Wendover Funding, 1993-1996; Legal Assistant, W.A. Bason, Attorney at Law, 1990-1993.
Carrie Freeman Chief Financial Officer	Chief Financial Officer, North Carolina Housing Finance Agency, May 2016 to present, Manager of Bond Financing, October 2007 to May 2016; Tax Manager, Visa International Service Association, 2002-2005; Senior Tax Analyst and Tax Manager, The Gap, Inc., 2000-2001; Supervisor-Tax, Senior Business Analyst, Business Analyst, Analyst, Carolina Power & Light, 1996-2000; Senior, Staff, Arthur Andersen LLP, 1992-1996.
Sonia Joyner Director of Homeownership Programs	Director of Home Ownership Programs, North Carolina Housing Finance Agency, February 2018 to present, Manager of Strategic Investment Services, 2015-2018, Team Leader of Strategic Investment Services 2010-2015, Senior Housing Production Officer, 1999-2010, Loan Underwriter 1997-1999.
Kevin Brodie Manager of Finance	Manager of Finance, North Carolina Housing Finance Agency, 2017 to present; Senior Captive Insurance Specialist, North Carolina Department of Insurance, 2014-2017, Senior Regulatory Specialist, 2007-2014; Chief Financial Officer, Upper Room COGIC, 2005-2007, Director of Finance, 2001-2005; Treasury Supervisor, Business Telecom, Inc., 1998-2001; Senior Accountant, Kaiser Foundation Health Plan, Inc., 1994-1997.
Jennifer Percy General Counsel	General Counsel, North Carolina Housing Finance Agency 2012-present; Counsel and Manager of Legal Services, North Carolina Housing Finance Agency 2006-2012; Associate, Nelson Mullins Riley & Scarborough 2006; Attorney, North Carolina Housing Finance Agency 2003-2005.

<u>Name and Position</u>	<u>Experience</u>
Tim Carroll Chief Information Officer	Chief Information Officer, North Carolina Housing Finance Agency, 2014 to present, Manager of Information Technology, 2011-2014, Senior Systems Analyst, 2006-2011; Senior Consultant, Keane, Inc., Durham, NC 1999-2006.

The Agency is located at 3508 Bush Street, Raleigh, North Carolina 27609, its mailing address is P.O. Box 28066, Raleigh, North Carolina 27611-8066, and its telephone number is (919) 877-5700. The Agency's web site is www.nchfa.com. Carrie Freeman is the contact person at the Agency for questions regarding the Agency's bond programs. Her telephone number is 919-877-5680 and her e-mail address is scfreeman@nchfa.com.

THE PROGRAM

General

Under the Trust Agreement, the type of low and moderate income housing financing that will be provided, and the security for the Program Obligations to be financed by a given Series of Bonds is determined and set forth in the Supplemental Trust Agreement authorizing that Series of Bonds entered into by the Agency at the time such Bonds are issued. Program Obligations may involve financing for purposes of, among others, home ownership, home improvement and residential rental housing.

Program Loans under the FirstHome Mortgage Program

Historically, proceeds of Bonds have been used by the Agency to purchase Program Loans originated by Lenders specifically for sale to the Agency for the purpose of providing financing for residential housing for low and moderate income households in North Carolina. The mortgage program financed with the sale of the tax-exempt bond proceeds for the purchase of Program Loans to date is called the FirstHome Mortgage program ("FirstHome"). Under this program, the mortgage loans were purchased as Program Loans and are reflected on the Statement of Net Position as mortgage loans.

Program Securities under the NC Home Advantage Mortgage Program

In 2013, the Agency created a new mortgage loan product called NC Home Advantage Mortgage ("HomeAd"). The mortgage loans are pooled into GNMA and Fannie Mae mortgage-backed securities by the Agency's master servicer, which is currently ServiSolutions. The Agency plans to begin purchasing Freddie Mac mortgage-backed securities when ServiSolutions obtains Freddie Mac approval. HomeAd production is funded using two sources of funds: (1) through the issuance of tax-exempt mortgage revenue bonds and (2) through the sale of MBS to a third party. The bond-funded MBS are reflected on the Agency's Statement of Net Position as investments.

The HomeAd program provides multiple down payment assistance options to borrowers, including no down payment assistance, 3% down payment assistance, 5% down payment assistance, or \$8,000 of down payment assistance across all loan types (FHA, USDA, VA and conventional). Only the \$8,000 down payment assistance option is bond-funded, and this down payment assistance option is called NC 1st Home Advantage Down Payment Assistance. Series 40 proceeds will be used to purchase NC 1st Home Advantage Down Payment Assistance loans ("Series 40 DPA Loans").

The proceeds of the Series 40 Bonds and other funds deposited to the Series 40 Program Account will provide the funds for the purchase of Series 40 Program Securities. Only the proceeds of the Series 40 Bonds will be used to purchase Series 40 DPA Loans. The interest rates, origination fees and terms of the Series 40 Securitized Mortgage Loans underlying the MBS may vary. The Agency anticipates (a) Series 40 Securitized Mortgage Loans consisting of FHA/VA/USDA insured mortgage loans will be financed through the purchase of GNMA Certificates by the Trustee, (b) Series 40 Securitized Mortgage Loans consisting of conventional loans

may also be financed through the purchase of Fannie Mae Certificates by the Trustee and (c) when ServiSolutions obtains Freddie Mac approval, Series 40 Securitized Mortgage Loans consisting of conventional loans will be financed through the purchase of Freddie Mac Certificates by the Trustee. The term of the Series 40 Securitized Mortgage Loans will be 30 years. The Agency expects to evaluate and change interest rates as appropriate in light of rates in the residential mortgage market generally, economic conditions and financial considerations of the Agency, all within the limitations established by federal tax laws and regulations. See "TAX TREATMENT." The Agency has entered into (and anticipates entering into additional) mortgage origination agreements ("Origination Agreements") with qualified mortgage lending institutions (the "Lenders"), pursuant to which the Lenders may originate Series 40 Securitized Mortgage Loans under the Program. Upon closing of the Series 40 Securitized Mortgage Loans, the Lenders will sell approved GNMA Loans, the Fannie Mae Loans and Freddie Mac Loans to ServiSolutions, which ServiSolutions will pool into fully modified GNMA Certificates, Fannie Mae Certificates and Freddie Mac Certificates (Program Securities).

In connection with the origination of Series 40 Securitized Mortgage Loans, the Trustee, on behalf of the Agency, will purchase from ServiSolutions, (i) fully modified GNMA Certificates (as defined herein) backed by Series 40 Securitized Mortgage Loans and guaranteed as to timely payment of principal and interest by GNMA, (ii) Fannie Mae Certificates (as defined herein) backed by Series 40 Securitized Mortgage Loans and guaranteed as to timely payment of principal and interest by Fannie Mae, or (iii) when ServiSolutions obtains Freddie Mac approval, Freddie Mac Certificates (as defined herein) backed by Series 40 Securitized Mortgage Loans and guaranteed as to timely payment of principal and interest by Freddie Mac. The obligations of GNMA are considered general obligations of the United States backed by its full faith and credit. The obligations of Fannie Mae under its guarantees of the Fannie Mae Loans are obligations of Fannie Mae only. The obligations of Freddie Mac under its guarantees of the Freddie Mac Loans are obligations of Freddie Mac only. The Fannie Mae Loans and the Freddie Mac Loans, including the interest thereon, are not guaranteed by the United States or constitute debts or obligations of the United States or any agency or instrumentality of the United States, other than Fannie Mae and Freddie Mac respectively, and Fannie Mae and Freddie Mac respectively are not entitled to the full faith and credit of the United States. See "Appendix E: SUMMARY OF GNMA CERTIFICATE, FANNIE MAE CERTIFICATE AND FREDDIE MAC CERTIFICATE PROGRAM."

Series 40 DPA Loans are not required to be insured or guaranteed pursuant to any federal or private mortgage insurance or guaranty program. Notwithstanding any other provision of the Trust Agreement or the Fortieth Supplemental Trust Agreement, a Series 40 DPA Loan may be secured by a mortgage that is subordinate to the first mortgage on the financed property made in connection with the origination of the related Series 40 Securitized Mortgage Loan, and the mortgage may be further subordinated to other mortgages and liens on the financed property as may be approved by the Agency. Initially, it is the intention of the Agency that no principal on the Series 40 DPA Loans will be due on Series 40 DPA Loans during the first fifteen years of such loan unless (i) the property purchased with such loan is sold during such period, (2) the Series 40 Securitized Mortgage Loan related to the Series 40 DPA Loan is refinanced, or (3) there is a default under the first mortgage loan related to the Series 40 DPA Loan. If the events described in the preceding sentence do not occur as of the applicable date, 20% of the original principal of the Series 40 DPA Loans will be reduced on each of the eleventh, twelfth, thirteenth, fourteenth and fifteenth anniversaries of the origination of the Series 40 DPA Loan.

In addition to the reduction in the principal amount of any Series 40 DPA Loan permitted by the terms thereof, in the event that there is a default under a Series 40 DPA Loan and a subsequent foreclosure under the mortgage securing such Series 40 DPA Loan, and upon such foreclosure the amount received for payment of the Series 40 DPA Loan is less than the principal amount of the Series 40 DPA Loan, the principal amount of the Series 40 DPA Loan shall be further reduced by the deficiency between the principal amount of the Series 40 DPA Loan and the amount available for payment (and no transfer from the Revenue Reserve Fund to the Series 40 Principal/Special Redemption Account pursuant to the Trust Agreement shall be necessary). The Agency may also elect to reduce the principal amount of any Series 40 DPA Loan at any time in connection with the sale of the property securing the Series 40 DPA Loan in the event that the proceeds of the sale are not sufficient to prepay the entire principal amount of the Series 40 DPA Loan following the application of the proceeds of the sale to the payment of any mortgage loan that is senior to the Series 40 DPA Loan and to other costs related to the sale of the property.

The Agency may also waive the requirement that the principal of a Series 40 DPA Loan be paid in connection with the refinancing of the related Series 40 Securitized Mortgage Loan if the Agency concludes that the refinancing will carry out certain of its programmatic objectives. Upon such a waiver, the Series 40 DPA Loan will be made subordinate to the new mortgage loan providing for the refinancing.

In addition, the Agency may waive the requirement that the principal of a Series 40 DPA Loan be paid for any other reason if such waiver of payment is consistent with the program objectives of the Agency.

The Series 40 DPA Loans purchased with the proceeds of the Series 40 Bonds are Program Loans, and therefore Program Obligations, under the Trust Agreement and, as such, are subject to the pledge of the Program Obligations to secure the payment of the Bonds as provided in the Trust Agreement. Any payments on Series 40 DPA Loans (which at present are expected to be derived only from Prepayments of Series 40 DPA Loans as described above shall be deposited to the Series 40 Program Account. In addition, Series 40 Program Securities purchased with amounts not derived from proceeds of the Series 40 Bonds are Program Securities, and therefore Program Obligations, under the Trust Agreement and, as such, are subject to the pledge of the Program Obligations to secure the payment of the Bonds as provided in the Trust Agreement.

ServiSolutions

ServiSolutions is the Master Servicer for the purchase of Series 40 Securitized Mortgage Loans from Mortgage Lenders, the issuance of GNMA Certificates, Fannie Mae Certificates and Freddie Mac Certificates backed by such Series 40 Securitized Mortgage Loans, and, with respect to the GNMA Certificates, Fannie Mae Certificates and Freddie Mac Certificates that will be acquired with Series 40 Bond proceeds, to sell the GNMA Certificates, Fannie Mae Certificates and Freddie Mac Certificates to the Trustee. Once the GNMA Certificates, Fannie Mae Certificates and Freddie Mac Certificates have been issued to the Trustee, ServiSolutions' primary duties involve the collection and distribution to the Trustee of payments received on account of the underlying Series 40 Securitized Mortgage Loans. This includes payments received from GNMA, Fannie Mae and Freddie Mac with respect to defaulted Series 40 Securitized Mortgage Loans. ServiSolutions' ability to purchase and pool Series 40 Securitized Mortgage Loans, and to issue and deliver GNMA Certificates, Fannie Mae Certificates and Freddie Mac Certificates, underlies the Trustee's ability to spend Series 40 Bond proceeds in a timely manner. ServiSolutions and the Agency entered into a contract in August 2017, which limits the purchase of mortgage loans between the date of purchase from the lender to the date of settlement of the security. The contract limits ServiSolutions to \$60 million of purchases but allows the Agency to purchase up to \$40 million of mortgage loans for a total of \$100 million. This amount may be increased pursuant to a mutual agreement between the parties. The mortgage loans temporarily owned by the Agency earn interest for the Agency equal to the mortgage interest rate minus the servicing fee, and these loans are reflected as "Mortgage loans held for resale" on the financial statements.

The Agency is responsible under the Servicing Agreement for reviewing each Series 40 Securitized Mortgage Loan originated by the Mortgage Lenders to determine compliance with the Agency's program requirements. ServiSolutions reviews the Series 40 Securitized Mortgage Loans to determine compliance with GNMA, Fannie Mae and Freddie Mac loan documentation. Upon completion of such review, ServiSolutions is required to acquire approved Series 40 Securitized Mortgage Loans on behalf of the Agency, and complete all required documents and forms incidental to the inclusion of such Series 40 Securitized Mortgage Loans in GNMA, Fannie Mae and Freddie Mac pools.

Experience to Date Under The Program

The Agency has issued over \$2.5 billion of Bonds under the Trust Agreement (excluding Refunding Bonds) for the purposes of the Program. All of the Bonds issued up until the Series 37 Bonds funded a program in which the Agency purchased Program Loans and not Program Securities. A total of thirty-nine Series of Bonds have been issued under the Trust Agreement. In addition to Bonds paid at maturity or redeemed from available funds of the Agency, Series 1 through Series 26 and Series 28 through Series 31 were refunded by the Series 32 through Series 39 Bonds. Upon such refunding, the Program Loans financed by the Bonds that were refunded were transferred to the Program Account for the respective Series of Refunding Bonds.

The following table summarizes as of June 30, 2018 the outstanding Bonds under the Trust Agreement by Series of Bonds:

Bonds Payable (000's)

<u>Series</u>	<u>Date of Issue</u>	<u>Original Principal Amount</u>	<u>Amount Outstanding</u>
27*	06/26/2008	\$65,000	\$2,850
32	11/17/2011	136,160	43,675
33	07/19/2012	121,670	49,520
34	11/21/2013	66,150	26,120
35	05/06/2014	54,335	27,025
36	10/27/2015	66,000	39,445
37	11/17/2016	216,745	190,435
38	06/07/2017	255,560	252,570
39	06/13/2018	<u>150,000</u>	<u>150,000</u>
Total		<u>\$1,131,620</u>	<u>\$781,640</u>

* Redeemed in whole on July 1, 2018.

Through the issuance of the Series 36 Bonds, the Agency purchased Program Loans with bond proceeds. As described above, when a bond issue has been refunded, the Program Loans that were purchased with the Refunding Bonds were transferred to the Program Account created for the Refunding Bonds (although the Program Loans secure all Bonds on a parity basis). The following table summarizes as of June 30, 2018 the Program Loans held under the Trust Agreement and the Series of Bonds with which they are associated. Beginning with the Series 37 Bonds, bond proceeds (other than refunding proceeds) were used to purchase new Program Securities representing new securitized mortgage loans for home ownership. The table summarizes as of June 30, 2018 the Program Obligations held under the Trust Agreement and the Series of Bonds with which they are associated:

Program Obligations (000's)

<u>Series</u>	<u>Principal Balance Program Loans</u>	<u>Principal Balance Program Securities</u>	<u>Principal Balance Program Obligations</u>	<u>Weighted Average Loan Interest Rate</u>
27	\$18,763	-	\$18,763	6.00%
32	56,413	-	56,413	6.47
33	47,860	-	47,860	6.13
34	37,210	-	37,210	5.27
35	33,477	-	33,477	5.36
36	45,194	-	45,194	5.64
37	95,372	119,805	215,177	4.82
38	16,139	223,509	239,648	4.88
39*	<u>20,419</u>	<u>21,249</u>	<u>41,668</u>	<u>5.41</u>
Total	<u>\$370,847</u>	<u>\$364,563</u>	<u>\$735,410</u>	<u>5.21%</u>

*Note - A portion of the Series 39 Bonds refunded the remaining Series 22 Bonds on June 13, 2018. However, the Program Loans associated with Series 22 Bonds were not transferred to the Series 39 Program Account until July 1, 2018. This table reflects these Program Loans as a part of the Series 39 Program Account, even though the transfer did not take place until July 1, 2018.

The Series 40 Program Account and Program Securities

Purchase of Program Securities. Except as hereinafter provided, amounts deposited in the Series 40 Program Account pursuant to the Fortieth Supplemental Trust Agreement (whether derived from proceeds of the Series 40 Bonds, the transfer from the Revenue Reserve Equity Account or earnings from the investment of the Series 40 Program Account) shall be applied to the purchase of Series 40 Program Securities or Series 40 DPA Loans and lender compensation associated with the Series 40 Securitized Mortgage Loans associated with the Program Securities. All Series 40 Program Securities purchased shall comply with the requirements for GNMA Certificates, Fannie Mae Certificates or Freddie Mac Certificates, as the case may be, as set forth in the Fortieth Supplemental Trust Agreement. The Agency shall take such action as shall be necessary to assure that the Agency and its servicers comply with the requirements for GNMA Certificates, Fannie Mae Certificates or Freddie Mac Certificates. The Agency shall identify Series 40 Program Obligations purchased with the proceeds of the Series 40 Bonds separate from Series 40 Program Obligations purchased from other amounts deposited to the Series 40 Program Account and trace the repayments and prepayments of each to the original source of funding.

Purchase of Other Mortgage Backed Program Securities and Program Loans. The Fortieth Supplemental Trust Agreement provides that proceeds of the Series 40 Bonds may be used to purchase Program Securities consisting of mortgage-backed securities issued by Freddie Mac. The Agency intends to utilize proceeds of the Series 40 Bonds for such purpose when ServiSolutions obtains Freddie Mac approval. The Fortieth Supplemental Trust Agreement also provides that the Agency may use the proceeds of the Series 40 Bonds to purchase Program Loans meeting the requirements of the Trust Agreement and the Fortieth Supplemental Trust Agreement, but at present the Agency does not intend to utilize the proceeds of the Series 40 Bonds for such purpose. No amounts deposited to the Series 40 Program Account shall be applied to purchase new Program Loans except Series 40 DPA Loans unless the Agency files with the Trustee a certificate indicating that arrangements are in place for the servicing of the Program Loans so purchased in accordance with the requirements of the Trust Agreement.

The Fortieth Supplemental Trust Agreement provides that amounts deposited to the Series 40 Principal/Special Redemption Account that are not required to be applied to pay principal or mandatory sinking fund redemption of Series 40 Bonds and are not required to be applied to the special redemption of the Series 40 PAC Bonds may be applied for a number of purposes, including to purchase additional Program Obligations. The requirements of the Fortieth Supplemental Trust Agreement for the purchase of Program Securities and Program Loans with the proceeds of the Series 40 Bonds also apply to the purchase of any additional Program Securities and Program Loans from these "recycled" principal payments.

Requirements for Program Securities and Program Loans. Appendix F hereto sets forth a discussion of the additional requirements of the Trust Agreement and the Supplemental Trust Agreements thereunder for Program Securities and also sets forth a discussion of the requirements of the Trust Agreement and Supplemental Trust Agreements thereunder for the Program Loans now held under the Trust Agreement and Program Securities purchased with the proceeds of the Series 40 Bonds (other than Series 40 DPA Loans, which are not required to be insured or guaranteed pursuant to any federal or private mortgage insurance or guaranty program). Appendix F also includes a summary of the major provisions of the insurance or guaranty programs providing additional security for the payment of Program Loans.

AMENDMENT OF TRUST AGREEMENT

As described under "SECURITY FOR AND SOURCES OF PAYMENT OF THE SERIES 40 BONDS," the Fortieth Supplemental Trust Agreement includes certain provisions regarding the handling of scheduled payments and Prepayments on Program Obligations in the Series 40 Program Account, including the creation of the Series 40 Principal/Special Redemption Account. Such provisions only apply to the Series 40 Bonds and only apply so long as no Event of Default has occurred and is continuing under the Trust Agreement.

The Agency intends to amend the Trust Agreement to revise the provisions of the Trust Agreement regarding the handling of scheduled payments and Prepayments on all Program Obligations held under the Trust

Agreement so that the handling will be consistent with the manner created for the Series 40 Bonds. Such amendment will become effective only upon the receipt of the consent of the requisite amount of owners of Bonds issued and Outstanding under the Trust Agreement. BY THEIR PURCHASE AND OWNERSHIP OF THEIR INTEREST IN THE SERIES 40 BONDS, THE BENEFICIAL OWNERS OF INTERESTS IN THE SERIES 40 BONDS CONSENT TO THE AMENDMENT OF THE PROVISIONS OF THE TRUST AGREEMENT REGARDING THE HANDLING OF SCHEDULED PAYMENTS AND PREPAYMENTS OF PROGRAM OBLIGATIONS IN A MANNER CONSISTENT WITH THE TREATMENT ESTABLISHED FOR THE PROGRAM OBLIGATIONS IN THE SERIES 40 PROGRAM ACCOUNT AS DESCRIBED IN THIS OFFICIAL STATEMENT.

FEDERAL TAX REQUIREMENTS

General

The Series 40 Bonds are subject to the requirements of the Internal Revenue Code of 1986, as amended (the "Code") and the regulations thereunder (the "Federal Tax Requirements"). Pursuant to the Federal Tax Requirements, interest on "qualified mortgage bonds" is not includable in gross income for federal income tax purposes. Bonds are "qualified mortgage bonds" if all of the following requirements are met: (i) all proceeds of the issue exclusive of issuance costs and a reasonably required reserve fund are to be used to finance owner-occupied residences, (ii) the mortgages financed with the issue meet certain eligibility requirements, (iii) the yield that is earned by the issuer of the bonds from such mortgages does not exceed specified limitations and certain investment earnings derived from non-mortgage investments are paid to the United States, (iv) certain proceeds of the issue are available for financing housing located in "targeted areas" and (v) the use of proceeds of the bonds does not meet the private business tests of Sections 141(b)(1) and 141(b)(2) of the Code. In addition to the foregoing requirements, qualified mortgage bonds must meet certain other requirements relating to the issue itself.

Failure to meet the above requirements at any time during the term of the Series 40 Bonds could result in interest on the Series 40 Bonds being subject to federal income taxation as of the date of issuance. The Agency, however, has covenanted to comply with all such requirements. In addition, the Federal Tax Requirements provide that certain requirements will be deemed to have been satisfied if certain steps are taken (see "Good Faith Effort" below).

Eligibility Requirements

The new mortgage loans to be financed with the proceeds of the Series 40 Bonds (whether Program Loans, Series 40 Securitized Mortgage Loans or the Series 40 DPA Loans) must meet the following eligibility requirements:

Residence Requirements. All residences for which owner financing is provided with the proceeds of the Series 40 Bonds must be single family residences located within the State, each of which can reasonably be expected to become the principal residence of the mortgagor within 60 days after the financing is provided. Each borrower is required to certify at the closing of the home mortgage loan that he or she intends to make the financed residence his principal residence within 60 days.

Absence of Prior Home Ownership. Except as described below, at least 95% of the proceeds of an issue, exclusive of a reasonably required reserve fund ("net proceeds"), must be used to finance residences of borrowers who have not had a present ownership interest in a principal residence at any time during the three-year period prior to the date on which the mortgage is executed. The Agency requires the borrower to provide his or her federal income tax returns for the preceding three years for review for evidence of prior ownership of a principal residence or to certify that he or she was not required to file federal income tax returns for the preceding three years, and to certify at the closing of the home mortgage loan that he or she has not had a present ownership interest in a principal residence at any time within the preceding three years. The Code creates an exception from this requirement for mortgage loans for residences located in targeted areas as

described below and for mortgage loans and home ownership by veterans (who have not previously received the benefit of mortgage loans as described in this sentence).

Purchase Price Limitations. The Code requires that the "acquisition cost" of each residence being financed may not exceed 90% (or 110% in the case of "targeted areas" as discussed below) of the "average area purchase price" applicable to such residence. The term "acquisition cost" is defined to mean the cost of acquiring a residence as a completed residential unit but does not include (i) usual and reasonable settlement or financing costs, (ii) the value of services performed by the mortgagor or members of his or her family in completing the residence, and (iii) the cost of land which has been owned by the mortgagor for at least two years before the date on which construction of a residence begins. For the purpose of this limitation, the term "average area purchase price" means, with respect to any residence, the average purchase price of single family residences in the Metropolitan Statistical Area ("MSA") or non-MSA county in which the residence is located which were purchased during the most recent twelve-month period for which sufficient statistical information is available. The determination as to whether a residence meets the purchase price requirements must be made as of the date on which the Lender commits to make the Program Loan or, if earlier, the date of purchase of the residence.

First-time homebuyers may purchase new or existing homes at a current sale price limit of \$250,000 and still qualify for the Agency's low-interest rate mortgage program. The current sales price limit is subject to change.

Income Restrictions. The Code requires that all financing provided by an issue of qualified mortgage bonds be provided to mortgagors whose family income is 115% or less of the applicable median family income. With respect to any financing provided for "targeted area" residences, as described below, one third of the amount of such financing may be made to mortgagors who do not satisfy this requirement if the remaining two-thirds of such "targeted area" financing is made to mortgagors whose family income is 140% or less of the applicable median family income. Under the Code, the above percentages for households consisting of less than three persons are reduced to 100% for "non-targeted areas" and 120% for "targeted areas," respectively. For purposes of this income restriction, applicable median family income is the greater of the area median gross income for the area where the residence is located or the statewide median gross income. Each mortgagor is required to provide an affidavit that his or her family income does not exceed the applicable income limit. The applicable income restriction shall be the low or moderate income restriction of the Agency or the applicable median family income restriction of the Federal Tax Requirements, whichever is less.

New Program Loan Requirement. In order to comply with the Federal Tax Requirements, none of the proceeds of a bond issue may be used to acquire or replace existing mortgages (except for construction period loans and temporary financings with a term not to exceed 24 months). The Agency's review procedures are designed to meet these restrictions.

Program Loan Assumption Limitation. To meet the Federal Tax Requirements, each mortgage financed with the proceeds of a bond issue may be assumed only if the residence requirements, absence of prior home ownership, purchase price limitations and the income restrictions are met with respect to the mortgage assumption. The determinations as to compliance with these requirements are to be made as of the date on which the mortgage is being assumed. Accordingly, the Agency must make the required statistical study or otherwise determine (e.g., by reliance on "safe harbor" statistics published by the U.S. Treasury) the relevant average area purchase prices for each statistical area within the State on an annual basis, and must assure compliance with the other applicable Federal Tax Requirements as long as any Series 40 Bonds are outstanding.

Requirements Related to Arbitrage

In addition to the arbitrage requirements that apply to all tax-exempt bonds under Section 148 of the Code, the Agency must satisfy two additional arbitrage requirements. First, certain limitations are imposed upon the yield the Agency may receive from the Program Obligations. The Code and the Treasury regulations thereunder require that all fees, charges and other amounts borne by the mortgagor be taken into account in determining the yield on the Program Obligations. Accordingly, in computing the yield on the Program

Obligations, the Agency takes into account all discount points paid by the seller and origination fees paid by the mortgagor. Since the Lenders are prohibited from charging any other fees and charges in excess of those which would be charged when owner financing is not provided through the use of tax-exempt bonds, the Agency does not have to take such other charges into account in such computation. In addition, the Agency has reserved the right to adjust the yield on the Program Loans should circumstances indicate that such an adjustment is necessary in order to comply with the arbitrage requirements. In addition, the Agency may make a "yield reduction payment" to the federal government that will reduce the yield on the portfolio of Program Obligations allocated to the Series 40 Bonds.

The second principal arbitrage requirement obligates the Agency to pay to the United States government amounts earned on non-mortgage investments in excess of the amounts which would have been earned on such investments if invested at a yield equivalent to the yield on the Series 40 Bonds, plus the earnings on such excess.

Other Requirements

Application of Certain Payments. The Federal Tax Requirements provide that all prepayments and repayments on Series 40 Program Securities and Series 40 DPA Loans financed with proceeds of the Series 40 Bonds that are received more than ten years after the date of issuance of the Series 40 Bonds must be applied to the payment of principal of, or to redeem, Series 40 Bonds no later than the beginning of the second semi-annual period beginning after the date of receipt of such payments.

Targeted Area Requirement. In order to comply with the Federal Tax Requirements, the Agency will, for at least one year after owner financing is first made available with respect to new mortgage loans financed with proceeds of the Series 40 Bonds, make available for mortgage loans in Targeted Areas within the State an amount equal to 20% of the proceeds of the Series 40 Bonds deposited in the Series 40 Program Account. The Agency's efforts to place mortgage financing in Targeted Areas will include the Agency's general advertising that mortgage funds are available for such areas.

Information Reporting Requirement. In addition to the information reporting requirement applicable to all tax-exempt obligations, issuers of qualified mortgage bonds must compile and submit to the Internal Revenue Service (the "Service") for each year in which proceeds of a qualified mortgage bond issue are used to provide mortgages, a report containing information on each mortgagor, including information with respect to the eligibility requirements and other data pertaining to a mortgagor's income.

Recapture of Portion of Federal Subsidy. The Code imposes a recapture provision (the "Recapture Provision"), which requires a payment to the United States from certain mortgagors of an amount determined to be the subsidy provided by a qualified mortgage upon disposition of the residence financed by the Program Loan. The Agency has established procedures to comply with the requirements imposed on it by the Recapture Provision. The Agency has also created a Recapture Tax Reimbursement Program for borrowers who receive first mortgage loans derived from mortgage revenue bond financing. Eligible borrowers will be reimbursed by the Agency for any Recapture Provision payment that they pay to the federal government after they have sold their home. The Agency estimates that its liability will be minimal.

Good Faith Effort

An issue of qualified mortgage bonds that fails to meet the Eligibility Requirements will be treated as meeting all such requirements if:

- (i) the issuer in good faith attempted to meet such requirements before the mortgages were executed;
- (ii) 95% of the net proceeds devoted to owner-financing were devoted to residences with respect to which (at the time the mortgages were executed or assumed) all such requirements were met; and

- (iii) any failure to meet such requirements is corrected within a reasonable period after such failure is first discovered.

Failure to meet one or more of the Eligibility Requirements can be corrected by either calling the non-qualifying mortgage or replacing it with a qualifying mortgage.

In determining whether the 95% requirement referred to in clause (ii) above is satisfied, the Treasury regulations provide that the Agency may rely on affidavits evidencing compliance from the mortgagors and sellers of residences and upon the examination by the Agency or its agents of the income tax returns filed by the mortgagors with the Internal Revenue Service for the preceding three years which indicate no prior home ownership during such period (or statements in the mortgagors affidavits that one or more of such returns were not required to have been filed).

The failure to meet the arbitrage and targeted area requirements will not affect the tax-exempt status of a qualified mortgage bond if:

- (i) the issuer in good faith attempted to meet all such requirements; and
- (ii) any failure to meet such requirements is due to inadvertent error after taking reasonable steps to comply with such requirements.

Exception from Federal Tax Requirements

The Agency is not required to comply with the foregoing requirements with respect to any Series 40 Securitized Mortgage Loan that is included in a Series 40 Program Security that is purchased with funds other than the proceeds of the Series 40 Bonds and investment earnings thereon (such as Program Securities purchased with funds transferred from the Revenue Reserve Equity Account), or any Series 40 Program Loan that is derived from a payment or repayment of a Series 40 Securitized Mortgage Loan or Series 40 Program Loan that was originally funded from such other funds to the extent that failure to comply would not cause interest on the Series 40 Bonds to be includable in the gross income of the owners of the Series 40 Bonds for purposes of federal income taxation.

Agency Procedures

In order to comply with the Federal Tax Requirements, the Agency has established procedures that include an approval process that must be completed before the Agency enters into a conditional commitment to purchase a Program Loan or a Program Security securitizing a mortgage loan, including the examination of affidavits to determine applicant eligibility and Lender compliance, and guidance and assistance to the Lenders.

The Agency will not purchase any Program Loan or a Program Security securitizing a mortgage loan until it has reviewed the documentation to verify compliance with the Federal Tax Requirements. As described above under "THE PROGRAM," the Agency begins its review of the mortgage loan application after the Lender has processed and approved the loan application in accordance with applicable loan underwriting procedures. Once the Lender has completed its processing and has approved the mortgage loan, a submission package, which includes the loan application and the affidavits, is forwarded to the Agency.

The Agency will require that each submission package contain an affidavit from each mortgagor which represents and warrants, among other things (i) that he or she has not had a previous ownership interest in a principal residence within the preceding three years (the Code creates an exception from this requirement for mortgage loans in targeted areas and for mortgage loans and home ownership by veterans who have not previously benefitted by such mortgage loans); (ii) that he or she will occupy the premises as his or her principal residence within 60 days after the mortgage loan is made; (iii) that the residence is a completed residential unit which needs no alteration for normal occupancy; (iv) that no more than 15% of the property will be used for business purposes; and (v) that the statement of family income set forth in the application is true and complete. The Agency will also require each mortgagor to submit for inspection such mortgagor's federal income tax

returns for each of the three years preceding the origination of the mortgage loan or a certificate that the mortgagor was not required to file a federal income tax return during such period to verify the absence of prior home ownership during such period. The Agency will also require that each loan package contain an affidavit from the seller of the residence which evidences compliance with the purchase price limitations.

The Agency has published a Program Guide describing the compliance process each Lender must perform with respect to the Federal Tax Requirements. The Agency regularly holds training classes and has held conversations with mortgage lenders to explain the procedures designed to assure compliance.

Lenders will be required to make representations and warranties that certain Federal Tax Requirements have been met and to repurchase mortgage loans if misstatements or misrepresentations by any party in connection therewith adversely affect the loan's eligibility for purchase under the Federal Tax Requirements.

OTHER AGENCY PROGRAMS

Single Family Programs

In addition to Bonds issued pursuant to the Trust Agreement, the Agency has issued bonds pursuant to separate trust agreements or bond resolutions entered into by the Agency and the Trustee on November 20, 2009 (the "2009 Trust Agreement"), the Single Family Revenue Bond Resolution adopted by the Agency on February 28, 1985 (the "1985 Resolution"), the Single Family Revenue Bond Resolution adopted by the Agency on April 14, 1983 (the "1983 Resolution"), the Home Mortgage Revenue Bond Resolution adopted by the Agency on November 12 1981 (the "1981 Resolution"), the Single Family Housing Bond Resolution adopted by the Agency on April 25, 1980 (the "1980 Resolution"), and the Single Family Mortgage Purchase Bond Resolution adopted by the Agency on July 28, 1976 (the "1976 Resolution") for the purpose of providing moneys to purchase mortgage loans for single family residential housing for households of low and moderate income in the state. All single family bond resolutions and trust agreements have been retired except the Trust Agreement and the 2009 Trust Agreement. As of June 30, 2018, the 2009 Trust Agreement had \$104,705,000 in single family home ownership bonds outstanding.

Multifamily Programs

In addition to its home ownership programs, the Agency has several programs to provide financing for residential rental housing for low and moderate income households. As of June 30, 2018, the Agency had \$4,751,000 in multifamily mortgage loans in the Trust Agreement. These multifamily loans were not financed by Bonds issued under the Trust Agreement, but were deposited to the Trust Agreement following the final payment of the Agency's bonds that financed the purchase of such mortgage loans. The Agency also provides "conduit" financing of residential rental developments from time to time as described below under "Other Activities."

The Agency also administers both the federal and state low-income housing tax credit programs and the rental production program. These funds are available to developers, on a competitive basis, for the development of affordable rental housing in the State. The Agency's goals include supporting the best developments possible given the limited resources available. Therefore, the Agency selects developments serving low-income residents for the longest period of time, at appropriate locations, with strong market demand, with the healthiest financial structures, the best architectural design and the best quality of building materials and workmanship. The Agency has administered this program since its inception in 1987 and has helped create over 2,200 projects comprising over 81,590 rental units, allocating approximately \$459 million of tax credits. The state low-income housing tax credit program expired in January 2015, in spite of the Agency's attempts to extend its sunset provision. The state low-income housing tax credit program was replaced by the Workforce Housing Loan Program ("WHLP") in fiscal year 2015. The WHLP is a state program which provides loans up to \$1 million to fund construction or substantial rehabilitation of affordable rental developments, and it is administered in combination with the federal low-income housing tax credit program. It received a \$20 million appropriation in 2018.

Other Activities

The Agency established a mortgage credit certificate ("MCC") program in July 1987. An MCC permits first-time homebuyers who meet federal limits for family income and acquisition costs to take a federal income tax credit of up to 30% of annual mortgage interest for existing construction homes and up to 50% for newly-constructed homes, up to a maximum credit of \$2,000 per year. As of June 30, 2018, the Agency had issued over 35,200 certificates under the MCC program totaling over \$3.4 billion in mortgages.

In 2010, the Agency became eligible to administer up to \$482.8 million from the United States Department of the Treasury's ("Treasury") Hardest Hit Fund to help prevent home foreclosures for workers who lose their jobs or experience other employment-related hardships. The Agency applied for and received another \$223.7 million of funds from Treasury in May 2016, bringing the total funds to \$706.5 million. Funds are expected to be available through 2020 and to assist over 30,000 homeowners. More details about Treasury's HHF are in the following website: <http://treasury.gov/initiatives/financial-stability/TARP-Programs/housing/hhf/Pages/default.aspx>.

In July 2011 the State Home Foreclosure Prevention Project was transferred to the Agency from the Office of the North Carolina Commissioner of Banks. This effort funds free counseling assistance through many of the same HUD-Approved counseling agencies that are participating in the NC Foreclosure Prevention Fund to homeowners facing foreclosure. No Agency funds are used to operate the program.

Since 1987 the General Assembly of North Carolina has provided appropriations for the North Carolina Housing Trust Fund to produce housing for low-income households by leveraging private, local government, and federal resources. The Agency manages the Trust Fund and pays its operating costs so that all appropriated funds go directly into housing construction and rehabilitation. The annual appropriation for the Trust Fund has varied over its history, from the initial appropriation of \$21 million in 1987 to zero. Appropriations were \$7.66 million for fiscal year 2016, \$7.66 million for fiscal year 2017 and \$7.66 million for fiscal year 2018. In addition, the Agency received a \$20 million appropriation for fiscal 2017 for disaster recovery efforts related to Hurricane Matthew, which had been fully committed in fiscal year 2018. The annual appropriation for the Trust Fund does not affect the Agency's operating budget.

The Agency provides additional financing assistance for some residential rental housing through the issuance of bonds of the Agency, the proceeds of which are loaned to residential rental housing developers to acquire or construct and equip and furnish residential rental housing facilities. These bond issues are "conduit" financings in which the Agency's obligation for payment thereof is limited to the payment received from the third-party borrowers and the properties, revenues and the other security pledged to the payment of the bonds. The bonds are not secured by any funds or other assets that secure the payment of the Bonds issued under the Trust Agreement. As of June 30, 2018, the Agency had \$17,691,000 of conduit financing bonds outstanding.

The Agency may issue additional series of bonds under any of its programs, including the Program, and may adopt other programs under which bonds could be issued. The Agency's ability to issue additional bonds to finance its programs is restricted by federal tax law.

TAX TREATMENT

Opinion of Bond Counsel. Certain federal tax requirements must be met subsequent to the initial issuance and delivery of the Series 40 Bonds in order that interest on such Bonds be excluded, on and after the date of such issuance and delivery, from the gross income of the owners thereof for federal income tax purposes under the Code. The Agency has established procedures in its Program Documents and the Fortieth Supplemental Trust Agreement to meet the Federal Tax Requirements. The Agency has also covenanted in the Fortieth Supplemental Trust Agreement to comply with the requirements of Sections 143 and 148 of the Code. Bond Counsel is of the opinion that the procedures established as of the date hereof in the Agency's Program Documents and the Fortieth Supplemental Trust Agreement are sufficient, if followed, to comply with the Federal Tax Requirements. The Agency has also covenanted, in the Fortieth Supplemental Trust Agreement, to comply with the regulations promulgated with respect to the rebate and other arbitrage requirements under

Sections 143 and 148 of the Code. Failure to comply with such aforementioned covenants or to carry out the procedures set forth in the Program Documents may cause interest on the Series 40 Bonds to become included in gross income for federal income tax purposes retroactive from their date of issue.

In the opinion of Womble Bond Dickinson (US) LLP, Raleigh, North Carolina, as Bond Counsel, assuming that the Agency will carry out the aforementioned procedures set forth in the Program Documents and comply with the aforementioned covenants contained in the Fortieth Supplemental Trust Agreement, interest on the Series 40 Bonds is not includable in the gross income of the owners of the Series 40 Bonds for purposes of federal income taxation.

Bond Counsel is of the opinion that interest on the Series 40 Bonds will not be treated as a preference item for purposes of computing the alternative minimum tax imposed by the Code on certain taxpayers.

Bond Counsel is further of the opinion that interest on the Series 40 Bonds is exempt from all income taxes of the State.

Original Issue Premium. The Series 40 Term Bonds maturing July 1, 2047 (the "Series 40 PAC Bonds") are being sold at initial offering prices which are in excess of the principal amount payable at maturity. The difference between (a) the initial offering prices to the public (excluding bond houses and brokers) at which a substantial amount of the Series 40 PAC Bonds is sold and (b) the principal amount payable at maturity of such Series 40 PAC Bonds constitutes original issue premium, which original issue premium is not deductible for federal income tax purposes. In the case of an owner of a Series 40 PAC Bond, however, the amount of the original issue premium which is treated as having accrued over the term of such Series 40 PAC Bond is reduced from the owner's cost basis of such Series 40 PAC Bond in determining, for federal income tax purposes, the taxable gain or loss upon the sale, redemption or other disposition of such Series 40 PAC Bond (whether upon its sale, redemption or payment at maturity). Owners of Series 40 PAC Bonds should consult their tax advisors with respect to the determination, for federal income tax purposes, of the "adjusted basis" of such Series 40 PAC Bonds upon any sale or disposition and with respect to any state or local tax consequences of owning a Series 40 PAC Bond.

Other Tax Consequences. Ownership or transfer of, or the accrual or receipt of interest on, the Series 40 Bonds may result in collateral federal, State of North Carolina, other state or local tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, taxpayers who may be eligible for the federal earned income tax credit, and taxpayers subject to franchise, estate, inheritance, gift or capital gains taxes. Prospective purchasers of the Series 40 Bonds should consult their tax advisors as to any such possible collateral tax consequences. Except to the extent covered in their legal opinion, Bond Counsel expresses no opinion regarding any such collateral tax consequences.

The Internal Revenue Service has an ongoing program of auditing tax-exempt obligations to determine whether, in the view of the Service, interest on such tax-exempt obligations is includable in the gross income of the owners thereof for federal income tax purposes. No assurances can be given as to whether or not the Service will commence an audit of the Series 40 Bonds.

Interest paid on tax-exempt obligations, such as the Series 40 Bonds, will be subject to information reporting in a manner similar to interest paid on taxable obligations. Although such reporting requirement does not, in and of itself, affect the excludability of interest with respect to the Series 40 Bonds from gross income for federal income tax purposes, such reporting requirement causes the payment of interest with respect to the Series 40 Bonds to be subject to backup withholding if such interest is paid to beneficial owners who (a) are not "exempt recipients" and (b) either fail to provide certain identifying information (such as the beneficial owner's taxpayer identification number) in the required manner or have been identified by the Service as having failed to report all interest and dividends required to be shown on their income tax returns. Generally, individuals are not exempt recipients, whereas corporations and certain other entities generally are exempt recipients. Amounts

withheld under the backup withholding rules from a payment to a beneficial owner would be allowed as a refund or credit against such beneficial owner's federal income tax liability provided the required information is furnished to the Service.

FINANCIAL STATEMENTS

The financial statements of the Agency as of and for the year ended June 30, 2018, included in this Official Statement as Appendix A have been audited by BDO USA, LLP, independent auditors, as stated in their report appearing herein.

RATINGS

Moody's Investors Service, Inc. ("Moody's") and S&P Global Ratings ("S&P") have assigned ratings of Aa1 and "AA+" respectively, to the Series 40 Bonds. Such ratings are not a recommendation to buy, sell or hold securities. Any desired explanation of the significance of such ratings should be obtained from Moody's and S&P, respectively. There is no assurance that a particular rating will remain in effect for any given period of time or that it will not be lowered, suspended or withdrawn entirely if, in the judgment of the rating agency furnishing such rating, circumstances so warrant. Any suspension, downward revision or withdrawal of one or both of such ratings could have an adverse effect on the marketability or the market price of the Series 40 Bonds. The Agency assumes no responsibility to take any actions with regard to possible rating changes.

Due to the ongoing uncertainty regarding the economy of the United States of America (including, without limitation, matters such as the current and future political uncertainty regarding the United States debt limit), obligations, such as the Series 40 Bonds, issued by state and local governments, and instrumentalities thereof, could be subject to a rating downgrade. Additionally, if a significant default or other financial crisis should occur in the affairs of the United States or of any of its agencies or political subdivisions, then such event could also adversely affect the market for and ratings, liquidity, and market value of outstanding debt obligations, including the Series 40 Bonds. When certain automatic spending cuts are imposed on the federal government as a result of actions taken or not taken by the federal government (commonly referred to as a sequester) or when the federal government fails to pass certain spending authorizations prior to certain deadlines, resulting in a cessation of various governmental functions and operations (commonly referred to as a government shutdown), there may not be any immediate direct adverse impact on FHA, VA or the Agency. No assurance can be given, however, that a sequester or a government shutdown that lasts an extended period of time would continue to have no direct adverse impact upon the United States housing industry in general or the Agency in particular.

LITIGATION

At the time of the delivery of and payment for the Series 40 Bonds, the Agency will certify that, to the best of its knowledge, there is no controversy or litigation of any nature at such time pending or threatened to restrain or enjoin the issuance, sale, execution or delivery of the Series 40 Bonds, or in any way contesting or affecting the validity of the Series 40 Bonds or any proceedings of the Agency taken with respect to the issuance or sale thereof or the pledge or application of any moneys or security provided for the payment of the Series 40 Bonds or the existence or powers of the Agency.

CERTAIN LEGAL MATTERS

Legal matters incident to the authorization, issuance and sale of the Series 40 Bonds are subject to the approving opinion of Womble Bond Dickinson (US) LLP, Raleigh, North Carolina, Bond Counsel to the Agency. Copies of the approving opinion of said law firm in substantially the form included herein as Appendix B will be available at the time of delivery of the Series 40 Bonds. Certain legal matters will be passed upon for the Agency by the General Counsel for the Agency and for the Underwriters by their counsel, Bode & Harrell, LLP, Raleigh, North Carolina.

LEGAL INVESTMENT

The Act provides that the Series 40 Bonds shall be securities in which all public officers and public bodies of the State and its political subdivisions, and all North Carolina insurance companies, trust companies, banking associations, investment companies, executors, administrators, trustees and other fiduciaries may properly and legally invest funds, including capital in their control or belonging to them.

UNDERWRITING

RBC Capital Markets, LLC; Merrill Lynch, Pierce, Fenner & Smith Incorporated; Citigroup Global Markets Inc.; Raymond James & Associates, Inc.; and Wells Fargo Bank, National Association (together, the "Underwriters"), have jointly and severally agreed, subject to certain conditions, to purchase all of the Series 40 Bonds at a price equal to the aggregate principal amount of the Series 40 Bonds. The Underwriters will receive from the Agency a fee of \$699,499.38. The initial public offering prices of the Series 40 Bonds may be changed from time to time by the Underwriters.

Citigroup Global Markets Inc., an underwriter of the Series 40 Bonds, has entered into a retail distribution agreement with Fidelity Capital Markets, a division of National Financial Services LLC (together with its affiliates, "Fidelity"). Under this distribution agreement, Citigroup Global Markets Inc. may distribute municipal securities to retail investors at the original issue price through Fidelity. As part of this arrangement, Citigroup Global Markets Inc. will compensate Fidelity for its selling efforts.

Wells Fargo Securities is the trade name for certain securities-related capital markets and investment banking services of Wells Fargo & Company and its subsidiaries, including Wells Fargo Bank, National Association, which conducts its municipal securities sales, trading and underwriting operations through the Wells Fargo Bank, NA Municipal Products Group, a separately identifiable department of Wells Fargo Bank, National Association, registered with the Securities and Exchange Commission as a municipal securities dealer pursuant to Section 15B(a) of the Securities Exchange Act of 1934.

Wells Fargo Bank, National Association, acting through its Municipal Products Group ("WFBNA"), one of the underwriters of the Series 40 Bonds, has entered into an agreement (the "WFA Distribution Agreement") with its affiliate, Wells Fargo Clearing Services, LLC (which uses the trade name "Wells Fargo Advisors") ("WFA"), for the distribution of certain municipal securities offerings, including the Series 40 Bonds. Pursuant to the WFA Distribution Agreement, WFBNA will share a portion of its underwriting or remarketing agent compensation, as applicable, with respect to the Series 40 Bonds with WFA. WFBNA also entered into an agreement (the "WFSLLC Distribution Agreement") with its affiliate Wells Fargo Securities, LLC ("WFSLLC"), for the distribution of municipal securities offerings, including the Series 40 Bonds. Pursuant to the WFSLLC Distribution Agreement, WFBNA pays a portion of WFSLLC's expenses based on its municipal securities transactions. WFBNA, WFSLLC, and WFA are each wholly-owned subsidiaries of Wells Fargo & Company.

The Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include sales and trading, commercial and investment banking, advisory, investment management, investment research, principal investment, hedging, market making, brokerage and other financial and non-financial activities and services. In the various course of their various business activities, the underwriters and their respective affiliates, officers, directors and employees may purchase, sell or hold a broad array of investments and actively trade securities, derivatives, loans, commodities, currencies, credit default swaps and other financial instruments for their own account and for the accounts of their customers, and such investment and trading activities may involve or relate to assets, securities and/or instruments of the Agency (directly, as collateral securing other obligations or otherwise) and/or persons and entities with relationships with the Agency. The underwriters and their respective affiliates may also communicate independent investment recommendations, market color or trading ideas and/or publish or express independent research views in respect of such assets, securities or instruments and may at any time hold, or recommend to clients that they should acquire, long and/or short positions in such assets, securities and instruments.

QUANTITATIVE CONSULTANT

cfX Incorporated, New York, New York, has served as quantitative consultant (the "Quantitative Consultant") to the Agency with respect to the Series 40 Bonds and, in such capacity, has provided the Agency with cash flow projections and other quantitative analyses reflecting the structure of the Series 40 Bonds.

The Quantitative Consultant will not engage in any underwriting activities with regard to the issuance and sale of the Series 40 Bonds. The Quantitative Consultant is not obligated to undertake and has not undertaken to make an independent verification or to assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement and is not obligated to review or ensure compliance with continuing disclosure undertakings. cfX Incorporated has registered with the Securities and Exchange Commission and the Municipal Securities Rulemaking Board as a Municipal Advisor.

CONTINUING DISCLOSURE

Pursuant to the Fortieth Supplemental Trust Agreement, the Agency hereby undertakes, for the benefit of the beneficial owners of the Series 40 Bonds, to provide to the Municipal Securities Rulemaking Board ("MSRB"):

- (a) by not later than seven months from the end of each fiscal year of the Agency, audited financial statements of the Agency prepared in accordance with Section 159-34 of the General Statutes of North Carolina, as it may be amended from time to time, or any successor statute, or, if such audited financial statements of the Agency are not available by seven months from the end of such fiscal year, unaudited financial statements of the Agency to be replaced subsequently by audited financial statements of the Agency to be delivered within fifteen (15) days after such audited financial statements become available for distribution;
- (b) concurrently with the delivery of the audited financial statements referred to in (a) above, the most recent financial and statistical data available to the Agency as of a date not earlier than the end of the preceding fiscal year, regarding Bonds payable, Program Obligations held under the Trust Agreement and Agency experience with Program Obligation delinquencies and Program Obligations in foreclosure, under the Trust Agreement, to the extent such items are not included in the audited financial statements referred to in (a) above;
- (c) in a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the following events with respect to the Series 40 Bonds:
 - (1) principal and interest payment delinquencies;
 - (2) non-payment related defaults, if material;
 - (3) unscheduled draws on debt service reserves reflecting financial difficulties;
 - (4) unscheduled draws on any credit enhancements reflecting financial difficulties;
 - (5) substitution of any credit or liquidity providers, or their failure to perform;
 - (6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security;
 - (7) modification to the rights of the beneficial owners of the Series 40 Bonds;

- (8) bond calls, other than calls for mandatory sinking fund redemption, if material, and tender offers;
 - (9) defeasance of any of the Series 40 Bonds;
 - (10) release, substitution or sale of any property securing repayment of the Series 40 Bonds, if material;
 - (11) rating changes;
 - (12) bankruptcy, insolvency, receivership or similar event of the Agency;
 - (13) the consummation of a merger, consolidation or acquisition involving the Agency or the sale of all or substantially all of the assets of the Agency, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;
 - (14) appointment of a trustee or a successor or additional trustee or the change of name of a trustee, if material; and
- (d) in a timely manner, notice of a failure of the Agency to provide required annual financial information described in (a) or (b) above on or before the date specified.

The Agency shall provide the documents referred to above to the MSRB in an electronic format as prescribed by the MSRB and accompanied by identifying information as prescribed by the MSRB.

The Agency may discharge its undertaking described above by transmitting the documents referred to above to any entity and by any method authorized by the U.S. Securities and Exchange Commission.

The Agency reserves the right to modify from time to time the information to be provided to the extent necessary or appropriate in the judgment of the Agency, provided that:

- (a) any such modification may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Agency;
- (b) the information to be provided, as modified, would have complied with the requirements of Rule 15c2-12 as of the date of the Official Statement, after taking into account any amendments or interpretations of Rule 15c2-12, as well as any changes in circumstances; and
- (c) any such modification does not materially impair the interests of the beneficial owners of the Series 40 Bonds, as determined by the Trustee or bond counsel to the Agency, or by approving vote of the Owners of a majority in principal amount of the Series 40 Bonds pursuant to the terms of the Trust Agreement at the time of the amendment.

In the event that the Agency makes such a modification, the annual financial information containing the modified operating data or financial information shall explain, in narrative form, the reasons for the modification and the impact of the change in the type of operating data or financial information being provided.

The continuing disclosure provisions of the Fortieth Supplemental Trust Agreement shall terminate upon payment, or provision having been made for payment in a manner consistent with Rule 15c2-12, in full of the principal and interest with respect to all of the Series 40 Bonds.

In the event of a failure of the Agency to comply with any provision of the covenant set forth above, the Trustee may (and, at the request of the owners of at least 25% aggregate principal amount of Outstanding Series

40 Bonds, shall), or any beneficial owner of the Series 40 Bonds may, take such actions as may be necessary and appropriate, including seeking mandamus or specific performance by court order, to cause the Agency to comply with the continuing disclosure provisions of the Fortieth Supplemental Trust Agreement. However, a default with respect to the continuing disclosure provisions of the Fortieth Supplemental Trust Agreement shall not be deemed an Event of Default under the Trust Agreement, and the remedy in the event of any failure of the Agency to comply with the continuing disclosure provisions of the Fortieth Supplemental Trust Agreement shall be the actions referred to above.

The Agency has not failed in any material respect to file any information required to be provided by any undertaking previously made by the Agency pursuant to the requirements of the Rule in the last five years.

MISCELLANEOUS

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the Agency and the purchasers or holders of any of the Series 40 Bonds.

NORTH CAROLINA HOUSING FINANCE AGENCY

By: /s/ S. Carrie Freeman
Chief Financial Officer

The interest rates, maturities, sale price and manner of sale of the Series 40 Bonds have been determined, with the approval of the North Carolina Housing Finance Agency and the Local Government Commission of the State of North Carolina.

By: /s/ Greg C. Gaskins
Secretary of the Local Government Commission
of North Carolina

Dated: November 1, 2018

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APPENDIX A

FINANCIAL STATEMENTS

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NORTH CAROLINA HOUSING FINANCE AGENCY

Financial Statements
Year Ended June 30, 2018

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Audited Financial Statements

June 30, 2018



**NORTH CAROLINA HOUSING FINANCE AGENCY
FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2018**

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MANAGEMENT DISCUSSION AND ANALYSIS (Unaudited)

June 30, 2018

The management discussion and analysis of the North Carolina Housing Finance Agency's financial performance provides an overview of its financial activities for the fiscal year ended June 30, 2018. The financial statements, accompanying notes, and supplementary information should be read in conjunction with the following discussion.

Overview

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

Financial Highlights

The following information is an analysis of the Agency's performance for the year ended June 30, 2018, compared to prior fiscal year's results and activities:

- *Total Assets* increased \$23,008,000, or 1.4%
- *Deferred Outflows of Resources* decreased \$344,000, or 5.8%
- *Total Liabilities* decreased \$8,245,000, or 0.8%
- *Deferred Inflows of Resources* increased \$4,684,000, or 105.5%
- *Total Net Position* increased \$26,225,000, or 3.6%

The Agency issued tax-exempt bonds in June 2017 and June 2018 to finance a portion of its NC Home Advantage (HomeAd) mortgage loans, which were securitized into MBS. These transactions caused an increase in *Investments* and *Bonds payable, net* as well as other related accounts. However, monthly bond calls using prepayments from the HomeAd program and FirstHome program resulted in a more modest increase in *Bonds payable, net* relative to the increase in *Investments*. These transactions are primarily responsible for the increases in the accounts below:

- *Investments* increased \$155,574,000, or 52.1%
- *Accrued interest receivable on investments* increased \$767,000, or 53.9%
- *Bonds payable, net* increased \$20,062,000, or 2.3%
- *Accrued interest payable* increased \$1,031,000, or 9.2%
- *Interest on investments* increased \$14,444,000, or 180.0%
- *Interest on bonds* increased \$879,000, or 3.4%

Although *Investments* increased substantially from prior year, the increase in overall interest rates during the year caused a decrease in *Net (decrease) increase in fair value of investments* of \$5,708,000, or 105.4%. The higher interest rates and a reduction in the notional amount of the swaps caused a decrease in both *Accumulated decrease in fair value of hedging derivative* and *Derivative instrument – interest rate swap* of \$975,000, or 36.5%.

The Agency has an arrangement with its master servicer to temporarily purchase a portion of its HomeAd mortgage loans if mortgage loans purchased by its master servicer exceed \$60 million. Because the volume of

purchases remained below \$60 million, there is no balance in *Mortgage loans held for resale* at June 30, 2018, representing a decrease of \$23,341,000, or 100%. *Accounts payable* decreased \$1,453,000, or 29.9% primarily due to changes in the amount of cash deposited in the clearing account with the Agency's trustee.

HomeAd production is funded with tax-exempt bonds and through the sale of MBS on the secondary market. The HomeAd loans associated with the Agency's HHF Down Payment Assistance (HHF DPA) program and the new 1st Home Advantage Down Payment Assistance (1st Home DPA) were primarily bond funded, causing a reduction in HomeAd production funded through sales on the secondary market. Because the HHF DPA was funded by the North Carolina Foreclosure Prevention Fund (NCFPF), which is a federal program, it caused a decrease in DPA loans funded with nonfederal funds. This resulted in overall decreases in *Program income/fees* of \$5,387,000, or 7.3%, and *Nonfederal program expense* of \$7,590,000, or 29.5%.

Tax-exempt mortgage revenue bonds became economically challenging to issue in the Great Recession; therefore, the Agency shifted from its historical FirstHome program to the HomeAd program in 2013, financing production through the sale of MBS. As a result, the portfolio of loans in the FirstHome program continues to decline from prepayments, resulting in decreases in *Mortgage loans receivable, net* and related accounts listed below:

- *Mortgage loans receivable, net* decreased \$89,557,000, or 12.6%
- *Accrued interest receivable on mortgage loans* decreased \$865,000, or 18.1%
- *Interest on mortgage loans* decreased \$5,582,000, or 15.0%
- *Mortgage servicing expense* decreased \$338,000, or 15.8%

Other liabilities decreased \$2,040,000, or 27.1% due to the use of insurance proceeds from an insurance claim related to Hurricane Matthew damage.

Unearned revenues decreased \$38,886,000, or 53.8%, primarily because disbursements for the NCFPF exceeded draws from the HHF. Despite this, *Federal program awards received* and *Federal program expense* decreased primarily due to slowing NCFPF production as it begins to wind down. In addition, *Federal program awards received* and *Federal program expense* decreased because of the wind down of the National Foreclosure Mitigation Counseling program. HOME program income was used instead of HOME entitlement. As a result, *Federal program expense* decreased less than *Federal program awards received*, as shown below:

- *Federal program awards received* decreased \$15,735,000, or 6.2%
- *Federal program expense* decreased \$5,149,000, or 2.0%

State appropriations received decreased \$36,051,000, or 71.2%, and *State grants received* increased \$18,332,000, or 138.9%, primarily because of the funding source for the Workforce Housing Loan Program (WHLP). In fiscal year 2017, WHLP was funded with a \$20 million appropriation. In fiscal year 2018, it was funded with a \$3.9 million appropriation and a \$16.1 million State settlement with Moody's Corporation, Moody's Investor's Service, Inc., and Moody's Analytics, Inc. (Moody's settlement) to resolve allegations regarding their business practices. The Moody's settlement is reported as *State grants received*. The wind down of the State Tax Credit (STC) program caused a \$36.7 million decrease to *State program expense*, which was offset by an increase in program expenditures related to Community Living Housing Fund (CLHF), WHLP, Key Rental Assistance (Key), and other programs. These factors netted to an overall decrease in *State program expense* of \$25,486,000, or 36.6%.

In fiscal year 2018, the Agency implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* (GASB 75). GASB 75 requires the Agency to record its proportionate share of the State's net postemployment benefits, deferred outflows of resources, deferred inflows of resources, and other postemployment benefits (OPEB) expense. The cumulative effect of the change related to GASB 75 was a decrease to beginning fiscal year 2018 *Net Position* of \$17,702,000. As a result of the GASB 75 adjustment, *Unrestricted net position* decreased by \$16,628,000, or 103.1%, resulting in a negative *Unrestricted net position* of \$502,000 as of June 30, 2018. Included in *General and administrative expense* is a \$902,000 OPEB expense related to GASB 75, which was more than offset by decreases in miscellaneous contractor services and other various operating expenses of the Agency. The effect of these transactions is summarized as follows:

- *Deferred outflows for pensions* decreased \$778,000, or 24.0%
- *Deferred outflows for other postemployment benefits* increased \$1,409,000, or 100%
- *Pension liability* decreased \$451,000, or 9.8%
- *Other postemployment benefits* increased \$14,467,000, or 100%
- *Deferred inflows for pensions* decreased \$82,000, or 37.6%
- *Deferred inflows for other postemployment benefits* increased \$5,026,000, or 100%
- *General and administrative expense* decreased \$2,086,000, or 7.1%

The net effect of the transactions detailed above, along with regular operations of the Agency, resulted in an increase in *Total Net Position* of \$26,225,000, or 3.6%. The primary drivers of the increase include new HomeAid production offset by decreases in the FirstHome portfolio, the initial phase of the NCFPF wind down, the impacts of the sunset STC program, and the accounting change related to GASB 75. The Agency continues to proactively manage its programs to further its mission of creating affordable housing for North Carolinians with low and moderate incomes.

Financial Analysis

The following tables summarize the changes in net position between June 30, 2018 and June 30, 2017 (*in thousands*):

	<u>2018</u>	<u>2017</u>	<u>Change</u>	<u>%</u>
<u>Condensed Statement of Net Position</u>				
Assets*				
Cash and cash equivalents	\$ 635,725	\$ 654,099	\$ (18,374)	(2.8)
Investments	454,446	298,872	155,574	52.1
Accrued interest receivable on investments	2,190	1,423	767	53.9
Mortgage loans receivable, net	619,934	709,491	(89,557)	(12.6)
Mortgage loans held for resale	-	23,341	(23,341)	(100.0)
Accrued interest receivable on mortgage loans	3,910	4,775	(865)	(18.1)
State receivables	-	131	(131)	(100.0)
Other assets, net	9,952	11,017	(1,065)	(9.7)
Total Assets	\$ 1,726,157	\$ 1,703,149	\$ 23,008	1.4
Deferred Outflows of Resources				
Deferred outflows for pensions	\$ 2,462	\$ 3,240	\$ (778)	(24.0)
Deferred outflows for other postemployment benefits	1,409	-	1,409	100.0
Accumulated decrease in fair value of hedging derivative	1,698	2,673	(975)	(36.5)
Total Deferred Outflows of Resources	\$ 5,569	\$ 5,913	\$ (344)	(5.8)
Liabilities*				
Bonds payable, net	\$ 900,410	\$ 880,348	\$ 20,062	2.3
Accrued interest payable	12,214	11,183	1,031	9.2
Accounts payable	3,413	4,866	(1,453)	(29.9)
Derivative instrument – interest rate swap	1,698	2,673	(975)	(36.5)
Unearned revenues	33,366	72,252	(38,886)	(53.8)
Pension liability	4,155	4,606	(451)	(9.8)
Other postemployment benefits	14,467	-	14,467	100.0
Other liabilities	5,495	7,535	(2,040)	(27.1)
Total Liabilities	\$ 975,218	\$ 983,463	\$ (8,245)	(0.8)
Deferred Inflows of Resources				
Deferred state grant	\$ 3,961	\$ 4,221	\$ (260)	(6.2)
Deferred inflows for pensions	136	218	(82)	(37.6)
Deferred inflows for other postemployment benefits	5,026	-	5,026	100.0
Total Deferred Inflows of Resources	\$ 9,123	\$ 4,439	\$ 4,684	105.5

	<u>2018</u>	<u>2017</u>	<u>Change</u>	<u>%</u>
Condensed Statement of Net Position (Continued)				
Net Position				
Net investment in capital assets	\$ 3,367	\$ 3,174	\$ 193	6.1
Restricted net position	744,520	701,860	42,660	6.1
Unrestricted net position	(502)	16,126	(16,628)	(103.1)
Total Net Position	<u>\$ 747,385</u>	<u>\$ 721,160</u>	<u>\$ 26,225</u>	<u>3.6</u>

Condensed Statement of Revenues, Expenses and Changes in Net Position

Operating Revenues				
Interest on investments	\$ 22,468	\$ 8,024	\$ 14,444	180.0
Net (decrease) increase in fair value of investments	(291)	5,417	(5,708)	(105.4)
Interest on mortgage loans	31,755	37,337	(5,582)	(15.0)
Federal program awards received	239,872	255,607	(15,735)	(6.2)
Program income/fees	68,488	73,875	(5,387)	(7.3)
Other revenues	944	1,021	(77)	(7.5)
Total Operating Revenues	<u>\$ 363,236</u>	<u>\$ 381,281</u>	<u>\$ (18,045)</u>	<u>(4.7)</u>
Operating Expenses				
Interest on bonds	\$ 27,042	\$ 26,163	\$ 879	3.4
Mortgage servicing expense	1,803	2,141	(338)	(15.8)
Federal program expense	246,260	251,409	(5,149)	(2.0)
Nonfederal program expense	18,179	25,769	(7,590)	(29.5)
General and administrative expense	27,111	29,197	(2,086)	(7.1)
Other expenses	992	1,839	(847)	(46.1)
Total Operating Expenses	<u>\$ 321,387</u>	<u>\$ 336,518</u>	<u>\$ (15,131)</u>	<u>(4.5)</u>
Operating Income	<u>\$ 41,849</u>	<u>\$ 44,763</u>	<u>\$ (2,914)</u>	<u>(6.5)</u>
Non-Operating Revenues (Expenses)				
State appropriations received	\$ 14,609	\$ 50,660	\$ (36,051)	(71.2)
State grants received	31,527	13,195	18,332	138.9
State program expense	(44,058)	(69,544)	25,486	(36.6)
Total Non-Operating Revenues (Expenses)	<u>\$ 2,078</u>	<u>\$ (5,689)</u>	<u>\$ 7,767</u>	<u>(136.5)</u>
Change in Net Position	<u>\$ 43,927</u>	<u>\$ 39,074</u>	<u>\$ 4,853</u>	<u>12.4</u>
Total net position - beginning (as previously reported)	\$ 721,160	\$ 682,086	\$ 39,074	5.7
Cumulative effect of change in accounting principle**	(17,702)	-	(17,702)	100.0
Total Net Position - Beginning	<u>\$ 703,458</u>	<u>\$ 682,086</u>	<u>\$ 21,372</u>	<u>3.1</u>
Total Net Position - Ending	<u>\$ 747,385</u>	<u>\$ 721,160</u>	<u>\$ 26,225</u>	<u>3.6</u>

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

** For fiscal year 2018, the Agency implemented GASB 75, which resulted in a decrease to the beginning fiscal year 2018 *Net Position* of \$17,702,000. The fiscal year 2017 financial information presented above has not been restated to reflect the cumulative effect of this change. See additional discussion in Financial Highlights and the Notes to the Financial Statements.

New Business

The Agency's production remained strong in fiscal year 2018, with funding remaining steady and multiple financing options for programs providing flexibility to the Agency and its borrowers. These items are discussed in more detail below.

Appropriations, Awards and Legislation

For fiscal year 2018, the Agency received the following appropriations and awards from the federal government, the North Carolina General Assembly, and other State departments, which are discussed in more detail below:

Federal:

\$	159.8 million	Section 8 (Project-Based and Traditional Contract Administration)
\$	12.4 million	HOME Investment Partnerships Program
\$	4.4 million	National Housing Trust Fund

North Carolina:

\$	20.0 million	Workforce Housing Loan Program*
\$	7.7 million	Housing Trust Fund*
\$	4.2 million	Community Living Housing Fund*
\$	5.8 million	Transitions to Community Living Voucher
\$	5.5 million	Key Rental Assistance
\$	3.0 million	HOME Match

* Appropriations from the Housing Trust Fund

The Agency received \$159.8 million in fiscal year 2018 to administer the Section 8 programs, which represents an increase of \$5.6 million from the prior year.

The \$12.4 million HOME award provided by the US Department of Housing and Urban Development (HUD) was consistent with amounts received in the prior fiscal year.

The \$4.4 million National Housing Trust Fund (NHTF) award provided by HUD was \$1.1 million greater than the prior fiscal year. Although NHTF was established in the Housing and Economic Recovery Act of 2008, the award received in fiscal year 2017 was the first time the Agency received the award.

The Agency received \$20 million in nonrecurring funds for WHLP in fiscal year 2018, consistent with the prior year. The fiscal year 2018 amount was comprised of a \$3.9 million WHLP appropriation and a \$16.1 million Moody's settlement which the State allocated to the program.

The Agency received a recurring \$7.7 million appropriation for the HTF in fiscal year 2018, consistent with the prior year. In fiscal year 2017, the Agency received a nonrecurring \$20 million appropriation related to the Disaster Recovery Act of 2016. The funds for disaster recovery efforts received in fiscal year 2017 were fully committed in fiscal year 2018.

The Agency received \$4.2 million in fiscal year 2017 for CLHF, which was appropriated and available for use in fiscal year 2018. This appropriation is \$1.3 million less than last year's CLHF appropriation.

The NC Department of Health and Human Services (DHHS) provides funding to the Agency to administer several DHHS programs, including the Transitions to Community Living Voucher (TCLV) program and the Key program. In fiscal year 2017, the Agency received \$5.8 million for TCLV, which was appropriated and available for use in fiscal year 2018, a \$3.6 million increase from the prior fiscal year. The Key program funding of \$5.5 million was consistent with prior year funding.

The HOME Match is funding received from the State to supplement the federal funding received from the HOME program. The HOME Match appropriation of \$3 million is the same level as the prior fiscal year.

The Federal Tax Cuts and Jobs Act (Tax Act) was signed into law on December 22, 2017. Initial drafts of the bill proposed to eliminate the issuance of tax-exempt private activity bonds (PABs), including multifamily and

single-family housing bonds, after December 31, 2017. The proposals also would have eliminated the Agency's Mortgage Credit Certificate (MCC) program and the 4% LIHTC. The Tax Act ultimately retained the issuance of tax-exempt PABs, allowing the Agency to continue this funding source and its MCC program. The tax rate reduction in the Tax Act decreased the value of the low-income housing tax credits; however, the Agency continued to have strong demand for its LIHTC program in fiscal year 2018.

New Activities

The Agency developed the 1st Home DPA for its HomeAd program in response to the wind down of the HHF DPA program in fiscal year 2018. Rolled out in March 2018, the 1st Home DPA offers \$8,000 in down payment assistance for a 15-year term at 0% interest. The loan is forgiven at the end of years 11 through 15 at a rate of 20% per year—the same terms as the Agency's existing 3% and 5% HomeAd DPA programs. The 3% and 5% HomeAd DPA serves any borrowers eligible for the HomeAd program, whereas the 1st Home DPA is limited to first-time home buyers, veterans or borrowers located in a targeted area within certain income and sales price limits. Unlike the HHF DPA, which was only available in five counties, the 1st Home DPA is available statewide to qualifying borrowers. The Agency issued Series 39 tax-exempt bonds in June 2018 to finance the 1st Home DPA and its related HomeAd first mortgages, which is discussed in more detail in the "Debt Administration" section.

In 2012, the State entered into a voluntary settlement agreement with the US Department of Justice (known as the Olmstead Settlement) for housing people with mental illness. In response to the settlement, DHHS created the Transitions to Community Living Initiative (TCLI) to ensure that people with certain disabilities can receive the necessary services and support to successfully live in the communities of their choice. In addition to the existing programs the Agency administers on behalf of DHHS for TCLI, the Agency created the Integrated Supportive Housing Program (ISHP) in collaboration with DHHS in fiscal year 2018. ISHP will finance up to \$13.5 million of integrated permanent supportive housing and is designed to allow innovation and flexibility to meet local needs as identified by Local Management Entities/Managed Care Organizations (LME/MCOs) in partnership with local housing developers. The funding for ISHP is provided by CLHF funding through the HTF.

The Agency's Board of Directors approved \$100,000 for the Landlord Incentive Pilot Program, a risk mitigation and incentive toolkit to assist local organizations in the recruitment and retention of landlords to provide housing for homeless veterans. This program was developed as a part of the Agency's participation with the Governor's Working Group on Veterans and the Operation Home Task Force focused on veterans housing issues. The NC Coalition to End Homelessness (NCCEH) serves as the administrator of the program. The Agency reimburses costs to landlords after submission and approval of the costs by NCCEH.

Debt Administration

The Agency issued tax-exempt bonds in fiscal year 2018 to finance a portion of HomeAd production and to refund an existing bond series. The Series 39 tax-exempt bond issuance closed in June 2018 for a total of \$150,000,000 par plus a premium of \$2,785,000. Most of the proceeds will be used to finance HomeAd production, but \$13,085,000 was used to refund Series 22CE in June 2018. The proceeds used for new production finances both the first mortgage and the Agency's new 1st Home DPA, which rolled out in March 2018. The 1st Home DPA provides \$8,000 in down payment assistance in the form of a 0% interest, subordinated mortgage loan that accompanies a HomeAd loan, discussed in more detail in the "New Business" section.

The Agency has three swaps with two counterparties, Bank of America and Goldman Sachs Mitsui Marine, discussed in detail in Note E, "Derivative Instrument – Interest Rate Swap." Only one of the three swaps has a remaining optional cancellation provision. This provision benefits the Agency as it allows cancellations with no associated termination fee. The counterparty for this swap is Bank of America, and the Agency exercised its optional cancellation for \$280,000 on July 1, 2017 and \$270,000 on January 1, 2018.

The Agency had monthly bond calls and biannual debt service payments in fiscal year 2018 which totaled \$131,725,000. The bond calls included prepayment calls and debt service reserve calls.

The Agency issued conduit multifamily mortgage revenue bonds of \$17,691,000 in March 2018 for the acquisition and rehabilitation of ten existing multifamily properties in nine counties serving families and the elderly. These bonds are not a debt of the Agency and are secured by the related properties. After the projects are placed in

service and the rehabilitation is complete, the bonds will be paid off with the proceeds of a US Department of Agriculture Rural Development (USDA) Section 538 loan. This issuance represents the only outstanding multifamily mortgage revenue bonds as two other issuances were redeemed within this fiscal year.

Programs and Activities

For the year ended June 30, 2018, the Agency recorded expenditures of \$275,702,000 in federal funds for the following programs:

- Carryover Loan Program (COLP)
- Community Partners Loan Pool (CPLP)
- Essential Single-Family Rehabilitation Loan Pool (ESFRLP)
- Hardest Hit Fund Down Payment Assistance (HHF DPA)
- Mortgage Payment Program (MPP)
- National Foreclosure Mitigation Counseling (NFMC)
- Principal Reduction Recast/Lien Extinguishment for Unaffordable Mortgages Program (PRRLE)
- Rental Production Program (RPP)
- Second Mortgage Refinance Program (SMRP)
- Section 8 Project-Based Contract Administration (Section 8 PBCA)
- Section 8 Traditional Contract Administration (Section 8 TCA)
- Self-Help Loan Pool (SHLP)
- Supportive Housing Development Program (SHDP)

For the year ended June 30, 2018, the Agency recorded expenditures of \$46,646,000 in State funds for the following programs:

- Displacement Prevention Partnership (DPP)
- Essential Single-Family Rehabilitation Loan Pool – Disaster Recovery (ESFRLP-DR)
- Housing Counseling Capacity Building Program (HCCBP)
- Housing Placement Services (HPS)
- Housing Services (HS)
- Key Rental Assistance (Key)
- Rental Production Program (RPP)
- Self-Help Loan Pool (SHLP)
- State Tax Credit (STC)
- Supportive Housing Development Program (SHDP)
- Transitions to Community Living Voucher (TCLV)
- Urgent Repair Program (URP)
- Workforce Housing Loan Program (WHLP)

For the year ended June 30, 2018, the Agency recorded expenditures of \$191,616,000 from other funding sources for the following programs:

- Community Partners Loan Pool (CPLP)
- Construction Training Partnership (CTP)
- Essential Single-Family Rehabilitation Loan Pool (ESFRLP)
- Multifamily Rental Assistance (MF RA)
- NC Home Advantage Mortgage (HomeAd)
- NC Home Advantage Down Payment Assistance (HomeAd DPA) and NC 1st Home Advantage Down Payment Assistance (1st Home DPA)

- Self-Help Loan Pool (SHLP)
- State Home Foreclosure Prevention Project (SHFPP)

For the year ended June 30, 2018, the Agency made awards of \$568,378,000 for the following programs:

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

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

Home Ownership Programs The Agency offers low-cost mortgages, down payment assistance, and MCCs for qualified buyers through the following programs:

- NC Home Advantage Mortgage offers affordable mortgage options and forgivable down payment assistance to first-time or move-up homebuyers. Borrowers are offered 30-year fixed rate mortgages and 15-year deferred, forgivable second mortgages of 3% or 5% of the first mortgage amount.
- NC 1st Home Advantage Down Payment Assistance program provides another down payment assistance option for qualifying veterans and first-time homebuyers using the HomeAd mortgage. This comes in the form of an \$8,000 deferred forgivable 15-year second mortgage.
- NC Home Advantage Tax Credit helps qualifying veterans and homebuyers increase their mortgage affordability by providing MCCs. MCCs are federal tax credits that reduce tax liability annually by up to 30% of mortgage interest for existing homes or up to 50% for new construction, each with a maximum credit of \$2,000 annually.
- Self-Help Loan Pool provides affordable mortgages to homebuyers purchasing homes through nonprofit Self-Help Housing loan pool members. Homebuyers are offered interest-free amortizing loans, with up to 33-year terms, for up to \$35,000, in combination with SHLP nonprofit member financing.
- Community Partners Loan Pool provides down payment assistance to qualifying homebuyers purchasing a home through local governments and nonprofits. Homebuyers are offered interest-free, deferred second mortgages up to 20% of the purchase price when combined with a HomeAd mortgage or up to 10% when combined with a USDA Section 502 loan, up to \$30,000.

Housing Preservation Programs The Agency partners with local governments, nonprofits, and regional councils to finance the rehabilitation of substandard owner-occupied homes to prevent displacement through the following programs:

- Essential Single-Family Rehabilitation Loan Pool provides essential and critical home rehabilitation for qualifying homeowners. A minimum of \$175,000 is provided to partners in the form of interest-free, deferred loans, and partners may use up to \$25,000 per unit for construction. The program benefits homeowners earning up to 80% of area median income who are elderly, disabled, qualified veterans, and/or people who live in homes with children under age six.
- Essential Single-Family Rehabilitation Loan Pool – Disaster Recovery program provides interest-free deferred loans to eligible homeowners to provide essential rehabilitations in response to damage from Hurricane Matthew and Tropical Storms Julia and Hermine. Homeowners earning up to 100% of area median income whose homes were affected by these storms in the counties listed in the Disaster Recovery Act of 2016 are eligible for loans up to \$40,000 for rehabilitation.

- Urgent Repair Program provides loans up to \$8,000 to assist qualifying homeowners with emergency repairs and modifications that address imminent threats to health or safety. Homeowners who are elderly, special needs, veterans or disabled earning up to 50% of area median income are eligible.
- Displacement Prevention Partnership offers loans through the NC Division of Vocational Rehabilitation and Independent Living Offices to repair or improve home accessibility for qualifying homeowners with mobility issues. Homeowners who are disabled earning up to 50% of area median income are eligible for loans up to \$8,000.

Foreclosure Prevention Programs The Agency provides foreclosure prevention services in partnership with housing counseling organizations approved by HUD through various programs, including the following:

- North Carolina Foreclosure Prevention Fund (NCFPF), which was made possible by funding from the HHF, is a suite of Agency-developed programs designed to help qualifying North Carolina homeowners who are struggling with their mortgages. These programs include the Mortgage Payment Program, the Principal Reduction Recast/Lien Extinguishment for Unaffordable Mortgages Program, and the Second Mortgage Refinance Program. Assistance comes in the form of interest-free deferred loans that serve to reduce monthly payments for homeowners on a reduced or fixed income or to make mortgage payments for homeowners recovering from hardship or seeking reemployment. More information on the NCFPF can be found on its website at www.ncforeclosureprevention.gov.
- The State Home Foreclosure Prevention Project provides free housing counseling and legal assistance to homeowners facing foreclosure. These services are funded through foreclosure filing fees, which are paid by servicers of North Carolina home loans.

Rental Development Programs The Agency finances affordable homes and apartments developed by local governments, nonprofits, and private developers through various programs, including the following:

- The Low-Income Housing Tax Credit program provides eligible rental developers with financing necessary to develop and substantially rehabilitate affordable rental housing in the State. The tax credit reduces the investors' federal tax liability by up to 9% of the eligible project cost each year for 10 years, and participation in the program ensures the creation and/or preservation of affordable rental housing for households earning up to 60% of the area median income.
- The Workforce Housing Loan Program provides long-term financing for tax credit developments. Assistance is available in the form of 30-year balloon loans for a percentage of development costs based on income designations for each county. Loans are available up to \$250,000 per project in high-income counties, up to \$1.5 million in moderate-income counties, and up to \$2 million in low-income counties.
- The Rental Production Program provides long-term financing for tax credit developments. Amortizing or deferred loans are available up to \$800,000 per project, with a maximum interest rate of 2% for up to 20 years.
- The Carryover Loan Program provides financing for the acquisition of land for 9% new construction tax credit properties which primarily serve households earning up to 60% of the area median income. The fixed rate loan has a 3.5% interest rate on the lower of 95% of the approved land cost or \$1,000,000.

Rental Assistance Programs The Agency administers rent assistance contracts for privately owned apartments through the following programs:

- Section 8 rent assistance projects are administered by the Agency for certain project-based Section 8 Housing Assistance Payment contracts on behalf of HUD. For Project-Based Contract Administration (Section 8 PBCA) projects, the Agency partners with NC Quadel Consulting Corporation to manage the contract administration duties. For Traditional Contract Administration (Section 8 TCA) projects, the Agency is directly responsible for receiving and distributing rental assistance payments from HUD. To assist in the

Section 8 TCA process, the Agency contracts with Independent CA Professionals, LLC to electronically process vouchers and submit to HUD.

- Key Rental Assistance, a DHHS program for which the Agency serves as a partner, provides rental assistance for low-income persons with disabilities, including those experiencing homelessness. The Agency is responsible for executing agreements with property owners, reviewing income eligibility documentation at move-in and recertification periods, making rental assistance payments to owners, and projecting costs of the program.
- The Transition to Community Living Voucher program, a DHHS program for which the Agency serves as a partner, was established in 2016 to create an efficient and effective state housing administration system to allow people with certain disabilities to successfully live in communities of their choice. The Agency supports LME/MCOs in administering vouchers through the development and maintenance of a secure electronic funds management and document collection system, reviewing payment requests for compliance and disbursing funds accordingly.

Supportive Housing Programs The Agency finances the development of supportive housing for North Carolinians through its partners across the State:

- The Supportive Housing Development Program provides amortizing or deferred loans to local governments, nonprofits, and regional councils to finance the production of emergency and permanent supportive housing. This program benefits people earning up to 50% of the area median income who have supportive housing needs or are experiencing homelessness. Loans are available up to the lesser of \$700,000 or 70% of project costs, depending on whether the area is an entitlement area.
- The Integrated Supportive Housing Program, a collaboration with DHHS, finances integrated permanent supportive housing to meet the needs of people with certain disabilities as identified by LME/MCOs in partnership with local housing developers.

Additional Information

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



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Independent Auditor's Report

The Board of Directors
North Carolina Housing Finance Agency

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities and programs of the North Carolina Housing Finance Agency (the "Agency"), a public agency and component unit of the State of North Carolina, as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Agency's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina Housing Finance Agency as of June 30, 2018, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A to the financial statements, during the year ended June 30, 2018, the Agency adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis on pages 3 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2018 on our consideration of the Agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Agency's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Agency's internal control over financial reporting and compliance.

BDO USA, LLP

September 26, 2018

NORTH CAROLINA HOUSING FINANCE AGENCY

STATEMENT OF NET POSITION

AS OF JUNE 30, 2018

(in thousands)

ASSETS

Current assets:

Cash and cash equivalents	\$	15,338
Restricted cash and cash equivalents		620,387
Investments		1,006
Restricted investments		11,004
Accrued interest receivable on investments		2,190
Mortgage loans receivable		107,612
Accrued interest receivable on mortgage loans		3,910
Other assets		6,558
TOTAL CURRENT ASSETS	\$	768,005

Noncurrent assets:

Investments	\$	974
Restricted investments		441,462
Mortgage loans receivable, net		512,322
Other assets, net		3,394
TOTAL NONCURRENT ASSETS	\$	958,152
TOTAL ASSETS	\$	1,726,157

DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows for pensions	\$	2,462
Deferred outflows for other postemployment benefits		1,409
Accumulated decrease in fair value of hedging derivative		1,698
TOTAL DEFERRED OUTFLOWS OF RESOURCES	\$	5,569

LIABILITIES

Current liabilities:

Bonds payable	\$	26,200
Accrued interest payable		12,214
Accounts payable		3,413
Unearned revenues		19,506
Other liabilities		216
TOTAL CURRENT LIABILITIES	\$	61,549

Noncurrent liabilities:

Bonds payable, net	\$	874,210
Derivative instrument - interest rate swap		1,698
Unearned revenues		13,860
Pension liability		4,155
Other postemployment benefits		14,467
Other liabilities		5,279
TOTAL NONCURRENT LIABILITIES	\$	913,669
TOTAL LIABILITIES	\$	975,218

DEFERRED INFLOWS OF RESOURCES

Deferred state grant	\$	3,961
Deferred inflows for pensions		136
Deferred inflows for other postemployment benefits		5,026
TOTAL DEFERRED INFLOWS OF RESOURCES	\$	9,123

NET POSITION

Net investment in capital assets	\$	3,367
Restricted net position		744,520
Unrestricted net position		(502)
TOTAL NET POSITION	\$	747,385

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

NORTH CAROLINA HOUSING FINANCE AGENCY

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

YEAR ENDED JUNE 30, 2018

(in thousands)

OPERATING REVENUES

Interest on investments	\$ 22,468
Net decrease in fair value of investments	(291)
Interest on mortgage loans	31,755
Federal program awards received	239,872
Program income/fees	68,488
Other revenues	944
TOTAL OPERATING REVENUES	\$ 363,236

OPERATING EXPENSES

Interest on bonds	\$ 27,042
Mortgage servicing expense	1,803
Federal program expense	246,260
Nonfederal program expense	18,179
General and administrative expense	27,111
Other expenses	992
TOTAL OPERATING EXPENSES	\$ 321,387

OPERATING INCOME

\$ 41,849

NON-OPERATING REVENUES (EXPENSES)

State appropriations received	\$ 14,609
State grants received	31,527
State program expense	(44,058)
TOTAL NON-OPERATING REVENUES (EXPENSES)	\$ 2,078

CHANGE IN NET POSITION

\$ 43,927

Total net position - beginning (as previously reported)	\$ 721,160
Cumulative effect of change in accounting principle	(17,702)
TOTAL NET POSITION - BEGINNING	\$ 703,458
TOTAL NET POSITION - ENDING	\$ 747,385

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

NORTH CAROLINA HOUSING FINANCE AGENCY

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2018

(in thousands)

Cash flows from operating activities:	
Interest on mortgage loans	\$ 32,475
Principal payments on mortgage loans	104,369
Purchase of mortgage loans	(14,278)
Principal payments on mortgage loans held for resale	96,755
Purchase of mortgage loans held for resale	(73,414)
Federal program awards received	200,236
Federal program expense	(246,388)
Nonfederal program expense	(18,179)
Federal grant administration income	14,513
Program income/fees	55,146
Other expenses	(36,956)
Other revenues	5,511
Net cash provided by operating activities	\$ 119,790
Cash flows from non-capital financing activities:	
Issuance of bonds	\$ 150,000
Principal repayments on bonds	(131,725)
Interest paid	(22,807)
Bond issuance costs paid	(1,417)
State appropriations received	14,609
State grants received	31,398
State program expense	(44,058)
Net cash used in non-capital financing activities	\$ (4,000)
Cash flows from investing activities:	
Proceeds from sales or maturities of investments	\$ 16,689
Purchase of investments	(172,587)
Earnings on investments	21,734
Net cash used in investing activities	\$ (134,164)
Net decrease in cash	\$ (18,374)
Cash and cash equivalents at beginning of year	654,099
Cash and cash equivalents at end of year	\$ 635,725
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 41,849
Adjustments to reconcile operating income to net cash provided by operating activities:	
Interest on investments	(22,468)
Decrease in fair value of investments	291
Interest on bonds	27,042
Change in assets and liabilities:	
Decrease in mortgage loans receivable	89,557
Decrease in accrued interest receivable on mortgage loans	865
Decrease in mortgage loans held for resale	23,341
Decrease in other assets	5,066
Decrease in accounts payable and other liabilities	(6,867)
Decrease in unearned revenues	(38,886)
Total adjustments	\$ 77,941
Net cash provided by operating activities	\$ 119,790

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

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2018

A. AUTHORIZING LEGISLATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

In 2008, the State authorized the formation of the State Home Foreclosure Prevention Project (SHFPP) in response to the foreclosure crisis. State statute requires that all parties who wish to initiate a foreclosure against a home in North Carolina remit a \$75 fee to the Agency. The fees collected are used to counsel and/or provide legal assistance to homeowners at risk of foreclosure. Any excess funds are allocated to the North Carolina Housing Trust Fund (HTF) annually. SHFPP transferred \$140,000 to the HTF for fiscal year 2018. Funds in the amount of \$2,027,000 were received and recorded as *Program income/fees* under Agency Programs. Expenses of \$1,140,000 related to SHFPP are reflected in *Nonfederal program expense*. During fiscal year 2018, the Agency earned fees of \$751,000 for the administration of this program.

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

the HTF is to increase the supply of decent, affordable, and energy-efficient housing for residents of the State with low and moderate incomes. The Housing Partnership is responsible for developing policy for the operation of most programs within the HTF. The Agency staff provides services to the Housing Partnership and administers the HTF programs. The Agency received State appropriations in the amount of \$11,609,000 for the year ended June 30, 2018. Of this amount, \$7,660,000 is a recurring appropriation that is used to make loans and grants under the HTF programs. The remaining \$3,949,000 nonrecurring appropriation is for WHLP. State appropriations are reported in *Non-Operating Revenues (Expenses)* in the accompanying financial statements.

In fiscal year 2017, the Agency received \$4,221,000 from the North Carolina Department of Health and Human Services (DHHS) for the Community Living Housing Fund (CLHF), which was appropriated by the General Assembly in fiscal year 2018 and is reported in *State grants received*. Additional funds for CLHF of \$3,961,000 were received and recorded as *Deferred state grant* in *Deferred Inflows of Resources*. These funds will only be available for disbursement upon appropriation by the General Assembly. Also included in *State grants received* is \$16,051,000 for WHLP, which constitutes the remainder of the \$20,000,000 in WHLP funding the Agency received in fiscal year 2018. These funds were provided by a State settlement with Moody's Corporation, Moody's Investor's Services, Inc. and Moody's Analytics, Inc. to resolve allegations regarding their business practices.

Federal and State Programs The Agency administers eight federal programs. Of the Agency's federal programs, the Section 8 programs, the Hardest Hit Fund (HHF), and the HOME Investment Partnerships Program (HOME) represent 58%, 27%, and 13% of federal expenditures, respectively. The Agency receives a fee for administering these programs. The HOME program is matched with State funds appropriated by the General Assembly; in fiscal year 2018, \$3,000,000 of HOME Match funds were received.

In fiscal year 2018, the Agency received \$5,750,000 from DHHS for the Transitions to Community Living Voucher program (TCLV) and other housing outcomes. TCLV is a tenant-based, rental assistance program, which also provides assistance with security deposits, holding fees and risk mitigation claims. These funds are reported in *State grants received*. As of June 30, 2018, \$3,901,000 related to TCLV is recorded as *State program expense*. The Agency earned fees of \$1,381,000 for the administration of this program.

The Agency received \$5,505,000 from DHHS in fiscal year 2018 for the administration of the Key Rental Assistance (Key) program, which is reflected in *State grants received*. The Key program provides assistance and services to low-income individuals with disabilities and those who are homeless. During fiscal year 2018, \$13,475,000 was disbursed and is reflected in *State program expense*. The Agency earned fees of \$250,000 for the administration of the program.

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

The Agency's former FirstHome program was funded with tax-exempt mortgage revenue bonds, and the mortgage loans are reflected in *Mortgage loans receivable* and *Mortgage loans receivable, net* in both the 1998 and 2009 Home Ownership Bond Programs. The related income for this program is reflected in *Interest on mortgage loans*.

The operations for the NC Home Advantage Mortgage (HomeAd) program are financed through the sale of mortgage-backed securities (MBS) as well as tax-exempt mortgage revenue bonds, and all HomeAd production is reflected in the 1998 Home Ownership Bond Program. In contrast to the FirstHome program, in which the Agency owns the mortgage loans, all HomeAd production is pooled into MBS, regardless of the method of financing. For HomeAd loans funded through the sale of MBS, the related program income is recorded in *Program income/fees*. The MBS funded with bond proceeds are reflected in *Investments*, which also include other government securities held by the Agency, as

described in Note B, "Cash, Cash Equivalents, Investments, Fair Value Measurements and Securities Lending Transactions." The corresponding earnings from the bond-funded MBS are reflected in *Interest on investments*. The down payment assistance loans and lender compensation incurred by the HomeAd program are reflected in *Nonfederal program expense*, regardless of the method of financing.

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

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

Investments *Investments* are reported at fair value in accordance with GASB Section 150, *Investments*.

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

Mortgage loans held for resale Occasionally, the Agency purchases a portion of HomeAd mortgage loans from its originating lenders to hold from the time of loan purchase to the subsequent securitization of the loans. When these loans are purchased, they are reflected in *Mortgage loans held for resale*. At June 30, 2018, there was no balance reported in this account. The interest income and servicing fees associated with these loans are reflected in *Interest on mortgage loans* and *Mortgage servicing expense*, respectively.

Other assets, net Fixed assets, net of accumulated depreciation, in the amount of \$3,367,000 are included in *Other assets, net* in the accompanying financial statements. Assets of \$5,000 or greater are capitalized and depreciated over a five-year economic useful life using the straight-line method. *Other assets* (current) for Federal and State Programs of \$1,329,000 includes receivables related to the HOME, Section 8, HHF, National Foreclosure Mitigation Counseling and National Housing Trust Fund programs. *Other assets* (current) in the amount of \$5,026,000 are reflected in the Home Ownership Bond Programs and include mortgage payments collected by servicers that will be remitted to the Agency in fiscal year 2019.

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

Unearned revenues *Unearned revenues* includes monitoring fees received for the Low-Income Housing Tax Credit. These fees are amortized on a straight-line basis over the life of the tax credit or

over the life of the loan. Also included in *Unearned revenues* is funding from the US Department of the Treasury (Treasury) for the HHF, which is used to assist homeowners at risk of foreclosure.

Interprogram receivable (payable) During the normal course of operations, the Agency has numerous transactions among programs to provide services. If certain transactions among programs have not been settled as of June 30, 2018, these balances are recorded as *Interprogram receivable (payable)*. These interprogram transactions are eliminated in the accompanying financial statements.

Deferred Outflows/Inflows of Resources In addition to Assets, the Statement of Net Position includes a separate section for *Deferred Outflows of Resources*. This section of the financial statements represents a consumption of net position that applies to a future period and will not be recognized as an expense or expenditure until then. The Agency has three items that meet this criterion in fiscal year 2018: contributions to the pension plan, contributions to other postemployment benefits (OPEB), and an accumulated decrease in fair value of hedging derivative instruments. In addition to Liabilities, the Statement of Net Position includes a separate section for *Deferred Inflows of Resources*. This section of the financial statements represents an acquisition of net position that applies to a future period and will not be recognized as revenue until then. The Agency has three items that meet the criterion: deferred state grant revenue, deferred inflows related to pensions, and deferred inflows related to OPEB resulting from the implementation of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75).

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

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

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

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

The Agency implemented GASB 75 in fiscal year 2018. The implementation of this statement required the Agency to record a beginning net OPEB liability and asset and the effects of contributions made by the Agency during the measurement period (fiscal year ending June 30, 2017). As a result of the implementation, net position as of June 30, 2017, as previously reported in the Agency's 2017 audited financial statements, was adjusted as follows (*in thousands*):

	<u>Retiree Health Benefit Fund</u>	<u>Disability Income Plan</u>	<u>TOTAL</u>
June 30, 2017 Net position, as previously reported	\$ -	\$ -	\$ 721,160
Prior period adjustment			
Net OPEB (liability) asset (measured at June 30, 2016)	(18,267)	27	(18,240)
Deferred outflows			
Contributions during fiscal year ended June 30, 2017	505	33	538
Total prior period adjustment	\$ (17,762)	\$ 60	\$ (17,702)
June 30, 2017 Net position, as adjusted			\$ 703,458

The effect of the adoption of GASB 75 on the Agency's financial statements is as follows (*in thousands*):

	Without GASB 75	With GASB 75
Investment in capital assets	\$ 3,367	\$ 3,367
Restricted net position	744,460	744,520
Unrestricted net position	17,260	(502)
Total net position at June 30, 2018	\$ 765,087	\$ 747,385

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

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

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

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

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

Cash and cash equivalents As of June 30, 2018, the Agency had deposits in pooled investment accounts of the State Treasurer with a carrying value of approximately \$237,172,000, and a bank balance of approximately \$238,035,000. The State Treasurer investment account has the characteristics of a demand deposit account in that the Agency may deposit and withdraw cash at any time without prior notice or penalty. Included in the investment accounts of the State Treasurer is \$4,109,000 of escrow and replacement reserves maintained on behalf of multifamily and single-family mortgagors; accordingly, a corresponding liability of the same amount is also included on the Statement of Net Position.

The Agency had deposits with a carrying value of \$398,551,000 and a bank balance approximating \$398,933,000 on deposit with the Agency's fiduciary agent. Such deposits are held in accordance with State Statute 159-31(b) by a third-party custodian. The Agency also had deposits held in other financial institutions with both a carrying value and bank balance of \$2,000.

Deposits - Custodial Credit Risk Custodial credit risk is the risk that in the event of a bank failure, the Agency's deposits may not be returned. At June 30, 2018, the Agency was not exposed to any material custodial credit risk.

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

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

At June 30, 2018, the Agency held the following investments with the listed maturities at annual rates ranging from 1.63% to 6.90%. Ratings are displayed with the Moody's Investors Service (Moody's) rating listed first and the Standard & Poor's (S&P) rating listed second (*in thousands*):

Investments	Carrying Amount	Investment Maturities (<i>In Years</i>)			
		Less Than 1	1 – 5	6 – 10	More Than 10
GNMA MBS					
Rated Aaa/AA+	\$129,627	\$ -	\$ 501	\$ 15	\$129,111
FNMA MBS					
Rated Aaa/AA+	246,918	-	75	-	246,843
Government Securities					
Rated Aaa/AA+	77,901	12,010	58,392	7,499	-
Total Categorized	\$454,446	\$ 12,010	\$ 58,968	\$ 7,514	\$375,954

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

Credit Risk Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. State statutes authorize the Agency to invest in (i) direct obligations or obligations on which the principal and interest are unconditionally guaranteed by the US Government; (ii) obligations issued by an approved agency or corporation wholly-owned by the US Government; (iii) interest-bearing time deposits, certificates of deposit, or other approved forms of deposits in any bank or trust company in North Carolina which satisfies insurance and, if necessary, collateral requirements for holding Agency money; (iv) duly established investment programs of the State Treasurer; (v) repurchase agreements; and (vi) repurchase agreements with banks and financial institutions which are chartered outside of the State and meet specified rating and collateral requirements of the various trust agreements. The MBS are securitized by FNMA (fair value - \$246,918,000, rated Aaa/AA+) and by GNMA (fair value - \$129,627,000, rated Aaa/AA+). The GNMA MBS are direct obligations of the US Government. The government securities are direct obligations of the Treasury (rated Aaa/AA+) and have a fair value of \$77,901,000.

Concentration of Credit Risk Concentration of credit risk is the risk of loss related to the percentage of the Agency's investment portfolio in any single issuer, except for investments explicitly

backed by the US government. Listed below are the Agency's investments in a single issuer which exceed 5% of total investments as of June 30, 2018 (*in thousands*):

<u>Investment Issuer</u>	<u>Amount</u>
FNMA - MBS	\$246,918
Federal Home Loan Bank	58,128

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

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

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

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

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

The Agency had the following recurring fair value measurements as of June 30, 2018 (*in thousands*):

Investment Type	Fair Value	Input Level	
Short Term Investment Fund (STIF)	\$430,365	Level 2	The ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year-end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the State's custodian.
Government Securities	\$77,901	Level 2	Valuation of the underlying assets is performed using the policies and procedures established by the Agency's custodian.
MBS	\$376,545	Level 2	Valuation of the underlying assets is performed using the policies and procedures established by the Agency's custodian.
Derivative Instrument - Interest Rate Swap	\$1,698	Level 2	The fair value was estimated by a consulting firm using the zero coupon method.

Securities Lending Transactions GASB Section 160, *Investments—Security Lending* (GASB 160), establishes accounting and financial reporting standards for transactions where governmental entities transfer their securities to broker-dealers and other entities (borrowers) in exchange for collateral (which may be cash, securities, or letters of credit) and simultaneously agree to return the collateral in exchange for the original securities in the future. The Agency does not directly engage in securities lending transactions; however, the State Treasurer is authorized to engage in these types of transactions under State Statute 147-69.3(e). The types of securities include government securities and corporate bonds and notes which are held in the pooled investment accounts of the State Treasurer. A securities custodian manages the securities lending program for the State and receives cash as collateral from the borrowers. Collateral is invested in a collateral investment pool and must be maintained at 100% of the market value of the original securities. This investment in the collateral investment pool is considered to be a highly liquid investment. The State has a custodial credit risk related to the transactions.

Throughout fiscal year 2018, the Agency had deposits in the pooled investment accounts of the State Treasurer. The risk associated with these transactions will be recorded by the State in its fiduciary funds. No allocation will be made to the Agency; therefore, the accompanying financial statements do not reflect the risk associated with securities lending transactions in accordance with GASB 160.

C. MORTGAGE LOANS RECEIVABLE

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

The existing and future mortgage loans which the Agency may purchase under the bond programs must comply with guidelines established by the Agency, including the requirement that all such mortgage loans be insured by the Federal Housing Administration, guaranteed by the Veterans Administration, guaranteed by the US Department of Agriculture, Rural Development, insured under a private mortgage insurance program, or have a loan-to-value ratio equal to or less than 80%. As of June 30, 2018, all outstanding FirstHome mortgage loans purchased with mortgage revenue bond proceeds satisfy these requirements. The Agency has allowances for loan principal and interest losses in the single-family FirstHome mortgage loan program of \$390,000 and \$234,000, respectively, as of June 30, 2018.

Mortgage loans made with funds from the Agency Programs, Housing Trust Fund Programs, and Federal and State Programs have allowances for loan losses of \$347,000, \$57,000 and \$42,000, respectively, as of June 30, 2018.

For the Home Ownership Bond Programs, the Agency has collateralized \$472,900,000 in mortgage loans receivable and \$604,893,000 in cash and investments pledged to repay the \$886,345,000 single-family bonds payable outstanding as of June 30, 2018. Proceeds from the bonds issued were used to finance housing throughout the State. The outstanding bonds are payable through fiscal year 2049 and are repaid from principal and interest on mortgage loans and MBS, unexpended bond proceeds and proceeds from the sale of investments. The Agency expects 100% of the mortgage loans and MBS, both principal and interest, to pay the principal and interest debt service requirements on the bonds. The total debt service requirement to be paid based on projected cash flows as of June 30, 2018 is \$1,318,981,000 (see "Maturities" under Note D).

For the current fiscal year, debt service payments, bond calls and related interest payments totaling \$154,532,000 were made for the Home Ownership Bond Programs. Payments received on mortgage loans and MBS for the Home Ownership Bond Programs were \$119,001,000 and \$22,025,000 respectively.

D. BONDS PAYABLE

Bonds payable activity for the year ended June 30, 2018 was as follows (*in thousands*):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Bonds payable				
Home Ownership	\$ 868,070	\$ 150,000	\$ (131,725)	\$ 886,345
Bond premium	12,278	2,785	(998)	14,065
Total Bonds payable, net	\$ 880,348	\$ 152,785	\$ (132,723)	\$ 900,410

Bonds payable as of June 30, 2018 are as follows (*in thousands*):

<u>Issue</u>	<u>Stated Rates (%)</u>	<u>Final Maturity</u>	<u>Principal Amount</u>
Home Ownership Revenue Bonds			
(1998 Housing Revenue Bonds Trust Agreement)			
Series 27 A	6.00	1/1/2038	\$ 2,850
Series 32	4.00	1/1/2030	43,675
Series 33	2.413 – 4.319	1/1/2034	49,520
Series 34	2.162 – 3.752	7/1/2035	26,120
Series 35	2.040 – 3.786	7/1/2032	27,025
Series 36	1.541 – 3.532	1/1/2033	39,445
Series 37	Variable – 3.600	7/1/2041	190,435
Series 38	1.300 – 4.000	7/1/2047	252,570
Series 39	1.900 – 4.000	7/1/2048	150,000
			<u>\$ 781,640</u>
(2009 Housing Revenue Bonds Trust Agreement)			
Series A-1 and Series 1	2.920 – 4.500	7/1/2041	\$ 44,070
Series A-2 and Series 2	2.640 – 4.250	7/1/2041	60,635
			<u>\$ 104,705</u>
Total Bonds Outstanding			<u>\$ 886,345</u>
Plus Bond Premium			<u>\$ 14,065</u>
Total Bonds Payable, Net			<u>\$ 900,410</u>

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

Maturities Debt service requirements, including sinking fund requirements on term bonds, subsequent to June 30, 2018, are as follows (*in thousands*):

Bonds Outstanding without Interest Rate Swaps

Fiscal Year		
Ending June 30	Principal	Interest
2019	\$ 24,130	\$ 26,475
2020	30,935	28,295
2021	32,235	27,484
2022	33,895	26,581
2023	34,665	25,571
2024-2028	169,105	112,008
2029-2033	168,765	83,654
2034-2038	153,825	56,742
2039-2043	112,610	31,740
2044-2048	102,475	11,612
2049	1,755	35
Total Requirements	\$ 864,395	\$ 430,197

Bonds Outstanding with Interest Rate Swaps

Fiscal Year		
Ending June 30	Principal	Interest
2019	\$ 2,070	\$ 345
2020	1,920	328
2021	1,790	297
2022	1,660	266
2023	1,530	239
2024-2028	8,280	772
2029-2033	4,500	188
2034-2035	200	4
Total Requirements	\$ 21,950	\$ 2,439

Total Bonds Outstanding

Fiscal Year		
Ending June 30	Principal	Interest
2019	\$ 26,200	\$ 26,820
2020	32,855	28,623
2021	34,025	27,781
2022	35,555	26,847
2023	36,195	25,810
2024-2028	177,385	112,780
2029-2033	173,265	83,842
2034-2038	154,025	56,746
2039-2043	112,610	31,740
2044-2048	102,475	11,612
2049	1,755	35
Total Requirements	\$ 886,345	\$ 432,636

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

For the year ended June 30, 2018, scheduled and unscheduled bond redemptions were as follows (*in thousands*):

<u>Issue</u>	<u>Amount Redeemed</u>
Housing Revenue Bonds (1998 Trust Agreement)	\$ 114,705
Housing Revenue Bonds (2009 Trust Agreement)	17,020
Total Home Ownership Bond Programs	\$ 131,725

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

Bonds payable as of June 30, 2018 for special facilities are as follows (*in thousands*):

<u>Issue</u>	<u>Bond Type</u>	<u>Bonds Outstanding</u>
Series 2018 (WWJ Investments, LLC)	Multifamily Housing Revenue Bonds	\$ 17,691

Bonds related to special facilities that were redeemed during the fiscal year ended June 30, 2018 are as follows:

<u>Issue</u>	<u>Bond Type</u>	<u>Redemption Date</u>
2002 Resolution* (Series D)	Multifamily Housing Revenue Bonds	10/17/2017
2016 Resolution (Series A)	Multifamily Housing Revenue Bonds	6/1/2018

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

E. DERIVATIVE INSTRUMENT - INTEREST RATE SWAP

Summary Information During fiscal year 2018, the Agency did not initiate any new swaps. The existing swaps with Bank of America, N.A. and Goldman Sachs Mitsui Marine remain in place to hedge Series 37C. Series 37C was a private placement, and the interest payment is equal to 70% of the 1-month LIBOR rate plus 28 basis points (bps).

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

Hedgeable Item	Hedging Derivative Instrument	Notional Amount	Classification	Fair Value at June 30, 2018 Liability	Classification	Net Decrease in Fair Value
Series 37C (formerly Series 16C)	Pay-Fixed Interest Rate Swap	\$7,120	Hedging Derivative	\$(490)	Deferred Outflows of Resources	\$305
Series 37C (formerly Series 17C)	Pay-Fixed Interest Rate Swap	\$10,140	Hedging Derivative	\$(889)	Deferred Outflows of Resources	\$471
Series 37C (formerly Series 18C)	Pay-Fixed Interest Rate Swap	\$4,690	Hedging Derivative	\$(319)	Deferred Outflows of Resources	\$199

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

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

Terms and Credit Risk The terms and credit risk of the outstanding swaps as of June 30, 2018 were as follows (*in thousands*):

Notional Amount	Counterparty	Counterparty Credit Rating Moody's/S&P	Date of Swap Execution	Maturity Date of Swap	Fixed Rate	Floating Index
\$7,120*	Bank of America, N.A.	Aa3/A+	9/16/2003	7/1/2032	3.810%	63%L** + 0.30%
\$10,140	Bank of America, N.A.	Aa3/A+	12/11/2003	7/1/2032	3.725%	63%L** + 0.30%
\$4,690	Goldman Sachs Mitsui Marine	Aa2/AA-	4/20/2004	1/1/2035	3.251%	63%L** + 0.30%

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

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

Fair Value In total, the swaps have a fair value of negative \$1,698,000 as of June 30, 2018. Because the coupons on the Agency’s variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap. Additionally, if at the time

of termination, the swap has a negative fair value, the Agency would be liable to the counterparty for a payment equal to the swap's fair value.

Interest Rate Risk Under all of the swaps, the Agency pays the counterparties a fixed rate and receives a variable payment computed as 63% of 1-Month LIBOR plus 30 bps. The variable payment to the bondholder is computed based on 70% of 1-month LIBOR plus 28 bps, which was 1.66772% as of June 30, 2018.

Basis risk and termination risk The swaps expose the Agency to basis risk as the LIBOR rate changes, changing the synthetic rate on the bonds. The swap contracts for the Agency use a compound formula for the floating rate index to reduce this risk. During the accounting period, the Agency realized a cost of 25 bps for all variable-rate series due to the floating rate formula for its swap contracts when compared to the floating rate on the bonds. For all swaps, collateral thresholds have been established if the counterparty ratings reach A2 for Moody's or A for S&P. The Agency's swaps may be terminated if the counterparty's or the Agency's rating falls below Baa2 as issued by Moody's or BBB as issued by S&P.

Credit Risk Credit risk is the risk that the counterparty will not fulfill its obligations. All contracts as of June 30, 2018 reflect liabilities and, therefore, the Agency does not have current credit risk on its contracts. The Agency monitors the ratings of its counterparties to ascertain credit risk.

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

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

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

Quantitative Method of Evaluating Effectiveness To assess the effectiveness of each hedging derivative instrument, the Agency employed the Synthetic Instrument Method. Under the Synthetic Instrument Method, a hedging derivative instrument is effective if the synthetic price is substantively fixed. The synthetic price as of the evaluation date, June 30, 2018, is compared to the synthetic price expected at the establishment of the hedge by calculation of an effectiveness percentage. If the effectiveness percentage is within a range of 90 to 111 percent, the synthetic price is substantively fixed. Following are the results of the testing as of the end of the reporting period:

Hedgeable Item	Hedgeable Item Effective Bond Variable Rate	Derivative Instrument Floating Rate	Floating Rate Basis	Synthetic Price	90 to 111% Range	Test Performance
Series 37C (formerly Series 16C)	1.5084	1.2613	(0.2471)	4.1%	3.4% – 4.2%	PASS
Series 37C (formerly Series 17C)	1.5084	1.2613	(0.2471)	4.0%	3.4% – 4.1%	PASS
Series 37C (formerly Series 18C)	1.5084	1.2613	(0.2471)	3.5%	2.9% – 3.6%	PASS

Swap Payments and Associated Debt As rates vary, variable-rate bond interest payments and net swap payments will differ between the fixed rate paid to the counterparty and the variable rate paid to the Agency. Using rates as of June 30, 2018, debt service requirements of the variable-rate debt and net swap payments are as follows (*in thousands*):

Fiscal Year Ending June 30	Variable-Rate Bond		Interest Rate	Total
	Principal	Interest	Swap, Net	Interest
2019	\$ 2,070	\$ 345	\$ 463	\$ 808
2020	1,920	328	405	733
2021	1,790	297	366	663
2022	1,660	266	329	595
2023	1,530	239	294	533
2024-2028	8,280	772	949	1,721
2029-2033	4,500	188	227	415
2034-2035	200	4	4	8
Total	\$ 21,950	\$ 2,439	\$ 3,037	\$ 5,476

F. NONCURRENT LIABILITIES

Noncurrent liabilities for the year ended June 30, 2018 were as follows (*in thousands*):

	Beginning Balance	Prior Year Adj.	Additions	Deletions	Ending Balance	Due Within One Year
Bonds payable						
Bonds payable, net	\$868,070	\$ -	\$150,000	\$(131,725)	\$886,345	\$ 26,200
Bond premium	12,278	-	2,785	(998)	14,065	-
Derivative instrument – interest rate swap	2,673	-	-	(975)	1,698	-
Unearned revenues	72,252	-	39,259	(78,145)	33,366	19,506
Pension liability	4,606	-	-	(451)	4,155	-
OPEB liability*	-	18,267	-	(3,800)	14,467	-
Other liabilities						
Compensated absences	1,193	-	292	(111)	1,374	204
Deposits payable	6,342	-	5,841	(8,062)	4,121	12
	\$967,414	\$18,267	\$198,177	\$(224,267)	\$959,591	\$ 45,922

* Additional information regarding the OPEB liability is included in Note J, "Other Postemployment Benefits."

G. OPERATING LEASE

The Agency leases two adjacent buildings with future minimum lease payments for fiscal years 2019, 2020, 2021, 2022 and 2023 in the amounts of \$766,000, \$696,000, \$587,000, \$580,000 and \$146,000, respectively. Rent expenses for all operating leases totaled \$737,000 for the year ended June 30, 2018. The Agency's lease for the main building will expire September 2022.

H. FEDERAL AWARDS

As a designated Public Housing Authority for the US Department of Housing and Urban Development (HUD) Section 8 programs, the Agency requisitions Section 8 program funds and makes disbursements to eligible landlords. For the year ended June 30, 2018, \$154,401,000 was received by the Agency and disbursed to property owners and is included in *Federal program awards received* and *Federal program expense* in Federal and State Programs.

The Agency is designated as the participating entity under grant agreements with HUD for the HOME program. The HOME program provides funding for the purpose of developing affordable housing for persons of low and very low income. For the year ended June 30, 2018, \$18,206,000 was received and is included in *Federal program awards received* in Federal and State Programs. In fiscal year 2018, the Agency disbursed \$32,168,000, which is included in *Federal program expense* and *Mortgage loans receivable, net*, depending upon the terms of the transaction.

The Agency received repayments of mortgage loans that were funded under the Tax Credit Assistance Program. These repayments provide funding for the Carryover Loan Program. For the year ended June 30, 2018, \$5,841,000 was disbursed and is included as a part of *Mortgage loans receivable, net* in Federal and State Programs.

The Agency was selected as a participating entity under a grant agreement with Treasury for the HHF, which provides funding for homeowners facing foreclosure and stabilizes neighborhoods with poorly performing housing indicators. For the year ended June 30, 2018, \$67,262,000 was received by the Agency and is included in *Federal program awards received*, and \$67,272,000 was disbursed by the Agency and is included in *Federal program expense* in Federal and State Programs.

The Agency earned fees of \$16,016,000 for administering these and other federal programs for the year ended June 30, 2018. Of these fees, \$4,240,000 was paid to Quadel Consulting Corporation for the Section 8 Project-Based Contract Administration, and \$2,244,000 was paid to counseling agencies for HHF counseling services, which are reported in *General and administrative expense*.

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

I. PENSION PLAN

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

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

Funding Policy Plan members are required to contribute 6% of their annual covered salary, and the Agency is required to contribute at an actuarially determined rate. The fiscal year 2018 rate is 10.78% of the annual covered payroll. The contribution requirements of plan members and the Agency are established and may be amended by the General Assembly. The following table represents the three-year trend of the annual contributions made by the Agency to the State retirement system. The Agency made 100% of its required contributions for the years ended June 30, 2018, 2017, and 2016 (*in thousands*):

	2018	2017	2016
Retirement Contribution	\$954	\$862	\$722
Percentage of Covered Payroll	10.78%	9.98%	9.15%

Net Pension Liability At June 30, 2018, the Agency reported a liability of \$4,154,000 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017. The total pension liability used to calculate the net pension was determined by an actuarial valuation as of December 31, 2016. The total pension liability was then rolled forward to the measurement date of June 30, 2017 utilizing update procedures incorporating the actuarial assumptions. The Agency's proportion of the net pension liability was based on a projection of the Agency's long-term

share of future payroll covered by the pension plan, relative to the projected future payroll covered by the pension plan of all participating TSERS employers, actuarially determined. At June 30, 2017 and at June 30, 2016, the Agency's proportion was 0.05326% and 0.05011%, respectively.

Deferred Outflows/Inflows of Resources Related to Pensions For the year ended June 30, 2018, the Agency recognized pension expense of \$1,198,000. At June 30, 2018, the Agency reported *Deferred Outflows of Resources* and *Deferred Inflows of Resources* related to pensions from the following sources (*in thousands*):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between actual and expected experience	\$ 90	\$ 136
Changes of assumptions	656	-
Net difference between projected and actual earnings on pension plan investments	562	-
Change in proportion and differences between Agency's contributions and proportionate share of contributions	200	-
Contributions subsequent to the measurement date	954	-
Total	\$ 2,462	\$ 136

Deferred Outflows of Resources of \$954,000 related to pensions resulting from Agency contributions subsequent to the measurement date will be recognized as a decrease of the net pension liability in the year ended June 30, 2019. Other amounts reported as *Deferred Outflows of Resources* and *Deferred Inflows of Resources* related to pensions will be recognized as pension expense as follows (*in thousands*):

Year ending June 30:	
2019	\$ 306
2020	855
2021	436
2022	(225)
Total	\$ 1,372

Actuarial Assumptions The total pension liability was determined by an actuarial valuation performed as of December 31, 2016. The total pension liability was calculated through the use of update procedures to roll forward from the actuarial valuation date to the measurement date of June 30, 2017. The update procedures incorporated the actuarial assumptions used in the valuation. The entry age normal actuarial cost method was utilized. Inflation is assumed to be 3%, and salary increases range from 3.50% to 8.10% which includes 3.5% inflation and productivity factor. The long-term expected rate of return on pension plan investments used in the determination of the total pension liability is 7.20% and is net of pension plan investment expense, including inflation.

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

The actuarial assumptions used in the December 31, 2016 valuations were based on the results of an actuarial experience review for the period January 1, 2010 through December 31, 2014.

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

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the plan's target asset allocation as of June 30, 2017 (the valuation date) are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Opportunistic Fixed Income	6.0%
Inflation Protection	4.0%

The information above is based on 30-year expectations developed with the consulting actuary and is part of the asset liability and investment policy of the North Carolina Retirement Systems, including TSERS. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. Return projections do not include any excess return expectations over benchmark averages. All rates of return and inflation are annualized. The long-term expected real rate of return for the Bond Index Investment Pool as of June 30, 2017 is 1.3%.

Discount Rate The discount rate used to measure the total pension liability was lowered from 7.25% to 7.20% for the December 31, 2016 valuation. The discount rate is in line with the long-term nominal expected return on pension plan investments. The calculation of the net pension liability is a present value calculation of future net pension payments. These net pension payments assume that contributions from plan members will be made at the current statutory contribution rate and that contributions from employers will be made at contractually required rates, actuarially determined. Based on these assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate The following presents the Agency's proportionate share of the net pension liability calculated using the discount rate of 7.20%, as well as what the Agency's proportionate share of the net pension asset or net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.20%) or one percentage point higher (8.20%) than the current rate (*in thousands*):

	<u>1% Decrease (6.20%)</u>	<u>Discount Rate (7.20%)</u>	<u>1% Increase (8.20%)</u>
Agency's proportionate share of the net pension liability	\$8,699	\$4,226	\$478

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

J. OTHER POSTEMPLOYMENT BENEFITS

Plan Description In addition to providing pension benefits, the Agency participates in two postemployment benefit plans, the Retiree Health Benefit Fund (RHBF) and the Disability Income Plan of North Carolina (DIPNC), that are administered by the State as pension and other employee benefit trust funds. The Agency makes monthly contributions to the State for these benefits. The State's CAFR includes financial statements and required supplementary information for each plan. See Note I. "Pension Plan" for information about obtaining the CAFR from the North Carolina Office of State Controller.

The RHBF has been established as a fund to provide health benefits to long-term disability beneficiaries of the DIPNC and retirees who have at least five years of creditable service with TSERS. TSERS pays the full cost of coverage for retirees enrolled in the State's self-funded Teachers' and State Employees' Preferred Provider Organization medical plan who were hired prior to October 1, 2006, and retire with five or more years of State TSERS membership service. For employees hired on or after October 1, 2006, TSERS will pay the full cost of coverage for retirees with 20 or more years of service, TSERS will pay 50% of the cost of coverage for retirees with at least 10 years but less than 20 years of service, and the retiree with less than 10 years of service will pay the full cost of coverage. In addition, persons who became surviving spouses of retirees prior to October 1, 1986 receive the same coverage as retirees. Retirees and the aforementioned surviving spouses pay for the entire cost of coverage of their dependents.

Short-term and long-term disability benefits are provided through the DIPNC. Long-term disability benefits are payable from the DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five years of contributing membership service with TSERS earned within 96 months prior to the end of the short-term disability period; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period, after salary continuation payments cease, or after monthly payments for workers' compensation cease, whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of employees' usual occupation; (4) the disability must have been continuous, likely to be permanent and incurred at the time of active employment; (5) the employee must not be eligible to receive unreduced retirement benefits from TSERS; and (6) the employee must terminate employment as a permanent, full-time employee. In addition, recipients of long-term disability benefits are eligible to receive the State-paid health insurance coverage. The monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation reduced by any social security or worker's compensation to which the recipient may be entitled up to a maximum of \$3,900 per month. When an employee qualifies for an unreduced service retirement allowance from TSERS, the benefits payable from the DIPNC cease, and the employee will commence retirement under TSERS.

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

Contributions Contribution rates to RHBF, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill. Although DIPNC operates on a calendar year, disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly and coincide with the State's fiscal year. The Agency assumes no liability for retiree health care or long-term disability benefits other than its required contributions.

The following table represents the three-year trend of the annual contributions made by the Agency to the State postemployment benefit plans. The Agency made 100% of its required contributions for the years ended June 30, 2018, 2017, and 2016 (*in thousands*):

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Health Care Benefit	\$535	\$502	\$442
Disability Benefit	12	33	32
Percentage of Covered Payroll			
Health Care Benefit	6.05%	5.81%	5.60%
Disability Benefit	0.14%	0.38%	0.41%

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

Net OPEB Liability (Asset) At June 30, 2018, the Agency reported a liability of \$14,467,000 for its proportionate share of the collective net OPEB liability for RHBF. The Agency also reported an asset of \$27,000 for its proportionate share of the collective net OPEB asset for DIPNC. The net OPEB liability (asset) was measured as of June 30, 2017. The total OPEB liability (asset) used to calculate the net OPEB liability (asset) was determined by an actuarial valuation as of December 31, 2016, and update procedures were used to roll forward the total OPEB liability (asset) to June 30, 2017. The Agency's proportion of the net OPEB liability (asset) was based on the present value of future salaries for the Agency relative to the present value of future salaries for all participating employers, actuarially-determined. At June 30, 2017 and at June 30, 2016, the Agency's proportion was 0.05326% and 0.05011%, respectively.

Actuarial Assumptions The total OPEB liabilities (assets) for RHBF and DIPNC were determined by actuarial valuations as of December 31, 2016, using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified. The total OPEB liabilities (assets) were then rolled forward to June 30, 2017 utilizing update procedures incorporating the actuarial assumptions.

	<u>RHBF</u>	<u>DIPNC</u>
Valuation Date	12/31/2016	12/31/2016
Inflation	2.75%	3.00%
Salary Increases*	3.50% - 8.10%	3.50% - 8.10%
Investment Rate of Return**	7.20%	3.75%
Healthcare Cost Trend Rate - Medical	5.00% - 6.50%	N/A
Healthcare Cost Trend Rate - Prescription Drug	5.00% - 7.25%	N/A
Healthcare Cost Trend Rate - Medicare Advantage	4.00% - 5.00%	N/A
Healthcare Cost Trend Rate - Administrative	3.00%	N/A

* Salary increases include 3.5% inflation and productivity factor.

** Investment rate of return is net of pension plan investment expense, including inflation.

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

The projected long-term investment returns and inflation assumptions are developed through a review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projects are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. DIPNC is primarily invested in the Bond Index Investment Pool as of June 30, 2017.

Best estimates of real rates of return for each major asset class included in RHBF's target asset allocation as of June 30, 2017 (the valuation date) are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Opportunistic Fixed Income	6.0%
Inflation Protection	4.0%

The information in the preceding table is based on 30-year expectations developed with the consulting actuary and is part of the asset, liability, and investment policy of the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. Return projections do not include any excess return expectations over benchmark averages. All rates of return and inflation are annualized. The long-term expected real rate of return for the Bond Index Investment Pool as of June 30, 2017 (the valuation date) was 1.3%.

Actuarial valuations of the plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The actuarial assumptions used for RHBF are consistent with those used to value the pension benefits of TSERS where appropriate. These assumptions are based on the most recent pension valuations available. The discount rate used for RHBF reflects a pay-as-you-go approach.

Projections of benefits for financial reporting purposes of the plans are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and historical pattern of sharing of benefit costs between the employer and plan members to that point. Historically, the benefits funded solely by employer contributions applied equally to all retirees. Currently, as described earlier in the note, benefits are dependent on membership requirements.

The actuarial methods and assumptions used for DIPNC include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The actuarial assumptions used in the December 31, 2016 valuations were based on the results of an actuarial experience study prepared as of December 31, 2014.

Discount Rate The discount rate used to measure the total OPEB liability for RHBF was 3.58%. The projection of cash flows used to determine the discount rate assumed that contributions from employers will be made at the current statutorily determined contribution rate. Based on the above assumptions, the plan's fiduciary net position was not projected to be available to make projected future benefit payments of current plan members. As a result, a municipal bond rate of 3.58% was used as the discount rate used to measure the total OPEB liability. The 3.58% rate is based on the Bond Buyer 20-year General Obligation Index as of June 30, 2017.

The discount rate used to measure the total OPEB asset for DIPNC was 3.75%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the plan's fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on plan investments was applied to all periods of projected benefit payments to determine the total OPEB asset.

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

	1% Decrease (2.58%)	Discount Rate (3.58%)	1% Increase (4.58%)
RHBF	\$21	\$17	\$15
	1% Decrease (2.75%)	Discount Rate (3.75%)	1% Increase (4.75%)
DIPNC	\$ -	\$ -	\$ -

Sensitivity of the Net OPEB Liability to Changes in the Healthcare Cost Trend Rates The following presents the net OPEB liability of the plans, as well as what the plans' net OPEB liability would be if it were calculated using healthcare cost trend rates that are one percentage point lower or one percentage point higher than the current healthcare cost trend rates (*in thousands*):

	1% Decrease	Healthcare Cost Trend Rates	1% Increase
RHBF	\$14	\$17	\$22
	1% Decrease	Healthcare Cost Trend Rates	1% Increase
DIPNC	N/A	N/A	N/A

Deferred Outflows/Inflows of Resources Related to OPEB For the year ended June 30, 2018, the Agency recognized OPEB expense of \$886,000 for RHBFB and \$16,000 for DIPNC. At June 30, 2018, the Agency reported *Deferred Outflows of Resources* and *Deferred Inflows of Resources* related to OPEB from the following sources (*in thousands*):

Deferred Outflows of Resources Related to OPEB by Classification

	RHBFB	DIPNC	TOTAL
Difference between actual and expected experience	\$ -	\$ 8	\$ 8
Changes of assumptions	-	-	-
Net difference between projected and actual earnings on OPEB plan investments	-	-	6
Change in proportion and differences between Agency's contributions and proportionate share of contributions	845	3	848
Contributions subsequent to the measurement date	535	12	547
Total	\$ 1,380	\$ 29	\$ 1,409

Deferred Inflows of Resources Related to OPEB by Classification

	RHBFB	DIPNC	TOTAL
Difference between actual and expected experience	\$ 1,037	\$ -	\$ 1,037
Changes of assumptions	3,984	-	3,984
Net difference between projected and actual earnings on OPEB plan investments	5	-	5
Change in proportion and differences between Agency's contributions and proportionate share of contributions	-	-	-
Contributions subsequent to the measurement date	-	-	-
Total	\$ 5,026	\$ -	\$ 5,026

Amounts reported as *Deferred outflows of resources* related to contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability related to RHBFB and an increase of the net OPEB asset related to DIPNC in the fiscal year ended June 30, 2019. Other amounts reported as *Deferred Outflows of Resources* and *Deferred Inflows of Resources* related to OPEB will be recognized in OPEB expense as follows (*in thousands*):

Year ending June 30:	RHBFB	DIPNC
2019	\$ (837)	\$ 5
2020	(837)	5
2021	(837)	5
2022	(836)	2
2023	(835)	-
Total	\$ (4,182)	\$ 17

K. RISK MANAGEMENT

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

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

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

In addition to the State's policies, the Agency has Cyber Liability and Fraudulent Instruction coverage, which is intended to mitigate financial losses associated with criminal acts of breach and fraudulent impersonation of Agency staff.

L. SEGMENT INFORMATION

The Agency's Home Ownership Bond Programs are initially funded with bond proceeds. These proceeds are used to purchase mortgage loans which provide the income along with investment earnings to repay the debt. Condensed financial statements at June 30, 2018 for this segment are as follows (*in thousands*):

<u>STATEMENT OF NET POSITION</u>	<u>Home Ownership</u>
ASSETS	
Current assets:	
Restricted cash and cash equivalents	\$ 343,258
Restricted investments	9,998
Accrued interest receivable on investments	1,952
Mortgage loans receivable	91,562
Accrued interest receivable on mortgage loans	3,721
Other assets	5,026
Interprogram receivable	413
TOTAL CURRENT ASSETS	\$ 455,930
Noncurrent assets:	
Restricted investments	\$ 439,465
Mortgage loans receivable, net	416,313
TOTAL NONCURRENT ASSETS	\$ 855,778
TOTAL ASSETS	\$ 1,311,708
DEFERRED OUTFLOWS OF RESOURCES	
Accumulated decrease in fair value of hedging derivative	\$ 1,698
TOTAL DEFERRED OUTFLOWS OF RESOURCES	\$ 1,698

	<u>Home Ownership</u>
LIABILITIES	
Current liabilities:	
Bonds payable	\$ 26,200
Accrued interest payable	12,214
Accounts payable	1,115
TOTAL CURRENT LIABILITIES	<u>\$ 39,529</u>
Noncurrent liabilities:	
Bonds payable, net	\$ 874,210
Derivative instrument - interest rate swap	1,698
TOTAL NONCURRENT LIABILITIES	<u>\$ 875,908</u>
TOTAL LIABILITIES	<u>\$ 915,437</u>
NET POSITION	
Restricted net position	\$ 397,969
TOTAL NET POSITION	<u>\$ 397,969</u>
OPERATING REVENUES	
Interest on investments	\$ 18,702
Net decrease in fair value of investments	(114)
Interest on mortgage loans	29,824
Program income/fees	22,647
Other revenues	732
TOTAL OPERATING REVENUES	<u>\$ 71,791</u>
OPERATING EXPENSES	
Interest on bonds	\$ 27,042
Mortgage servicing expense	1,803
Nonfederal program expense	16,273
General and administrative expense	667
Other expenses	568
TOTAL OPERATING EXPENSES	<u>\$ 46,353</u>
OPERATING INCOME	<u>\$ 25,438</u>
NON-OPERATING EXPENSES	
Transfers out	\$ (85)
TOTAL NON-OPERATING EXPENSES	<u>\$ (85)</u>
CHANGE IN NET POSITION	<u>\$ 25,353</u>
TOTAL NET POSITION - BEGINNING	<u>\$ 372,616</u>
TOTAL NET POSITION - ENDING	<u>\$ 397,969</u>
<u>STATEMENT OF CASH FLOWS</u>	
Net cash provided by operating activities	\$ 150,422
Net cash used in non-capital financing activities	(6,034)
Net cash used in investing activities	(143,871)
Net increase in cash	\$ 517
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>\$ 342,741</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 343,258</u>

North Carolina Housing Finance Agency

Supplementary Information

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Independent Auditor's Report on Supplementary Information

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

BDO USA, LLP

September 26, 2018

NORTH CAROLINA HOUSING FINANCE AGENCY

COMBINING STATEMENT OF NET POSITION
AS OF JUNE 30, 2018

(in thousands)	AGENCY PROGRAMS		GRANT PROGRAMS		HOME OWNERSHIP BOND PROGRAMS		Total
			Housing Trust	Federal and	1998	2009	
			Fund Programs	State Programs			
ASSETS							
Current assets:							
Cash and cash equivalents	\$	15,338	-	-	-	-	\$ 15,338
Restricted cash and cash equivalents		61,572	110,037	105,520	330,715	12,543	620,387
Investments		1,006	-	-	-	-	1,006
Restricted investments		1,006	-	-	8,990	1,008	11,004
Accrued interest receivable on investments		44	145	49	1,901	51	2,190
Mortgage loans receivable		193	2,662	13,195	74,030	17,532	107,612
Accrued interest receivable on mortgage loans		2	17	170	3,134	587	3,910
Other assets		203	-	1,329	3,661	1,365	6,558
Interprogram receivable (payable)		2,813	125	(3,351)	110	303	-
TOTAL CURRENT ASSETS	\$	82,177	112,986	116,912	422,541	33,389	\$ 768,005
Noncurrent assets:							
Investments	\$	974	-	-	-	-	\$ 974
Restricted investments		1,997	-	-	433,516	5,949	441,462
Mortgage loans receivable, net		1,826	12,612	81,571	332,324	83,989	512,322
Other assets, net		3,394	-	-	-	-	3,394
TOTAL NONCURRENT ASSETS	\$	8,191	12,612	81,571	765,840	89,938	\$ 958,152
TOTAL ASSETS	\$	90,368	125,598	198,483	1,188,381	123,327	\$ 1,726,157
DEFERRED OUTFLOWS OF RESOURCES							
Deferred outflows for pensions	\$	2,462	-	-	-	-	\$ 2,462
Deferred outflows for other postemployment benefits		1,409	-	-	-	-	1,409
Accumulated decrease in fair value of hedging derivative		-	-	-	1,698	-	1,698
TOTAL DEFERRED OUTFLOWS OF RESOURCES	\$	3,871	-	-	1,698	-	\$ 5,569
LIABILITIES							
Current liabilities:							
Bonds payable	\$	-	-	-	22,945	3,255	\$ 26,200
Accrued interest payable		-	-	-	10,577	1,637	12,214
Accounts payable		492	237	1,569	813	302	3,413
Unearned revenues		1,836	-	17,670	-	-	19,506
Other liabilities		211	-	5	-	-	216
TOTAL CURRENT LIABILITIES	\$	2,539	237	19,244	34,335	5,194	\$ 61,549
Noncurrent liabilities:							
Bonds payable, net	\$	-	-	-	772,510	101,700	\$ 874,210
Derivative instrument - interest rate swap		-	-	-	1,698	-	1,698
Unearned revenues		13,860	-	-	-	-	13,860
Pension liability		4,155	-	-	-	-	4,155
Other postemployment benefits		14,467	-	-	-	-	14,467
Other liabilities		5,279	-	-	-	-	5,279
TOTAL NONCURRENT LIABILITIES	\$	37,761	-	-	774,208	101,700	\$ 913,669
TOTAL LIABILITIES	\$	40,300	237	19,244	808,543	106,894	\$ 975,218
DEFERRED INFLOWS OF RESOURCES							
Deferred state grant	\$	-	3,961	-	-	-	\$ 3,961
Deferred inflows for pensions		136	-	-	-	-	136
Deferred inflows for other postemployment benefits		5,026	-	-	-	-	5,026
TOTAL DEFERRED INFLOWS OF RESOURCES	\$	5,162	3,961	-	-	-	\$ 9,123
NET POSITION							
Net investment in capital assets	\$	3,367	-	-	-	-	\$ 3,367
Restricted net position		45,912	121,400	179,239	381,536	16,433	744,520
Unrestricted net position		(502)	-	-	-	-	(502)
TOTAL NET POSITION	\$	48,777	121,400	179,239	381,536	16,433	\$ 747,385

NORTH CAROLINA HOUSING FINANCE AGENCY

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

YEAR ENDED JUNE 30, 2018

(in thousands)	AGENCY PROGRAMS	GRANT PROGRAMS		HOME OWNERSHIP BOND PROGRAMS		Total
		Housing Trust	Federal and	1998	2009	
		Fund Programs	State Programs			
OPERATING REVENUES						
Interest on investments	\$ 1,075	1,428	1,263	18,429	273	\$ 22,468
Net (decrease) increase in fair value of investments	(177)	-	-	116	(230)	(291)
Interest on mortgage loans	29	565	1,337	25,533	4,291	31,755
Federal program awards received	-	-	239,872	-	-	239,872
Program income/fees	11,626	2,996	31,219	22,647	-	68,488
Other revenues	23	60	129	693	39	944
TOTAL OPERATING REVENUES	\$ 12,576	5,049	273,820	67,418	4,373	\$ 363,236
OPERATING EXPENSES						
Interest on bonds	\$ -	-	-	23,712	3,330	\$ 27,042
Mortgage servicing expense	-	-	-	1,409	394	1,803
Federal program expense	-	-	246,260	-	-	246,260
Nonfederal program expense	1,906	-	-	16,273	-	18,179
General and administrative expense	19,796	-	6,648	636	31	27,111
Other expenses	347	34	43	477	91	992
TOTAL OPERATING EXPENSES	\$ 22,049	34	252,951	42,507	3,846	\$ 321,387
OPERATING (LOSS) INCOME	\$ (9,473)	5,015	20,869	24,911	527	\$ 41,849
NON-OPERATING REVENUES (EXPENSES)						
Transfers in (out)	\$ 17,924	61	(17,900)	(85)	-	\$ -
State appropriations received	-	11,609	3,000	-	-	14,609
State grants received	-	20,272	11,255	-	-	31,527
State program expense	(1,510)	(23,903)	(18,645)	-	-	(44,058)
TOTAL NON-OPERATING REVENUES (EXPENSES)	\$ 16,414	8,039	(22,290)	(85)	-	\$ 2,078
CHANGE IN NET POSITION	\$ 6,941	13,054	(1,421)	24,826	527	\$ 43,927
Total net position - beginning (as previously reported)	\$ 59,538	108,346	180,660	356,710	15,906	\$ 721,160
Cumulative effect of change in accounting principle	(17,702)	-	-	-	-	(17,702)
TOTAL NET POSITION - BEGINNING	\$ 41,836	108,346	180,660	356,710	15,906	\$ 703,458
TOTAL NET POSITION - ENDING	\$ 48,777	121,400	179,239	381,536	16,433	\$ 747,385

NORTH CAROLINA HOUSING FINANCE AGENCY
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2018

(in thousands)	AGENCY PROGRAMS		GRANT PROGRAMS		HOME OWNERSHIP BOND PROGRAMS		Total
		Housing Trust Fund Programs	Federal and State Programs		1998	2009	
Cash flows from operating activities:							
Interest on mortgage loans	\$ 29	565	1,276	26,202	4,403	\$ 32,475	
Principal payments on mortgage loans	167	1,973	13,833	71,170	17,226	104,369	
Purchase of mortgage loans	-	(677)	(13,601)	-	-	(14,278)	
Principal payments on mortgage loans held for resale	-	-	-	96,755	-	96,755	
Purchase of mortgage loans held for resale	-	-	-	(73,414)	-	(73,414)	
Federal program awards received	-	-	200,236	-	-	200,236	
Federal program expense	-	-	(246,388)	-	-	(246,388)	
Nonfederal program expense	(1,906)	-	-	(16,273)	-	(18,179)	
Federal grant administration income	-	-	14,513	-	-	14,513	
Program income/fees	12,898	2,996	16,605	22,647	-	55,146	
Other expenses	(21,566)	191	(11,322)	(3,866)	(393)	(36,956)	
Other revenues	(378)	(76)	-	6,865	(900)	5,511	
Net cash (used in) provided by operating activities	\$ (10,756)	4,972	(24,848)	130,086	20,336	\$ 119,790	
Cash flows from non-capital financing activities:							
Issuance of bonds	\$ -	-	-	150,000	-	\$ 150,000	
Principal repayments on bonds	-	-	-	(114,705)	(17,020)	(131,725)	
Interest paid	-	-	-	(19,062)	(3,745)	(22,807)	
Bond issuance costs paid	-	-	-	(1,417)	-	(1,417)	
Net transfers	17,924	61	(17,900)	(85)	-	-	
State appropriations received	-	11,609	3,000	-	-	14,609	
State grants received	-	20,012	11,386	-	-	31,398	
State program expense	(1,510)	(23,903)	(18,645)	-	-	(44,058)	
Net cash provided by (used in) non-capital financing activities	\$ 16,414	7,779	(22,159)	14,731	(20,765)	\$ (4,000)	
Cash flows from investing activities:							
Proceeds from sales or maturities of investments	\$ 6,000	-	-	9,689	1,000	\$ 16,689	
Purchase of investments	-	-	-	(172,587)	-	(172,587)	
Earnings on investments	1,092	1,373	1,242	17,748	279	21,734	
Net cash provided by (used in) investing activities	\$ 7,092	1,373	1,242	(145,150)	1,279	\$ (134,164)	
Net increase (decrease) in cash	\$ 12,750	14,124	(45,765)	(333)	850	\$ (18,374)	
Cash and cash equivalents at beginning of year	64,160	95,913	151,285	331,048	11,693	654,099	
Cash and cash equivalents at end of year	\$ 76,910	110,037	105,520	330,715	12,543	\$ 635,725	
Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:							
Operating (loss) income	\$ (9,473)	5,015	20,869	24,911	527	\$ 41,849	
Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:							
Interest on investments	(1,075)	(1,428)	(1,263)	(18,429)	(273)	(22,468)	
Decrease (increase) in fair value of investments	177	-	-	(116)	230	291	
Interest on bonds	-	-	-	23,712	3,330	27,042	
Change in assets and liabilities:							
Decrease in mortgage loans receivable	507	1,236	103	70,570	17,141	89,557	
(Increase) decrease in interest receivable on mortgage loans	-	-	(61)	768	158	865	
Decrease in mortgage loans held for resale	-	-	-	23,341	-	23,341	
(Increase) decrease in other assets	(1,222)	(42)	395	6,835	(900)	5,066	
(Decrease) increase in accounts payable and other liabilities	(916)	191	(4,759)	(1,506)	123	(6,867)	
Increase (decrease) in unearned revenues	1,246	-	(40,132)	-	-	(38,886)	
Total adjustments	\$ (1,283)	(43)	(45,717)	105,175	19,809	\$ 77,941	
Net cash (used in) provided by operating activities	\$ (10,756)	4,972	(24,848)	130,086	20,336	\$ 119,790	

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

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

Our Values: We Care, We Act, We Lead

North Carolina Housing Finance Agency
3508 Bush Street
Raleigh, NC 27609-7509

919-877-5700 www.nchfa.com

APPENDIX B

**FORM OF APPROVING OPINION OF BOND COUNSEL
WITH RESPECT TO SERIES 40 BONDS**

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APPENDIX B

LEGAL OPINION

Upon the delivery of the Series 40 Bonds, Womble Bond Dickinson (US) LLP, Bond Counsel to the Agency, proposes to issue its approving opinion in substantially the following form:

November ___, 2018

North Carolina Housing Finance Agency
Raleigh, North Carolina

We have acted as bond counsel to the North Carolina Housing Finance Agency (the "Agency") in connection with the authorization and issuance of \$ _____ North Carolina Housing Finance Agency Home Ownership Revenue Bonds, Series 40 (1998 Trust Agreement) (the "Series 40 Bonds"). We have examined (i) the Constitution and laws of the State of North Carolina, including Chapter 122A of the General Statutes of North Carolina, as amended (the "Act"), (ii) certified copies of the proceedings of the Agency authorizing the issuance, sale and delivery of the Series 40 Bonds, (iii) executed originals of the Trust Agreement, dated as of May 1, 1998 (the "Trust Agreement"), and the Fortieth Supplemental Trust Agreement, dated as of November 1, 2018 (the "Fortieth Supplemental Trust Agreement") pursuant to which the Series 40 Bonds are issued and (iv) other proofs submitted relative to the issuance and sale of the Series 40 Bonds.

The Series 40 Bonds are dated as of their date of delivery.

The Series 40 Bonds are issued for the purposes of providing funds to the Agency, together with other available funds, to (a) purchase Program Securities securitizing mortgage loans made to low and moderate income persons for single family residential housing in North Carolina, (b) purchase Series 40 DPA Loans as described in the Fortieth Supplemental Trust Agreement and (c) pay a portion of the costs of issuance of the Series 40 Bonds.

The Series 40 Bonds are issued under and pursuant to the Trust Agreement and the Fortieth Supplemental Trust Agreement. The Agency has heretofore issued thirty-nine series of Bonds under the Trust Agreement (the "Existing Bonds"). The Trust Agreement also provides for the issuance, from time to time, under the conditions, limitations and restrictions therein set forth, of additional Bonds. The Existing Bonds, the Series 40 Bonds and any such additional Bonds are herein collectively referred to as the "Bonds."

The Series 40 Bonds are subject to redemption prior to their maturity at the times, in the manner and upon the terms set forth in the Trust Agreement and the Fortieth Supplemental Trust Agreement.

The Series 40 Bonds are subject to the requirements of the Internal Revenue Code of 1986, as amended (the "Code"), and the regulations promulgated thereunder, that must be met subsequent to the issuance and delivery of the Series 40 Bonds in order that interest on the Series 40 Bonds be excluded, on and after the date of such issuance and delivery, from the gross income of the owners thereof for federal income tax purposes under the Code. The Agency has established procedures to meet the requirements of the Code. The Agency has also covenanted in the Fortieth Supplemental Trust Agreement to comply with the requirements of the Code, and in particular Sections 143 and 148 of the Code. Our opinion in paragraph 6 below with respect to the treatment of interest on the Series 40 Bonds for purposes of federal income taxation is rendered on the assumption that the Agency will carry out its procedures and comply with the aforementioned covenant contained in the Fortieth Supplemental Trust Agreement.

From such examination, we are of the opinion, as of the date hereof and under existing law, that:

1. The Agency has been duly created as a body politic and corporate constituting a public agency and instrumentality of the State of North Carolina with good, right and lawful authority to carry out the program of purchasing the Program Loans and to perform its obligations under the terms and conditions of the Trust Agreement and the Fortieth Supplemental Trust Agreement.

2. The Agency has duly authorized, executed and delivered the Trust Agreement and the Fortieth Supplemental Trust Agreement and such Agreements constitute legal, valid and binding agreements of the Agency, enforceable in accordance with their terms.
3. The Series 40 Bonds are valid and binding special obligations of the Agency secured by a valid pledge in the manner and to the extent set forth in the Trust Agreement, enforceable in accordance with their terms.
4. The Trust Agreement creates the valid and binding pledge it purports to create of the Program Obligations, Revenues and Prepayments (as such terms are defined in the Trust Agreement), and all moneys, securities and Funds and Accounts held or set aside pursuant to the Trust Agreement, to secure the payment of the Bonds in accordance with the terms thereof, subject to the provisions of the Trust Agreement permitting the disposition, use and payment thereof for or to the purposes and on the terms and conditions of the Trust Agreement. Such pledge shall become effective with respect to the assets and revenues so pledged immediately upon the receipt thereof by the Agency in the manner provided in the Trust Agreement.
5. The Series 40 Bonds do not constitute a debt, liability or obligation of the State of North Carolina or of any political subdivision thereof or a pledge of the faith and credit of the State or of any such political subdivision, but are payable solely from the revenues and assets of the Agency pledged therefor.
6. Assuming that the Agency will carry out the procedures mentioned above and comply with the covenants with respect to the Code contained in the Fortieth Supplemental Trust Agreement and other certificates and documents, interest on the Series 40 Bonds is not includable in the gross income of the owners thereof for federal income tax purposes. Interest on the Bonds is not treated as a preference item in computing the alternative minimum tax imposed by the Code. Interest on the Series 40 Bonds is exempt from all income taxes of the State of North Carolina. The Code and other laws of taxation, including the laws of taxation of the State of North Carolina, of other states, and of local jurisdictions, may contain other provisions that could result in tax consequences, upon which we render no opinion, as a result of the ownership or transfer of the Series 40 Bonds or the inclusion in certain computations of interest that is excluded from gross income for purposes of federal and North Carolina income taxation.

The rights of the owners of the Series 40 Bonds and the enforceability thereof and of the Trust Agreement and Fortieth Supplemental Trust Agreement may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore and hereafter enacted to the extent constitutionally applicable, and their enforcement may also be subject to the exercise of judicial discretion in appropriate cases.

[To be signed "Womble Bond Dickinson (US) LLP"]

APPENDIX C

**SUMMARY OF CERTAIN PROVISIONS OF THE TRUST AGREEMENT
AND THE FORTIETH SUPPLEMENTAL TRUST AGREEMENT**

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**SUMMARY OF CERTAIN PROVISIONS OF THE TRUST AGREEMENT
AND THE FORTIETH SUPPLEMENTAL TRUST AGREEMENT**

Definitions

In addition to words and terms elsewhere defined in this Official Statement, the following words and terms have the following meanings under the Trust Agreement, the Supplemental Trust Agreements thereunder and as used in this Official Statement, unless some other meaning is plainly intended:

"Bond Insurance" means an irrevocable policy of municipal bond insurance, a guaranty agreement or any similar instrument issued or entered into with a municipal bond insurer assuring timely payment of principal and interest on all or a portion of a Series of Bonds.

"Borrower" means the borrower under a Program Loan.

"Capital Appreciation Bond" means any Bond or Bonds of a Series sold at a price less than the principal amount thereof payable at maturity, if such Bond or Bonds are designated as a Capital Appreciation Term or Serial Bond or Bonds (or such other term describing Bonds having the characteristics of Capital Appreciation Bonds) by the Supplemental Trust Agreement providing for the issuance of such Series of Bonds.

"Cash Flow Certificate" means a certificate that is filed as required or permitted by an Authorized Officer, which certificate, after taking into account the effect of the conditions or circumstances for which such certificate is required, will show that scheduled payments of principal and interest on the Program Obligations are such that the Revenues, including, without limitation, investment income (based on the investment rates reasonably expected by the Agency to be received from the investment of amounts held under the Trust Agreement and to be set forth in such certificate) on the Funds and Accounts available for such payments, excluding the investment of amounts held in the Insurance Reserve Fund, and the moneys held for the credit of the Debt Service Reserve Fund (and any Special Debt Service Reserve Account with respect to any Bonds secured by a Special Debt Service Reserve Account) shall be sufficient to pay when due the principal of, Sinking Fund Requirements on account of, and interest on the Bonds and the Program Expenses.

Each Cash Flow Certificate shall set forth the assumptions upon which the investments therein are based, which assumptions shall be based upon the Agency's reasonable expectations at the time such Cash Flow Certificate is filed.

In determining the amount held in any Fund or Account under the Trust Agreement for purposes of preparing a Cash Flow Certificate, accrued but unpaid interest on amounts held in such Fund or Account invested in Investment Obligations shall be credited to the Fund or Account as if the same had been received and deposited to such Fund or Account on the date of calculation. In determining the amount held in the Funds and Accounts under the Trust Agreement, amounts held under any Fund or Account created under a Supplemental Trust Agreement shall be included in the calculation, unless the Supplemental Trust Agreement expressly excludes such amounts.

"Compounded Amount" means the amount of principal and accrued interest of a Capital Appreciation Bond as of a given date determined in the manner provided in the Supplemental Trust Agreement authorizing the issuance of such Capital Appreciation Bond.

"Debt Service Reserve Requirement" means, as of any particular time of calculation, the sum of the amounts established in each Supplemental Trust Agreement authorizing the issuance of a Series of Bonds secured by the Debt Service Reserve Fund as the portion of the Debt Service Reserve Requirement attributable to that Series (which amounts may decrease or increase over time in accordance with the terms of the Supplemental Trust Agreement). The portion of the Debt Service Reserve Requirement attributable to any Series of Bonds may be met through a deposit of cash, Investment Obligations or Reserve Alternative Instruments, or any combination thereof, as the case may be.

"Defeasance Obligations" means (a) noncallable Government Obligations and (b) Defeased Municipal Obligations.

"Defeased Municipal Obligations" means obligations of state or local government municipal bond issuers which are rated the highest rating category by each Rating Agency, the provision for the payment of the principal of, premium, if any, and interest on which shall have been made by deposit with a trustee or escrow agent of Government Obligations, the maturing principal of and interest on which, when due and payable, shall provide sufficient money to pay the principal of, premium, if any, and interest on such obligations of state or local government municipal bond issuers. References in this definition to state or local government bond issuers shall mean the State of North Carolina, local government bond issuers, and, to the extent permitted by law, states other than the State of North Carolina and local government bond issuers other than North Carolina local government bond issuers.

"Federal Mortgage Agency" means the Government National Mortgage Association, Fannie Mae, Freddie Mac and any other public or private agency created by the United States Congress for the purpose of housing finance and which is an agency or instrumentality of the United States or sponsored thereby.

"FHA Insured Program Loan" means a Program Loan the payment of which is insured by the Federal Housing Administration under the National Housing Act of 1934, as amended.

"Financing Fees" means any fees, charges or deposits that are authorized to be collected by the Agency from a Borrower or a Lender in order for the Agency to assure that funds are available in the Program Fund to purchase a Program Obligation on behalf of a specific Borrower. Financing Fees may be refundable or non-refundable as shall be specified in the Supplemental Trust Agreement authorizing the issuance of the Bonds financing the segment of the Program for which such Financing Fees are paid. Financing Fee shall not be "Revenues" within the meaning of the Trust Agreement unless a Supplemental Trust Agreement specifically designates such funds as Revenues.

"Government Obligations" means direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States Government.

"Insurance Reserve Requirement" means, as of any particular time of calculation, the sum of the amounts, if any, established in each Supplemental Trust Agreement authorizing the issuance of a Series of Bonds as the portion of the Insurance Reserve Requirement attributable to that Series (which amounts may increase or decrease over time in accordance with the terms of the Supplemental Trust Agreement). The portion of the Insurance Reserve Requirement attributable to any Series of Bonds may be met through a deposit of cash, Investment Obligations or Reserve Alternative Instruments, or any combination thereof, as the case may be.

"Interest Payment Date" means for any Bond the dates specified in the Supplemental Trust Agreement authorizing such Bonds as the "Interest Payment Date" therefor, notwithstanding that in respect of Capital Appreciation Bonds all or some portion of the interest is paid on a deferred basis.

"Investment Obligations" means

(1) Government Obligations,

(2) bonds, debentures, notes or other similar obligations (but not including "stripped" coupon obligations or the principal portion of any stripped obligation purchased in excess of par) issued by the Federal Intermediate Credit Bank, the Federal Home Loan Banks, Fannie Mae, the Bank for Cooperatives, the Federal Financing Bank, the Federal Farm Credit Bank, Freddie Mac, the Government National Mortgage Association, the Federal Housing Administration, the Farmers Home Administration, the Export-Import Bank, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank and the Federal Land Banks, if the timely payment of the principal of and interest thereon is secured by the full faith and credit of the United States of America,

(3) interest bearing time deposits or certificates of deposit or such other forms of deposit as the Local Government Commission may approve in any bank or trust company located outside or in the State, including a Depository, provided that such bank or trust company with which moneys are invested as herein provided: (i) is duly chartered under the laws of the United States or any state within the United States and authorized to engage in banking or trust activities, (ii) has a credit rating from a Rating Agency with respect to such bank's or trust company's long-term unsecured debt (or, if the debt of the bank is not rated, if its parent holding company has such a rating and the obligations of such institution are expressly and unconditionally guaranteed by the parent holding company) in one of its top two ratings categories, without regard to gradations within a category, and (iii) is approved by the Local Government Commission,

(4) deposits with the State Treasurer in an investment program established pursuant to Section 147-69.3 of the General Statutes of North Carolina,

(5) repurchase agreements that meet the requirements of Section 122A-11(5) of the General Statutes of North Carolina or any successor statute,

(6) participating shares in a mutual fund for North Carolina local governments if the investments of the fund are limited to those qualifying for investment under Section 159-30(c) of the North Carolina General Statutes, as amended, and the fund is certified by the Local Government Commission of North Carolina as a mutual fund permitted for local government investment;

(7) any other investment in which the Agency is authorized from time to time to invest the moneys held under the Trust Agreement, if the Agency receives confirmation from each Rating Agency that such investment would not impair such Rating Agency's Rating then in effect with respect to any Bonds.

"Lender" means any bank or trust company, savings bank, national banking association, savings and loan association, building and loan association, life insurance company, mortgage banking company, any governmental entity or other entity or institution authorized to transact mortgage lending business in the State, including the Agency and any local housing authority.

"Market Value" means the fair market value of property financed by a Program Loan, as demonstrated by an appraisal prepared by an appraiser acceptable to the Agency.

"Mortgage" means a deed of trust or other instrument securing a Program Loan that, unless the Mortgage secures a Series 40 DPA Loan, constitutes a first lien upon the property secured thereby, subject to minor easements, rights of way, and similar exceptions customarily acceptable to lenders of funds secured by residential real property and acceptable to the Agency.

"Officer's Certificate" means a certificate signed by an Authorized Officer, including certificates signed by an "electronic signature" of such Authorized Officer.

"Opinion of Counsel" means a written opinion of counsel who may (except as otherwise expressly provided in the Trust Agreement) be counsel for the Agency.

"Outstanding," when used with reference to the Bonds, shall mean, as of a particular date, all Bonds theretofore authenticated and delivered under the Trust Agreement, except:

(1) Bonds theretofore canceled by the Trustee;

(2) Bonds for the payment or redemption of which moneys or Defeasance Obligations, or both, in the necessary amount have theretofore been deposited in separate accounts with the Trustee in trust for the Owners (whether upon or prior to maturity or the redemption date of

such Bonds), the principal of and the interest on such Defeasance Obligations, if any, when due, providing sufficient moneys to pay, with such other moneys so deposited with the Trustee, the principal and redemption premium of and the interest on such Bonds being paid or redeemed; and

(3) Bonds in exchange for or in lieu of which other Bonds have been authenticated and delivered pursuant to the Trust Agreement.

"PMI Insured Program Loan" means a Program Loan the payment of which has been insured by a private mortgage insurance company that has been approved by Fannie Mae or Freddie Mac to insure mortgages purchased by them.

"Prepayments" means any moneys representing principal of a Program Obligation received or recovered by or for the account of the Agency from any payment of principal of any Program Obligation prior to the scheduled payment of principal called for by such Program Obligation, including, without limitation, (i) any payments of principal of any Program Obligation prior to the scheduled payment of principal called for by such Program Obligation, including any prepayment penalty, fee, premium or other additional charge as may be provided by the terms of such Program Obligation, (ii) amounts received upon the sale, assignment or other disposition of any Program Obligation, (iii) proceeds from the condemnation of any property financed by a Program Obligation, (iv) amounts received from any legal proceedings taken upon an event of default by a Borrower, (v) any amounts received by the Agency from a claim under any mortgage insurance, mortgage guarantee, mortgage pool insurance, title insurance or hazard insurance (other than amounts to be applied to replace, repair or restore the property with respect to which the hazard insurance payment was paid), (vi) amounts received from the sale or other disposition, including pursuant to foreclosure proceedings, of any property financed under a Program Obligation, and (vii) transfers from the Insurance Reserve Fund or the Revenue Reserve Fund of amounts to cover the deficiencies between the principal amount of a Program Loan and the amount received by the Agency upon the disposition of the same from the proceeds of foreclosure and any applicable insurance or guaranty payments.

"Program" means the Agency's program created under the Trust Agreement for the Agency to acquire Program Obligations and to hold the same, all for the purpose of assisting in providing housing to low and moderate income persons in the State.

"Program Expenses" means the Agency's expenses of carrying out and administering its powers, duties and functions relating to the Program as authorized by the Enabling Act, including, without limiting the generality of the foregoing, administrative expenses, salaries, supplies, utilities, mailing, labor, materials, office rent, maintenance, furnishings, equipment, machinery and apparatus, insurance premiums, legal, accounting, management, consulting and banking services and expenses, the fees and expenses of the Trustee and Depositaries, cost of issuance of Bonds not paid from proceeds of such Bonds, payments for pension, retirement, health and hospitalization and life and disability insurance benefits and any other expenses required or permitted to be paid by the Agency under the provisions of the Enabling Act or the Agreement, all to the extent such expenses are properly allocable to the Program in accordance with generally accepted accounting principles.

"Program Loan" means an obligation made or purchased by the Agency in order to finance or otherwise provide housing principally on behalf of households of low and moderate income with moneys in the Program Fund derived from the proceeds of, or otherwise made available in connection with the issuance of, Bonds pursuant to the Trust Agreement or that was purchased with the proceeds of bonds issued under another trust agreement or bond resolution of the Agency, which bonds were refunded by Bonds issued under the Trust Agreement. For purposes of Series 40 Bonds, Program Loans include Series 40 DPA Loans.

"Program Obligation" means any Program Loan or Program Security.

"Program Security" means an obligation representing an undivided interest in a pool of Program Loans, to the extent the payments to be made on such obligations are guaranteed or insured by a Federal Mortgage Agency, acquired by the Agency by the expenditure of funds from the Program Fund or that was purchased with

the proceeds of bonds issued under another trust agreement or bond resolution, which bonds were refunded by Bonds issued under the Trust Agreement.

"Rating" means with respect to any Series of Bonds, the rating issued by a Rating Agency in force immediately prior to the proposed action to be taken by the Agency, and an action which does not "impair" the Rating with respect to a Series of Bonds shall be an action that will not cause the Rating Agency to lower or withdraw the rating it has assigned to the Series of Bonds.

"Rating Agency" means any nationally recognized entity that, upon the request of the Agency, has issued a credit rating on any Series of Bonds issued under the Trust Agreement.

"Reserve Alternative Instrument" means an insurance policy, surety bond, irrevocable letter of credit, guaranty or similar instrument deposited in any Fund or Account created under the Trust Agreement, including any Supplemental Trust Agreement, in lieu of or in partial substitution for the deposit of cash and Investment Obligations in satisfaction of the Debt Service Reserve Requirement, Insurance Reserve Requirement, a Special Debt Service Reserve Account Requirement or other requirement of such Fund or Account. The Reserve Alternative Instrument shall be payable to make the payments otherwise required to be paid from such Fund or Account in a timely manner. Except as provided in the Trust Agreement, the provider of a Reserve Alternative Instrument shall be, at the time such Reserve Alternative Instrument is delivered to the Trustee (a) an insurer whose long term debt or claims paying ability has been assigned a rating by each Rating Agency in one of the two highest rating categories (without regard to gradations, such as "plus" or "minus," of such categories), or (b) a commercial bank, insurance company or other financial institution the bonds payable or guaranteed by which are assigned a rating by each Rating Agency in one of the two highest rating categories (without regard to gradations such as "plus" or "minus" of such categories). In the event that a Reserve Alternative Instrument is being delivered to provide all or a portion of a requirement of a Special Debt Service Reserve Account, then the Reserve Alternative Instrument and the requirements of the provider thereof shall meet the requirements set forth in the Supplemental Trust Agreement creating such Special Debt Service Reserve Account. Whenever for any purposes of the Trust Agreement the amounts on deposit in the Funds or Accounts under the Trust Agreement are required to be determined, the amount available to be drawn under any Reserve Alternative Instrument shall be deemed to be cash on deposit in the applicable Fund or Account.

"Reserve Fund Surety Bonds" means any surety bonds issued with regard to the Debt Service Reserve Fund Requirements or Insurance Reserve Fund Requirements for a particular series of Bonds.

"Revenues" means all payments of principal of and interest on the Program Obligations including both timely and delinquent payments (including late charges to the extent such late charges are collected by the Agency), and investment earnings on any amounts held in any Fund or Account under the Trust Agreement to the extent said earnings are required pursuant to the Trust Agreement or a Supplemental Trust Agreement to be deposited to the Revenue Fund, but shall not include Escrow Payments, Prepayments, Program Obligation Accrued Interest or Financing Fees, or escrow fees or servicing fees received by a Servicer pursuant to a Servicing Agreement (including the Agency acting as Servicer).

"Serial Bonds" means the Bonds of a Series which shall be stated to mature in fixed installments on a fixed payment date, rather than through mandatory redemption in accordance with Sinking Fund Installments, as designated by the Supplemental Trust Agreement authorizing the issuance thereof.

"Series" means any issued or authorized to be issued at any one time pursuant to the Trust Agreement and authorized as "Series" of Bonds by the Supplemental Trust Agreement authorizing the issuance thereof.

"Series 40 DPA Loans" means loans that are made to Borrowers in connection with the origination of Series 40 Securitized Mortgage Loans, which loans are made for down payment assistance and are made with proceeds of the Series 40 Bonds deposited to the Series 40 Program Account. Series 40 DPA Loans may have such programmatic features, including a zero interest rate and principal reductions upon meeting prescribed terms, and may be secured on a subordinated basis, as are provided for in the Trust Agreement. Series 40 DPA Loans are "Program Loans" for purposes of the Trust Agreement.

"Servicer" means any bank or trust company, savings bank, national banking association, savings and loan association, building and loan association, life insurance company and other mortgage banker or financial institution which shall service any of the Program Loans pursuant to a Servicing Agreement with the Agency, or the Agency if the Agency determines to service any Program Loans held pursuant to the Trust Agreement.

"Servicing Agreement" means an agreement between the Agency and a Servicer, if the Agency is not the Servicer, for the servicing of any of the Program Loans by the Servicer.

"Sinking Fund Calculation Period" means the period of time set forth in the Supplemental Trust Agreement authorizing the issuance of Term Bonds during which the Agency is to deposit from the Revenue Fund to the credit of the Sinking Fund Account an established amount to be applied to the purchase or redemption of such Term Bonds in accordance with a Sinking Fund Requirement for such period also established in such Supplemental Trust Agreement.

"Sinking Fund Requirement" means, with respect to the Term Bonds of any Sinking Fund Calculation Period, the principal amount fixed or computed for such Sinking Fund Calculation Period for the retirement of such Term Bonds by purchase or redemption (or by payment at maturity in the case of the final Sinking Fund Requirement for any maturity).

"State Treasurer" means the Treasurer of the State of North Carolina.

"Subordinated Indebtedness" means all indebtedness incurred by the Agency in respect of the Program that is made payable from the Revenues, but only after the payments described below under the heading "Application of Revenues and Other Moneys" have been made, to the extent incurred in accordance with the requirements of the Trust Agreement.

"Supplemental Trust Agreement" means a resolution of the Board providing for the issuance of any particular Series of Bonds which is required to be executed and delivered prior to the issuance of such Series.

"Swap Agreement" means any interest rate swap agreement entered into by the Agency with a Swap Provider, pursuant to which the Agency and the Swap Provider agree to make payments thereunder with respect to a notional amount corresponding to Bonds for the purpose of effectively converting the interest rate on the Agency's bonds bearing interest at a variable interest rate to a fixed interest rate, or converting the interest rate on the Agency's bonds bearing interest at a fixed interest rate to a variable interest rate.

"Swap Agreement Periodic Payments" means payments required to be paid by the Agency under a Swap Agreement, other than Swap Agreement Termination Payments.

"Swap Agreement Termination Payments" means payments required to be paid by the Agency under a Swap Agreement in connection with the termination of the Swap Agreement, whether voluntarily or upon the occurrence of an event of default or similar event thereunder.

"Swap Provider" means any financial institution with which the Agency enters into an interest rate swap agreement with respect to Bonds.

"Term Bonds" means the Bonds of a Series designated Term Bonds in the Supplemental Trust Agreement authorizing the issuance thereof.

"Trustee" means the Trustee serving as such under the Trust Agreement, whether original or successor.

"USDA Guaranteed Program Loan" means a Program Loan the payment of which is guaranteed by the United States Department of Agriculture Rural Development under its loan guarantee program created under Title V of the Housing Act of 1949, or any successor program.

"VA Guaranteed Program Loan" means a Program Loan the payment of which is guaranteed by the United States Veterans Administration.

Additional Bonds; Supplemental Trust Agreements

Bonds of the Agency may be issued under and secured by the Trust Agreement from time to time for the purpose of providing sufficient funds, with any other available funds, for (a) the making or purchase by the Agency of Program Obligations, (b) refunding Bonds of the Agency issued under the Trust Agreement or under trust agreements or bond resolutions other than the Trust Agreement, including the payment of any redemption premium thereon, (c) the payment of Program Expenses, (d) the payment of interest on such Bonds for the period specified in the Supplemental Trust Agreement authorizing the issuance thereof, and (e) the making of any deposit to the credit of the Debt Service Reserve Fund, the Insurance Reserve Fund or a Special Debt Service Reserve Account required in connection with the issuance of such Series of Bonds.

Before any Bonds shall be issued under the Trust Agreement, the Agency and the Trustee shall enter into a Supplemental Trust Agreement authorizing the issuance of such Bonds fixing the amount and the details thereof. Such Supplemental Trust Agreement shall designate the Series of Bonds and shall set forth the authorized denominations, dates, maturities, interest rates, Interest Payment Dates, redemption provisions, Sinking Fund Requirements and other terms of the details of the Bonds authorized thereby. Each Supplemental Trust Agreement shall specify whether the Series of Bonds authorized thereby shall be entitled to the benefit of the Debt Service Reserve Fund, a Special Debt Service Reserve Account created under the Supplemental Trust Agreement or neither and shall specify the Debt Service Reserve Requirement or the requirement for the Special Debt Service Reserve Account in connection with the Bonds of such Series. Each Supplemental Trust Agreement shall specify the Insurance Reserve Requirement in connection with the Program Obligations to be financed with the proceeds of the Bonds issued thereunder. Each Supplemental Trust Agreement shall specify any requirements for the Program Obligations to be purchased with the proceeds of the Bonds authorized thereby, including how payment of such Program Obligations must be insured, guaranteed or otherwise secured. Each Supplemental Trust Agreement shall specify whether a policy of Bond Insurance will be delivered in connection with the issuance of such Bonds and provide any additional covenants and provisions with respect thereto.

Funds and Accounts

The Trust Agreement and certain of the Supplemental Trust Agreements create the following Funds and Accounts:

- (a) Revenue Fund
- (b) Bond Service Fund
 - (i) Interest Account
 - (ii) Principal Account
 - (iii) Sinking Fund Account
- (c) Reserve Fund Surety Bond Reimbursement Fund
- (d) Swap Agreement Payment Fund
- (e) Debt Service Reserve Fund
 - (i) Contribution Reserve Account
 - (ii) Equity Reserve Account
 - (iii) Proceeds Reserve Account
- (f) Insurance Reserve Fund

- (g) Redemption Fund
- (h) Revenue Reserve Fund
- (i) Revenue Reserve Equity Account
- (i) Program Fund

A Supplemental Trust Agreement may provide for the creation of a Special Debt Service Reserve Account for the Bonds authorized by such Supplemental Trust Agreement and for the deposit of moneys to and withdrawal of moneys from such Account.

Any Supplemental Trust Agreement may establish such additional Funds and Accounts as shall be deemed necessary or desirable in order to effectuate the transactions contemplated by the Trust Agreement. The Fortieth Supplemental Trust Agreement creates such a special fund designated the "Series 40 Principal/Special Redemption Account," which is more fully discussed below.

Program Fund

Each Supplemental Trust Agreement authorizing the issuance of a Series of Bonds shall create a separate account in the Program Fund for the Program Obligations associated with the Bonds of such Series.

Money held for the credit of any Program Account shall be used to pay the following costs of the Program relating to the Series of Bonds for which such Account was established:

- (a) the amount determined by the Agency to be required to make or purchase any Program Obligation;
- (b) Costs of Issuance;
- (c) interest on such Bonds to the extent set forth in the Supplemental Trust Agreement authorizing such Series of Bonds;
- (d) any obligation or expense heretofore or hereafter incurred or paid by the Agency for any of the items mentioned in clause (b) above; and
- (e) to pay, either at maturity or otherwise in accordance with their terms, any notes theretofore issued by the Agency to provide interim financing for any of the purposes for which Bonds may be issued pursuant to the Trust Agreement.

The Agency covenants that immediately after any moneys are paid by the Trustee to a Lender or other person, firm, or corporation for the making of or purchase by the Agency of any Program Loans, or any notes of the Agency are paid pursuant to the Trust Agreement, the Agency will physically deliver, or cause to be physically delivered, to the Trustee the note or other instrument evidencing each Program Loan made or acquired as a result of such payment.

The Trustee shall not apply any moneys in the Program Fund to the purchase of a Program Security unless arrangements have been made so that immediately after such use the Trustee shall hold, on behalf of the Owners, a first perfected security interest in such Program Security, either through physical delivery of such Program Security or adequate notation on book-entry records for book-entry only securities. No Program Security shall be financed unless such Program Security represents a pass through or participation in a pool of mortgage loans that the Agency is eligible to finance under the Enabling Act and the Program Security provides for a guaranty of all payments to be made thereunder by a Federal Mortgage Agency.

Any Program Obligation may be withdrawn from the Program Fund and transferred by the Trustee to the recipient directed by the Agency free and clear from any pledge, lien, security interest or other interest

created under the Trust Agreement upon the delivery to the Trustee of an Officer's Certificate directing such transfer and certifying that:

(a) such transfer is being made in order to provide for the redemption (whether optional or special, to the extent permitted by the applicable Supplemental Trust Agreement) or purchase of Bonds having a value corresponding to the value of the Program Obligation being withdrawn as reasonably estimated by the Agency and set forth in the Officer's Certificate; and

(b) the proposed transfer of the Program Obligation to the Agency and the sale, assignment, transfer or other disposition thereof by the Agency would not have a material adverse effect on the ability of the Agency to pay the principal of, and interest on, and premium, if any on the Bonds as the same become due, and to pay the Program Expenses.

Pledge

Pursuant to the Trust Agreement, the Agency has pledged for the security of the Bonds, subject to the provisions of the Trust Agreement:

(a) All Program Obligations, Revenues, Program Obligation Accrued Interest, Financing Fees and Prepayments (as such terms are herein defined), and all moneys, securities and Funds and Accounts held or set aside pursuant to the Trust Agreement; and

(b) All money and securities held by or on behalf of the Trustee in all of the funds, accounts or subaccounts established pursuant to the Trust Agreement, except those funds, accounts and subaccounts that are expressly pledged in a Supplemental Trust Agreement as security only for a specified Series of Bonds and a Special Debt Service Reserve Account (hereinafter defined).

The pledge of the moneys, securities and Funds and Accounts and of the Program Obligations, Revenues, Program Obligation Accrued Interest, Financing Fees and Prepayments is valid and binding from and after the delivery of the first Bond delivered under the Trust Agreement. The Program Obligations, Revenues, Program Obligation Accrued Interest, Financing Fees and Prepayments and other moneys and securities so pledged and then or thereafter received by the Agency shall immediately be subject to the lien of such pledge without any physical delivery or further act, except that the Program Obligations shall be subject to the lien of such pledge only after the delivery of the Program Loan notes to the Trustee and the lien of such pledge shall be valid and binding as against all parties having claims of any kind in tort, contract or otherwise against the Agency, irrespective of whether such parties have notice thereof.

Application of Revenues and Other Moneys

All Revenues, Program Obligation Accrued Interest, Financing Fees and Prepayments shall be collected by or on behalf of the Agency and deposited as received in the name of the Trustee or with a qualified Depository or Depositaries designated by the Agency which shall receive the same as deposits of moneys held by the Trustee. The Trustee is only responsible for money actually deposited as described in the Trust Agreement.

Except as described below, all Revenues shall be deposited by the Trustee to the credit of the Revenue Fund.

Except as described below, any Prepayment shall be deposited by the Trustee to the credit of the Special Redemption Account for the Series of Bonds that provided the funds that financed the purchase of the Program Obligation to which such Prepayment relates (or that refunded the Bonds that financed such purchase), or, to the extent provided by the Supplemental Trust Agreement for the Series of Bonds that provided the funds that financed the purchase of the Program Obligation to which such Prepayment relates, to the credit of the Program Account for such Series of Bonds to be applied to purchase additional Program Obligations.

Notwithstanding the foregoing, the Fortieth Supplemental Trust Agreement provides that the Agency shall direct the Trustee to deposit principal payments on the Series 40 Program Obligations, whether constituting scheduled principal payments or Prepayments, to the Series 40 Principal/Special Redemption Account, to be applied as provided in the Fortieth Supplemental Trust Agreement as described in the Official Statement under the caption "SECURITY FOR AND SOURCES OF PAYMENT OF THE SERIES 40 BONDS—Series 40 Principal/Special Redemption Account and Disposition of Certain Funds."

Any Financing Fees attributable to a Series of Bonds received by the Agency shall be deposited by the Agency as received as shall be provided in the Supplemental Trust Agreement for such Series.

Any moneys or other assets received by the Trustee from the Agency with instructions that the same be deposited to the credit of any Fund or Account under the Trust Agreement shall be so deposited to such Fund or Account.

Except as described above with respect to the Fortieth Supplemental Trust Agreement, in the event the Trustee or Agency receives a single payment all or any part of which constitutes Revenues, Prepayments, Program Obligation Accrued Interest or Financing Fees, the Trustee or Agency, as the case may be, shall segregate such payment into Revenues, Prepayments, or Program Obligation Accrued Interest and Financing Fees prior to making the deposits provided for above.

Except as described below with respect to the amounts deposited to the Series 40 Principal/Special Redemption Account, the Trustee, as of the last business day of each month, shall withdraw from the Revenue Fund and deposit to the credit of the following several Funds or Accounts, but as to each Fund or Account only within the limitation herein below indicated with respect thereto and only after maximum payment within such limitation into every such Fund or Account previously mentioned in the following tabulation:

First: To the credit of the Interest Account, to the extent, if any, needed to increase the amount in the Interest Account so that it equals the amount of interest then or to become within the next ensuing six months due and payable on the Bonds of each Series then Outstanding; provided, however, that if interest on any Bonds is payable on a periodic basis other than a semi-annual basis, then the deposit requirement for the Interest Account may be adjusted pursuant to the Supplemental Trust Agreement authorizing such Bonds to reflect the payment of interest on such other periodic basis, provided, further, however, that the Agency shall not establish any schedule for the deposit of funds to the Interest Account to pay interest on Bonds on other than a semi-annual basis that would cause the Agency to default in the payment of the principal and Sinking Fund Requirements of, and interest on, any other Series of Bonds;

Second: To the credit of the Principal/Special Redemption Account, to the extent, if any, needed to increase the amount in the Principal Account so that it equals the amount of principal of the Serial Bonds of each Series then or to become due and payable within the next ensuing six months; provided, however, that if the principal of any Series of Bonds is payable on an annual basis, then such amount of principal of the Serial Bonds of such Series, then or to become due and payable within the next ensuing twelve months (or if the date of such deposit is the last business day of the first six months of such annual period, one-half of the amount of such principal to become due and payable within the next ensuing twelve months); and provided further, that if principal on any Bonds is payable on a periodic basis other than a semi-annual or annual basis, then the deposit requirement for the Principal Account may be adjusted pursuant to the Supplemental Trust Agreement authorizing such Bonds to reflect the payment of principal on such other periodic basis, provided, further, however, that the Agency shall not establish any schedule for the deposit of funds to the Principal Account to pay principal on Bonds on other than a semi-annual or annual basis that would cause the Agency to default in the payment of the principal and Sinking Fund Requirements of, and interest on, any other Series of Bonds;

Third: To the credit of the Sinking Fund Account, to the extent, , if any, needed to make the amounts so deposited in the then current Sinking Fund Calculation Period to the credit of the Sinking Fund Account for the Term Bonds of each Series then Outstanding equal to the Sinking Fund Requirements, if any, for each such Sinking Fund Calculation Period, plus the premiums, if any, on such principal amount of the Term Bonds which would be payable if such principal amount of Term Bonds were to be redeemed in such period from money held for the credit of the Sinking Fund Account;

Fourth: To the credit of the Reserve Fund Surety Bond Reimbursement Fund the amount, if any, necessary to make payments to the issuers of the Reserve Fund Surety Bonds to reimburse such issuers for payments with respect to the Reserve Fund Surety Bonds in accordance with the terms of the agreements between the Agency and such issuers in connection therewith;

Fifth: To the credit of the Swap Agreement Payment Fund the amount, if any, needed to increase the amount in that Account so that it equals the amount estimated at the time of the transfer to be necessary to pay to any Swap Providers (i) the Swap Agreement Periodic Payments required to be paid during the ensuing six months and (ii) any Swap Agreement Termination Payments then due and payable. In the event that the Agency enters into more than one Swap Agreement and there are not sufficient funds at the end of a month to make all deposits to all Accounts of the Swap Agreement Payment Fund, amounts shall be deposited to the Series 17 Account of the Swap Agreement Payment Fund and any other Account created with respect to a Swap Agreement on a pro rata basis;

Sixth: To the credit of the Debt Service Reserve Fund, to the extent, if any, needed to increase the amount in the Debt Service Reserve Fund so that it equals the Debt Service Reserve Requirement;

Seventh: To the credit of any Special Debt Service Reserve Account, to the extent, if any, needed to increase the amount in such Special Debt Service Reserve Account to the

amount required to be on deposit therein by the Supplemental Trust Agreement creating such Special Debt Service Reserve Account; in the event that there are deficiencies in more than one Special Debt Service Reserve Account, to the extent there are insufficient funds to make the deposits required to be made to all Special Debt Service Reserve Accounts, the available amount shall be deposited to all of the Special Debt Service Reserve Accounts pro rata based upon the amounts then required to be deposited to each such Special Debt Service Reserve Account;

Eighth: To the credit of the Insurance Reserve Fund, to the extent, if any, needed to increase the amount in the Insurance Reserve Fund so that it equals the Insurance Reserve Requirement;

Ninth: To the credit of the Revenue Reserve Fund, for deposit therein, the balance remaining.

Notwithstanding the foregoing, pursuant to the Fortieth Supplemental Trust Agreement, Revenues will not be transferred from the Revenue Fund to the Series 40 Principal/Special Redemption Account to pay principal or sinking fund redemption with respect to the Series 40 Bonds.

A Supplemental Trust Agreement may provide for the deposit of Revenues to a Fund or Account created thereunder or for another application of Revenues prior to the deposit of remaining Revenues to the credit of the Debt Service Reserve Fund, a Special Debt Service Reserve Account, the Insurance Reserve Fund or the Revenue Reserve Fund; provided however, that the Supplemental Trust Agreement providing for such change in the application of Revenues shall not be effective without the prior written consent of any Swap Provider that is adversely affected by such change.

Interest Account and Principal Account

The Trustee shall, on each Interest Payment Date, remit payment of interest on the Bonds then due from the Interest Account. The Trustee shall, on each Principal payment date, remit payment of principal on the Bonds then due from the Principal Account.

Sinking Fund Account

Moneys held for the credit of the Sinking Fund Account shall be applied during each Sinking Fund Calculation Period for the retirement of Term Bonds of each Series then Outstanding as provided in the Trust Agreement.

Series 40 Principal/Special Redemption Account

Notwithstanding the foregoing, pursuant to the Fortieth Supplemental Trust Agreement, payments of principal of the Series 40 Bonds, whether on account of a scheduled maturity or redemption, shall be paid from the Series 40 Principal/Special Redemption Account and not from the Principal Account or the Sinking Fund Account. Amounts not required to pay principal of the Series 40 Bonds shall be applied as provided in the Fortieth Supplemental Trust Agreement as described in the Official Statement under the caption "SECURITY FOR AND SOURCES OF PAYMENT OF THE SERIES 40 BONDS—Series 40 Principal/Special Redemption Account and Disposition of Certain Funds."

Reserve Fund Surety Bond Reimbursement Fund

Amounts deposited to the Reserve Fund Surety Bond Reimbursement Fund shall be applied to reimburse the issuer of the respective Prior Reserve Surety Bonds for the amount of drawings and to pay expenses with respect to drawings, including interest expenses, incurred by the Agency under agreements entered by the Agency in connection with the procurement of the Prior Reserve Fund Surety Bonds.

Swap Agreement Payment Fund

Amounts deposited to the respective accounts of the Swap Agreement Payment Fund shall be applied to make payments to the Swap Provider in accordance with the terms of the respective Swap Agreement.

Redemption Fund

Moneys in the Redemption Fund will be applied to the optional or special redemption of Bonds. Each Supplemental Trust Agreement authorizing a Series of Bonds under the Trust Agreement shall create a separate account in the Redemption Fund designated the Special Redemption Account. The Redemption Prices and the times and conditions for redemption of Bonds of each Series which are subject to redemption from moneys held for the credit of a Special Redemption Account, and the Redemption Prices and the times and conditions for redemption of Bonds of each Series which are subject to redemption from moneys held for the credit of the Optional Redemption Account shall be the respective Redemption Prices and times and conditions for redemption specified in the Supplemental Trust Agreement for such Series of Bonds. Any Supplemental Trust Agreement may provide redemption priorities or protection to any maturities of the Bonds authorized by such Supplemental Trust Agreement with respect to redemptions to be made.

Any Supplemental Trust Agreement may provide that Prepayments deposited to the Special Redemption Account created thereby may be applied to redeem Bonds other than the Series of Bonds authorized thereby, and may provide any additional conditions that must be met prior to such a redemption.

Debt Service Reserve Fund

Moneys deposited to the credit of the Debt Service Reserve Fund shall be credited to the Proceeds Reserve Account to the extent such moneys are proceeds of Bonds, to the Contribution Reserve Account to the extent that such moneys are derived from appropriations by the State to the Agency and to the Equity Reserve Account to the extent such moneys are not proceeds of Bonds or are not derived from appropriations by the State to the Agency. Any amounts deposited to the Debt Service Reserve Fund from the Revenue Fund as described above under the heading "Application of Revenues and Other Moneys" shall be credited to the Proceeds Reserve Account, Contribution Reserve Account or the Equity Reserve Account as necessary to replenish the amounts withdrawn from such respective Accounts as hereinafter described.

If at any time the moneys held for the credit of the Bond Service Fund, including moneys transferred from the Revenue Reserve Fund as described below under the heading "Revenue Reserve Fund" and any amounts transferred under Funds and Accounts created under any Supplemental Trust Agreement to the extent required to be transferred to the Bond Service Fund or an Account thereof, shall be insufficient to pay when due the interest, principal and Sinking Fund Requirements of the Bonds secured by the Debt Service Reserve Fund the Trustee shall transfer from the Debt Service Reserve Fund to the credit of the Bond Service Fund an amount sufficient to make up any such deficiency.

Amounts shall be transferred from the Debt Service Reserve Fund to the Bond Service Fund only to the extent necessary to pay the interest on and principal and Sinking Fund Requirements of Bonds secured by the Debt Service Reserve Fund. In the event that any portion of the Debt Service Reserve Requirement is being provided by a Reserve Alternative Instrument, the Trustee shall make such drawings under such Reserve Alternative Instrument, pursuant to the terms thereof, as shall be necessary so that the proceeds of such drawing shall be available to make the transfers to the Bond Service Fund required by this paragraph.

If at any time the moneys held for the credit of the Debt Service Reserve Fund shall exceed the Debt Service Reserve Requirement and all transfers of moneys from the Debt Service Reserve Fund have been made, subject to certain provisions of the Trust Agreement, the Agency, by an Officer's Certificate, may instruct the Trustee to withdraw from the Debt Service Reserve Fund the amount of the excess therein over the Debt Service Reserve Requirement. If the Trustee is directed to make such withdrawal, the Trustee shall (i) if the withdrawal is from the Proceeds Reserve Account, deposit the amount withdrawn to the Optional Redemption Account or a Special Redemption Account as shall be directed in such Officer's Certificate, or (ii) if the amount withdrawn is from the Contribution Reserve Account or the Equity Reserve Account, pay the amount as directed by the

Agency, including depositing such amounts to the credit of the Optional Redemption Account or a Special Redemption Account.

Any deficiency in the Debt Service Reserve Fund, whether resulting from a drawing on a Reserve Alternative Instrument or transfers of cash, may be satisfied through the deposit of additional moneys or the providing of an additional, or increase in a, Reserve Alternative Instrument. If a drawing under a Reserve Alternative Instrument occurs, amounts held in the Debt Service Reserve Fund shall be applied to reimburse the issuer of the Reserve Alternative Instrument, including interest thereon, in connection with such drawing under such terms as shall be agreed upon between the Agency and the issuer of the Reserve Alternative Instrument.

Insurance Reserve Fund

The Insurance Reserve Requirement with respect to each Series of Bonds, if any, is to be set forth in the Supplemental Trust Agreement authorizing the issuance of such Bonds. To date, the Insurance Reserve Requirement for each Series of Bonds, has been a percentage of the Program Loans to be financed with the proceeds of the Bonds, with the percentage based upon whether the Program Loan is an FHA Insured Program Loan, a VA Guaranteed Program Loan, a USDA Guaranteed Program Loan, a PMI Insured Program Loan or a Program Loan that does not require insurance or a guaranty. There is no Insurance Reserve Requirement with respect to the Series 40 Bonds and the provisions of the Trust Agreement regarding the Insurance Reserve Fund do not apply to the Program Obligations deposited to the Series 40 Program Account.

The Insurance Reserve Requirement for any subsequent Series of Bonds, if any, will be set forth in the Supplemental Trust Agreement authorizing the issuance of such Bonds.

Money deposited in the Insurance Reserve Fund shall be used for the purpose of paying the portion of any loss with respect to a Program Loan in default that is not paid from any public or private insuring or guaranteeing agency. To the extent any amounts in the Insurance Reserve Fund are required to be applied to the payment of Bonds, the Agency is not required to replenish such amounts.

Revenue Reserve Fund

Money deposited in the Revenue Reserve Fund shall be used in the following order of priority:

1. If at any time the moneys held to the credit of the Bond Service Fund shall be insufficient to pay when due the interest, principal or the Sinking Fund Requirements of any Bonds, the Trustee shall transfer from the Revenue Reserve Fund to the credit of the Bond Service Fund an amount sufficient to make up any such deficiency.
2. The Trustee shall transfer from the Revenue Reserve Fund such amount as shall be necessary to be paid from time to time to the United States of America or to the borrowers under the Program Obligations in order for the Agency to comply with the applicable covenants made by the Agency regarding the exclusion of interest on the Bonds from federal income taxation.
3. The Trustee shall transfer from the Revenue Reserve Fund to the credit of the applicable Special Redemption Account, whenever Prepayments are received with respect to any defaulted Program Loan, the amount, if any, by which the portion of such Prepayments to be deposited in such Special Redemption Account, representing the payment of principal on such Program Loan, is less than the amount by which the principal balance of the defaulted Program Loan has been reduced as a result of the receipt of such Prepayments, as determined in an Officer's Certificate filed with the Trustee.
4. The Trustee shall transfer from the Revenue Reserve Fund to the Agency any amount certified in an Officer's Certificate filed with the Trustee as necessary for the payment of real estate taxes, insurance, foreclosure fees, including appraisal and legal fees, and similar expenses incurred by the Agency in connection with the acquisition of any property secured by a mortgage on behalf of the Agency or expenses for repairs, rehabilitation, improvements, maintenance, renting or sale and similar expenses incurred by the Agency in connection with such property.

5. The Trustee shall transfer from the Revenue Reserve Fund to the Optional Redemption Account or any Special Redemption Account the amount specified to the Trustee by the Agency to redeem Bonds.

6. The Trustee shall transfer from the Revenue Reserve Fund to any Program Account the amount specified to the Trustee by the Agency in an Officer's Certificate for the purpose of paying Issuance Costs in connection with the issuance of a new Series of Bonds or to purchase additional Program Obligations.

7. The Trustee shall transfer from the Revenue Reserve Fund the amount specified to the Trustee by the Agency in an Officer's Certificate for the purpose of paying Program Expenses if, as shown by an Officer's Certificate filed with the Trustee, the Agency has purchased and owns Program Obligations with scheduled payments of principal and interest such that the Revenues and Prepayments, if any, estimated by the Agency in good faith to be received from such Program Obligations, together with any other moneys estimated in good faith to be available for the payments hereinafter mentioned, including, without limitation, investment income on the Funds and Accounts available for such payments and the moneys held for the credit of the Debt Service Reserve Fund and any Special Debt Service Reserve Account, shall be sufficient to pay when due (i) the Program Expenses and (ii) the principal of, Sinking Fund Requirements on account of, and interest on the Bonds.

8. The Trustee shall transfer from the Revenue Reserve Fund the amounts directed by the Agency for any purpose for which amounts in the Revenue Reserve Fund may be applied pursuant to the Trust Agreement.

9. The Trustee shall transfer from the Revenue Reserve Fund to the Agency's General Fund the amount specified to the Trustee by the Agency in an Officer's Certificate, at any time by which (A) the amount in the Revenue Reserve Fund, together with the amount in all other Funds and Accounts under the Resolution (other than the Interest Account and the Insurance Reserve Account) and the outstanding principal balance of all Program Obligations exceeds (B) 102% of the Outstanding principal amount of Bonds; but only if as shown by an Officer's Certificate filed with the Trustee, the Agency has purchased and owns Program Obligations with scheduled payments of principal and interest such that the Revenues and Prepayments, if any, estimated by the Agency in good faith to be received from such Program Obligations, together with any other moneys estimated in good faith to be available for the payments hereinafter mentioned, including, without limitation, investment income on the Funds and Accounts available for such payments and the moneys held for the credit of the Debt Service Reserve Fund and any Special Debt Service Reserve Account, shall be sufficient to pay when due (A) the Program Expenses and (B) the principal of, Sinking Fund Requirements on account of, and interest on the Bonds. For purposes of determining whether such a transfer to the General Fund may be made, investments in all Funds and Accounts shall be valued at cost plus amortization of discount or minus amortization of premium.

In addition, amounts deposited to the Revenue Reserve Fund may be applied to the following additional purposes:

(i) If at any time the Agency is required to make a Swap Agreement Periodic Payment or a Swap Agreement Termination Payment, the Trustee shall transfer from the Revenue Reserve Fund to the Swap Agreement Payment Fund the amount required to pay the applicable payment to the Swap Provider.

(ii) In the event there is a Swap Agreement Periodic Payment or a Swap Agreement Termination Payment required to be paid by the Agency, and such payment is paid by an insurer or guarantor, the Trustee shall transfer from the Revenue Reserve Fund to the Swap Agreement Payment Fund the amount required to reimburse the payment of the Swap Agreement Periodic Payment or a Swap Agreement Termination Payment by such insurer or guarantor.

Funds on deposit in the Revenue Reserve Fund shall be used for the purposes described in items (i) and (ii) above without regard to the priorities for expenditure of funds set forth above; provided, however, that if

funds are required for the purpose described in item 1. above (relating to transfers from the Revenue Reserve Fund to pay principal and interest on Bonds), then the funds shall be used for that purpose before the uses described in items (i) and (ii) above.

1974 Appropriation Reserve Fund

In addition to the foregoing, the Twelfth Supplemental Trust Agreement created the 1974 Appropriation Reserve Fund. In connection with the issuance of the Series 12 Bonds, the Agency deposited \$4,000,000 to the 1974 Appropriation Reserve Fund.

If at any time the moneys held to the credit of the Bond Service Fund shall be insufficient to pay when due the principal and Sinking Fund Requirements of, and interest on, the Bonds, and if the amounts transferred to the credit of the Bond Service Fund from the Debt Service Reserve Fund and the Revenue Reserve Fund are insufficient to make up the deficiency, the Trustee shall transfer from the 1974 Appropriation Reserve Fund to the credit of the Bond Service Fund an amount sufficient to make up the deficiency.

The Board may from time to time by resolution direct the Trustee to withdraw any moneys held for the credit of the 1974 Appropriation Reserve Fund and pay such moneys to the Agency or to the trustee under a bond resolution or trust agreement of the Agency other than the Trust Agreement for deposit by the Agency or such trustee to the credit of one or more debt service reserve funds securing bonds of the Agency not issued under the provisions of the Trust Agreement.

Investment of Money

Money held for the credit of each Fund and Account shall, as nearly as may be practicable, be continuously invested and reinvested by the Trustee, at the direction of the Agency, in Investment Obligations. The Investment Obligations may be purchased by the Trustee through its own investment division or other bank facilities established for such purpose.

Encumbrances

The Agency covenants that it will not create or suffer to be created any lien, encumbrance or charge upon the Program Obligations, Revenues, Prepayments or Funds and Accounts pledged under the Trust Agreement except the pledge, lien and charge for the security of the Bonds secured hereby upon the Program Obligations, Revenues, Prepayments and Funds and Accounts, except as otherwise provided in the Trust Agreement.

To the extent of their respective rights therein, the Agency and the Trustee have granted to the Swap Provider(s) a security interest in the moneys, securities and Funds and Accounts and Program Obligations, Revenues, Program Obligation Accrued Interest, Financing Fees and Prepayments (the "Trust Estate") to secure the obligations of the Agency to the Swap Providers under any Swap Agreements entered into by the Agency. Such security interest shall be subject and subordinate to the security interest in and pledge of the Trust Estate created in favor of the Trustee and the holders of the Bonds under the Trust Agreement and the security interest and pledge made by the Agency to the issuers of the Reserve Fund Surety Bonds to secure the payments required to be paid to such issuers in connection with drawings under such surety bonds from the Reserve Fund Surety Reimbursement Fund in accordance with the provisions of the Seventeenth Supplemental Trust Agreement.

The Agency may at any time issue indebtedness secured by a lien, pledge or other security interest in the Program Obligations, Revenues, Prepayments and Funds and Accounts pledged under the Trust Agreement if such indebtedness constitutes Subordinated Indebtedness. The Agency shall not incur such Subordinated Indebtedness unless:

- (i) Prior to incurring such Subordinated Indebtedness, the Agency shall file with the Trustee an Officer's Certificate to the effect that the incurrence of such Subordinated Indebtedness and the payment thereof from the Revenues and other amounts available will not

materially and adversely affect the ability of the Agency to pay the principal of, Sinking Fund Requirements on account of, and interest on the Bonds then outstanding.

(ii) The terms of such Subordinated Indebtedness shall provide that payment of such indebtedness shall be subordinate and junior in right of payment to the prior payment in the event (a) of any insolvency or bankruptcy proceedings, any receivership, liquidation, reorganization, arrangement or other similar proceedings in connection therewith, relative to the Agency or the Program, or in the event of any proceedings for voluntary liquidation, dissolution or other winding-up of the Agency or the Program whether or not involving insolvency or bankruptcy, (b) any Subordinated Indebtedness is declared or otherwise becomes due and payable before its stated maturity because of the occurrence of an event of default occurring under the documents pursuant to which such Subordinated Indebtedness was incurred, or (c) any Event of Default under the Trust Agreement shall occur and be continuing and (1) written notice of such default shall have been given to the Agency and (2) judicial proceedings shall be commenced in respect of such Event of Default within 180 days in the case of a default in payment of principal or interest on the Bonds and within 90 days in the case of any other default after the giving of such notice, then, for so long as any action described in clause (a), (b) or (c) hereof shall not have been remedied or cured in the opinion of the Trustee, the Owners of the Bonds shall be entitled to receive payment in full of all principal, premium and interest on all Bonds before the owners of the Subordinated Indebtedness are entitled to receive any payment on account of principal of or interest on the Subordinated Indebtedness, and to that end the Owners of the Bonds shall be entitled to receive for application in payment thereof any payment or distribution of any kind of character, whether in cash or property or securities, which may be payable or deliverable in any such proceedings in respect of the Subordinated Indebtedness after giving effect to any concurrent payment or distribution in respect to the Bonds.

Records and Accounts

The Agency covenants that promptly after the close of each Fiscal Year it will cause an audit to be made of its books and accounts by an independent firm of certified public accountants of recognized ability and standing. The Agency covenants that it will cause an annual report of the operations and accomplishments of each program of the Agency to be prepared. As soon as practicable thereafter, reports of each such audit and copies of each annual report shall be filed with the Trustee and the Local Government Commission, and copies of such reports shall be mailed to all Owners who have sent the Agency a written request for such reports.

Program Covenants

The Agency shall do all such acts and things necessary to receive and collect Revenues, Prepayments and Escrow Payments, and to enforce the Servicing Agreements, as may be consistent with sound banking practices and principles and shall diligently enforce, and take all steps, actions and proceedings reasonably necessary in the judgment of the Agency for the enforcement of all terms, covenants and conditions of the Program Obligations. The Agency may, in its discretion, reduce the amounts to be collected under any Program Loan to the extent that such action is required in connection with the federal income tax requirements relating to the tax-exempt status of the Agency's Bonds.

The Agency shall not cause Bonds to be purchased or redeemed unless, after such purchase or redemption, there shall be no material adverse effect on the ability of the Agency to pay when due the principal of and the interest on, and any Sinking Fund Requirements on account of, the Bonds then Outstanding.

The Agency will make or purchase Program Obligations with the proceeds of such Bonds with scheduled payments of principal and interest such that the Revenues and Prepayments, if any, estimated by the Agency to be received from such Program Obligations, together with any other moneys estimated to be available will be sufficient to pay when due the principal of, Sinking Fund Requirements on account of, and interest on the Bonds.

The Agency will not cause money to be withdrawn from the Debt Service Reserve Fund unless an Authorized Officer shall determine in an Officer's Certificate which shall be filed with the Trustee at the time of such withdrawal that such amounts being so withdrawn are not likely to be needed while any Bonds are Outstanding under the provisions of the Trust Agreement for paying the principal of, Sinking Fund Requirements on account of, and interest on Bonds secured by the Debt Service Reserve Fund.

The Agency will not delay in the prosecution and collection of any claim for a mortgage insurance or guarantee payment to which it shall be entitled, permit any such delay under its control nor fail to elect to assign any Program Obligation whenever it shall be necessary to do so to obtain the benefits of mortgage insurance or guarantees. The Agency shall not delay in the prosecution or collection of any claim for insurance which it shall be entitled to make or permit any such delay under its control.

Whenever necessary in order to protect and enforce the interests and security of Owners of the Bonds, the Agency shall commence foreclosure or pursue other appropriate remedies with respect to any Program Obligation which is in default. In the event that the Agency shall, in its discretion, determine such action to be in the best interests of the Owners of the Bonds, the Agency may bid for and purchase the premises covered by any such Program Obligation at any foreclosure sale thereof and may otherwise take possession of or acquire such property.

The Agency shall not expend for Program Expenses in any Fiscal Year more than is reasonable and necessary therefor.

Default and Remedies

Each of the following events is an "Event of Default":

(a) payment of the principal or Redemption Price of any of the Bonds is not made when the same shall become due and payable, either at maturity or by proceedings for redemption or otherwise; or

(b) payment of any installment of interest on any of the Bonds is not made when the same shall become due and payable; or

(c) the total amount deposited in the Sinking Fund Account in any applicable period set forth in a Supplemental Trust Agreement shall be less than the Sinking Fund Requirements for such period; or

(d) final judgment for the payment of money is rendered against the Agency and any such judgment is not discharged within sixty (60) days from the entry thereof or an appeal is not taken therefrom or from the order, decree or process upon which or pursuant to which such judgment was granted or entered, in such manner as to stay the execution of or levy under such judgment, order, decree or process or the enforcement thereof; or

(e) an order or decree is entered, with the consent or acquiescence of the Agency, appointing a receiver or receivers of any Revenues, Prepayments, or other money or assets, including the Program Obligations pledged under the provisions of the Trust Agreement, or if such order or decree, having been entered without the consent or acquiescence of the Agency, is not vacated, discharged or stayed on appeal within ninety (90) days after the entry thereof; or

(f) any proceeding is instituted, with the consent or acquiescence of the Agency, for the purpose of effecting a composition between the Agency and its creditors or for the purpose of adjusting the claims of such creditors pursuant to any federal or State statute now or hereafter enacted, if the claims of such creditors are under any circumstances payable from any Revenues or Prepayments, or other moneys or assets, including the Program Obligations, pledged under the provisions of the Trust Agreement; or

(g) the Agency defaults in the due and punctual performance of any other of the covenants, conditions, agreements and provisions contained in the Bonds or in the Trust Agreement or any Supplemental Trust Agreement on the part of the Agency to be performed, and such default continues for thirty (30) days after written notice specifying such default and requiring it to be remedied shall have been given to the Agency by the Trustee, which may give such notice in its discretion and shall give such notice at the written request of the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding; provided, however, that if the default cannot be corrected within such thirty day period and the Agency is pursuing diligent efforts to cure such default, then an Event of Default shall not have occurred so long as the Agency continues diligent efforts to cure the default.

Upon the happening and continuance of any Event of Default the Trustee may, and upon the written request of the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall, by a notice in writing to the Agency, declare the principal of all of the Bonds then Outstanding (if not then due and payable) to be due and payable immediately, and upon such declaration the same shall become and be immediately due and payable, anything contained in the Bonds or in the Trust Agreement to the contrary notwithstanding; subject to certain actions by the Agency to cure the Event of Default before the Bonds are paid.

Upon the happening and continuance of any Event of Default, then and in every such case the Trustee may proceed, and upon the written request of the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall proceed, to protect and enforce its rights and the rights of the Owners by such suits, actions or special proceedings in equity or at law, or by proceedings in the office of any board or officer having jurisdiction, for the specific performance of any covenant or agreement contained herein or in aid or execution of any power herein the enforcement of any proper legal or equitable remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce such rights.

In the enforcement of any remedy under the Trust Agreement, the Trustee shall be entitled to sue for, enforce payment of and receive any and all unpaid amounts then or during any default becoming and at any time remaining, due from the Agency for principal, interest or otherwise under any of the provisions of the Trust Agreement or of the Bonds and unpaid, with interest on overdue payments of principal at the rate or rates of interest specified in such Bonds, together with any and all costs and expenses, without prejudice to any other right or remedy of the Trustee or of the Owners, and to recover and enforce any judgment or decree against the Agency, but solely as provided herein and in such Bonds, for any portion of such amounts remaining unpaid and interest, costs and expenses as above provided, and to collect (but solely from money in the Funds and Accounts pledged to secure the Bonds under the provisions of the Trust Agreement and any other money available for such purpose) in any manner provided by law, the money adjudged or decreed to be payable.

If at any time the money in the Bond Service Fund shall not be sufficient to pay the interest on or the principal of the Bonds as the same shall become due and payable (either by their terms or by acceleration of maturities), such money, together with any money then available or thereafter becoming available for such purpose, including any money then held for the credit of any Funds and Accounts pledged to secure the payment of the Bonds, whether through the exercise of the remedies provided for in this Article or otherwise, shall be applied as follows:

(a) If the principal of all the Bonds shall not have become or shall not have been declared due and payable, all such money shall be applied:

first: to the payment to the persons entitled thereto of all installments of interest then due and payable in the order in which such payments became due and payable and, if the amount available shall not be sufficient to pay in full any particular installment, then to the payment, ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds;

second: to the payment to the persons entitled thereto of the unpaid principal of any of the Bonds which shall have become due and payable (other than Bonds called

for redemption for the payment of which money is held pursuant to the provisions of the Trust Agreement) in the order of their due dates, with interest on the principal amount of such Bonds at the respective rates specified therein from the respective dates upon which such Bonds became due and payable, and, if the amount available shall not be sufficient to pay in full the principal of the Bonds due and payable on any particular date, together with such interest, then principal of the Bonds due and payable on any particular date, together with such interest, then to the payment first of such interest, ratably, according to the amount of such interest due on such date, and then to the payment of such principal, ratably, according to the amount of such principal due on such date, to the persons entitled thereto without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds; and

third: to the payment of the interest on and the principal of the Bonds, to the purchase and retirement of Bonds and to the redemption of Bonds.

(b) If the principal of all the Bonds shall have become or shall have been declared due and payable, all such money shall be applied:

first: to the payment to the persons entitled thereto of all interest due and payable on or prior to maturity, if any, in the order in which such interest became due and payable and, if the amount available shall not be sufficient to pay in full any particular installment, then to the payment, ratably, according to the amounts due on such installment, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds, and then to the payment of any interest due and payable after maturity on the Bonds, ratably, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds; and

second: to the payment of the principal of the Bonds, ratably, to the persons entitled thereto, without preference or priority of any Bond over any other Bond.

Control of Proceedings by the Owners

The Owners of a majority in principal amount of the Bonds then Outstanding shall have the right, subject to the indemnification provisions described below to direct the method and place of conducting all remedial proceedings to be taken by the Trustee.

No Owner shall have any right to institute any suit, whether in equity or at law, on any Bond or for the execution of any trust under the Trust Agreement or for any other remedy unless such Owner previously shall have given to the Trustee written notice of the event of default on account of which such suit, action or proceeding is to be instituted, and unless also the Owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then Outstanding shall have made written request of the Trustee after the right to exercise such powers or right of action, as the case may be, shall have accrued, and shall have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers hereinabove granted or to institute such action, suit or proceeding in its or their name, and unless, also, there shall have been offered to the Trustee reasonable security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby, and the Trustee shall have refused or neglected to comply with such request within a reasonable time.

Nothing impairs the right of any Owner to enforce the payment of the principal of and interest on his Bond, or the obligation of the Agency to pay the principal of and interest on each Bond to the Owner thereof, at the time and place in said Bond expressed.

Concerning the Trustee

The Trustee shall be under no obligation to institute any suit, or to take any remedial proceeding under the Trust Agreement, or to enter any appearance or in any way defend in any suit in which it may be made

defendant, or to take any steps in the execution of the trusts hereby created or in the enforcement of any rights and powers under the Trust Agreement, until it shall be indemnified to its reasonable satisfaction against any and all costs and expenses, outlays and counsel fees and other reasonable disbursements, and against all liability.

Any bank or trust company acting as Trustee under the Trust Agreement, and its directors, officers, employees or agents, may in good faith buy, sell, own, hold and deal in any of the Bonds issued under and secured by the Trust Agreement, may join in any action which any Owner may be entitled to take with like effect as if such bank or trust company were not the Trustee under the Trust Agreement.

The Trustee may resign and thereby become discharged from the trusts hereby created by notice in writing to the Local Government Commission, the Agency and to all the Owners, but such resignation shall take effect immediately upon the appointment of a successor Trustee. If no Event of Default shall have occurred and be continuing, and no event that but for the giving of notice on the passage of time would become an Event of Default shall have occurred and be continuing, the Agency may remove the Trustee at any time. The Trustee may also be removed at any time for any breach of trust or for acting or proceeding in violation of, or for failing to act or proceed in accordance with, any provision of the Trust Agreement with respect to the duties and obligations of the Trustee, by any court of competent jurisdiction upon the application of the Agency or of the Owners of not less than ten per centum (10%) in aggregate principal amount of the Bonds then Outstanding.

Supplemental Trust Agreements

The Agency and the Trustee may from time to time and at any time enter into such Agreements supplemental hereto to amend the provisions hereof as, in the opinion of the Agency and the Trustee, shall not materially adversely affect the interests of the Owners (which supplemental indentures shall thereafter form a part hereof), including supplemental indentures:

(a) to cure any ambiguity or formal defect or omission, to correct or supplement any provision therein which may be inconsistent with any other provision herein, or to make any other provisions with respect to matters or questions arising under the Trust Agreement which shall not be inconsistent with the provisions of the Trust Agreement, or

(b) to grant to or confer upon the Trustee for the benefit of the Owners any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Owners or the Trustee, including, without limitation, the issuance of bearer Bonds with appurtenant interest coupons, or

(c) to add to the conditions, limitations and restrictions on the issuance of Bonds under the provisions of the Trust Agreement other conditions, limitations and restrictions thereafter to be observed, or

(d) to amend any of the provisions of the Trust Agreement to the extent required to permit compliance by the Agency with the Internal Revenue Code of 1986, as amended, and the regulations in effect thereunder, or

(e) to add to the covenants and agreements of the Agency in the Trust Agreement other covenants and agreements thereafter, to be observed by the Agency or to surrender any right or power herein reserved to or conferred upon the Agency, or

(f) to make any other change to the provisions of the Trust Agreement that do not materially impair the security of the Owners.

The Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding may consent to and approve the adoption by the Board of such other supplemental trust agreements as shall be deemed necessary or desirable by the Agency for the purpose of modifying, altering, amending, adding to, repealing or rescinding in any particular any of the terms or provisions contained in the Trust Agreement or in any supplemental indenture; provided, however, that nothing herein contained shall permit, or be construed as

permitting (a) an extension of the maturity of the principal of or the interest on any Bond, (b) a reduction in the principal amount or Redemption Price of any Bond, any Sinking Fund Requirement on account of the Bonds or the rate of interest on any Bond, (c) the creation of a lien upon or a pledge of the Program Obligations, Revenues, Prepayments and other money and assets pledged other than the lien and pledge created by the Trust Agreement, (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, or (e) a reduction in the aggregate principal amount of the Bonds required for consent to such supplemental indenture without the consent of the Owners of all Bonds Outstanding under the Trust Agreement.

A Supplemental Agreement that relates only to the issuance of a particular Series of Bonds and that does not purport to alter or amend the rights or security of any Owners of any Bonds of any other Series shall not be deemed or considered to be a supplemental trust agreement for purposes of the amendment provisions.

See the discussion in the Official Statement under the caption "AMENDMENT OF TRUST AGREEMENT" regarding the Agency's plan to amend the Trust Agreement to provide that payments on all Program Obligations will be handled in a manner consistent with the handling of the payments on Program Obligations deposited to the Series 40 Program Account to the payment of the Series 40 Bonds. By their purchase of the Series 40 Bonds, the owners thereof shall be deemed to have consented to such an amendment.

Defeasance

If, the Bonds have become due and payable in accordance with their terms or shall have been duly called for redemption or irrevocable instructions to call the Bonds for redemption shall have been given by the Agency to the Trustee, the whole amount of the principal and the interest and the premium, if any, so due and payable upon all of the Bonds then Outstanding shall be paid or sufficient money, or Government Obligations the principal of and the interest on which when due will provide sufficient money to pay such whole amount, shall be held by the Trustee for such purpose under the provisions of the Trust Agreement, and provision shall also be made for paying all other sums payable by the Agency, then and in that case the right, title and interest of the Trustee under the Trust Agreement shall thereupon cease, determine and become void.

APPENDIX D

BOOK-ENTRY-ONLY SYSTEM

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BOOK-ENTRY-ONLY SYSTEM

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the Series 40 Bonds. The Series 40 Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Series 40 Bond certificate will be issued for each maturity of the Series 40 Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instrument from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Series 40 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 40 Bonds on DTC's records. The ownership interest of each actual GSEs of each Series 40 Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 40 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Series 40 Bonds, except in the event that use of the book-entry system for the Series 40 Bonds is discontinued.

To facilitate subsequent transfers, all Series 40 Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of Series 40 Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 40 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 40 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series 40 Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Series 40 Bonds, such as redemptions,

tenders, defaults, and proposed amendments to the security documents. For example, Beneficial Owners of Securities may wish to ascertain that the nominee holding the Series 40 Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Series 40 Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Series 40 Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Agency as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 40 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Series 40 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from the Agency or the Trustee on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Agency or the Trustee, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Agency and the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Series 40 Bonds at any time by giving reasonable notice to the Agency or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, Series 40 Bonds are required to be printed and delivered.

The Agency may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Series 40 Bonds will be printed and delivered to DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Agency believes to be reliable, but the Agency takes no responsibility for the accuracy thereof.

APPENDIX E

SUMMARY OF GNMA CERTIFICATE, FANNIE MAE CERTIFICATE AND FREDDIE MAC CERTIFICATE PROGRAM

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SUMMARY OF GNMA CERTIFICATE, FANNIE MAE CERTIFICATE AND FREDDIE MAC CERTIFICATE PROGRAM

GNMA and the GNMA Certificates

The summary and explanation of the Government National Mortgage Association ("GNMA" or "Ginnie Mae"), GNMA's mortgage-backed securities program and the other documents referred to herein do not purport to be complete. Reference is made to the *Ginnie Mae Mortgage-Backed Securities Guide* (HUD Handbook 5500.3) (the "GNMA Guide") and to said documents for full and complete statements of their provisions. At the time of printing this Official Statement, the GNMA Guide and general information regarding GNMA can be accessed at <http://www.ginniemae.gov>. The Agency makes no representation regarding the content, accuracy or availability of the GNMA Guide or any information provided at such web site. Such web site is not part of this Official Statement. Further, the procedures and fees described below and in the GNMA Guide are those currently in effect and are subject to change at any time by GNMA.

GNMA is a wholly-owned corporate instrumentality of the United States within the Department of Housing and Urban Development ("HUD"), with its principal office in Washington, D.C. GNMA's powers are prescribed generally by Title III of the National Housing Act, as amended (12 U.S.C. § 1716 *et seq.*).

GNMA is authorized by Section 306(g) of the National Housing Act to guarantee the timely payment of the principal of and interest on securities ("GNMA Certificates") that represent undivided ownership interests in pools of mortgage loans that are: (i) insured by the Federal Housing Administration ("FHA") under the National Housing Act of 1934, as amended; (ii) guaranteed by the Department of Veterans Affairs under the Servicemen's Readjustment Act of 1944, as amended; (iii) guaranteed by the Rural Housing Service ("RHS") of the U.S. Department of Agriculture pursuant to Section 502 of Title V of the Housing Act of 1949, as amended; or (iv) guaranteed by the Secretary of HUD under Section 184 of the Housing and Community Development Act of 1992, as amended and administered by the Office of Public and Indian Housing ("PIH"). The GNMA Certificates are issued by approved servicers and not by GNMA. GNMA guarantees the timely payment of principal of and interest on the GNMA Certificates.

Section 306(g) of the National Housing Act further provides that "the full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guaranty under this subsection." An opinion, dated December 12, 1969, of an Assistant Attorney General of the United States, states that such guaranties under Section 306(g) of mortgage-backed securities (which are set forth in "GNMA Guaranty Agreements") are authorized to be made by GNMA and "would constitute general obligations of the United States backed by its full faith and credit."

In its corporate capacity under Section 306(d) of Title III of the Housing Act, GNMA may issue its general obligations to the U.S. Department of the Treasury ("Treasury") in an amount outstanding at any one time sufficient to enable GNMA, with no limitations as to amount, to perform its obligations under its guaranty of the timely payment of the principal of and interest on the GNMA Certificate. Treasury is authorized to purchase any obligations so issued by GNMA and has indicated in a letter dated February 13, 1970, from the Secretary of Treasury to the Secretary of HUD that Treasury will make loans to GNMA, if needed, to implement GNMA's guaranty. GNMA has covenanted to borrow from Treasury any amounts necessary to enable GNMA to honor its guaranty of the GNMA Certificates.

GNMA administers two guarantee programs – the "Ginnie Mae I MBS Program" and the "Ginnie Mae II MBS Program." The principal differences between the two programs relate to the interest rate structure of the mortgages backing the GNMA Certificates and the means by which principal and interest payments are made. These differences are not expected to affect adversely the availability of Revenues to pay principal of and interest on the Series 40 Bonds. While the Agency may permit Mortgage Lenders to issue GNMA Certificates under either GNMA program, proceeds of the Series 40 Bonds are expected to be used to purchase GNMA Certificates under the Ginnie Mae I MBS Program.

To issue GNMA Certificates, the Master Servicer must apply for and receive GNMA's commitment to guarantee mortgage-backed securities ("commitment authority"). The Master Servicer is obligated to pay

GNMA commitment fees. GNMA's commitment authority permits the Master Servicer to issue GNMA Certificates up to an approved dollar amount. Commitment authority expires in one year for single-family pools.

Each GNMA Certificate is to be backed by a separate mortgage pool consisting of qualified mortgages in a minimum aggregate amount of \$25,000. Under the Ginnie Mae I MBS Program, the Master Servicer will be required to pay to the Trustee, as the holder of the GNMA Certificates issued by the Master Servicer, the regular monthly installments of principal and interest on the Mortgage Loans that back those GNMA Certificates (less the Master Servicer's servicing fee, which includes a GNMA guaranty fee). Under the Ginnie Mae II MBS Program, the Master Servicer will be required to pay such amounts to the Paying and Transfer Agent for the Ginnie Mae II MBS Program (the "CPTA"), and the CPTA will be required to pay to the Trustee, as the holder of the GNMA Certificate, the regular monthly installments of principal and interest on the Mortgage Loans backing such GNMA Certificate.

Payment of interest and principal on each GNMA Certificate is required to be made in monthly installments by the 15th day of each month under the Ginnie Mae I MBS Program and by the 20th day of each month under the Ginnie Mae II MBS Program, commencing the month following the date of issue of the GNMA Certificate. In addition, each payment is required to include prepayments on Mortgage Loans underlying the GNMA Certificate that were received during the preceding calendar month.

Mortgage Loans underlying a particular GNMA Certificate issued pursuant to the Ginnie Mae I MBS Program must have the same annual interest rate. The annual Pass-Through Rate on each GNMA Certificate under the Ginnie Mae I MBS Program is 0.5% less than the annual interest rate on the Mortgage Loans included in the Mortgage pool backing that GNMA Certificate. Each Mortgage Loan in a Ginnie Mae II pool issued on or after July 1, 2003, must have a fixed interest rate that is at least 0.25% (but not more than 0.75%) higher than the interest rate on the related GNMA Certificate.

The Master Servicer is required to pay a monthly guaranty fee to GNMA for each GNMA Certificate for which the Master Servicer is the issuer of record. GNMA's monthly guaranty fee is computed based on the aggregate principal balance of the guaranteed securities outstanding at the beginning of the monthly reporting period. The monthly rate used to compute the fee is 0.06% (which may be reduced under GNMA's Targeted Lending Initiative) divided by 12. Under the GNMA program, the Master Servicer is responsible for servicing each pooled Mortgage Loans and is entitled to a servicing fee for each such loan. The servicing fee is based on and payable only from the interest portion of each monthly installment of principal and interest actually collected by the Master Servicer on the Mortgage Loan. The fee is equal to the difference between the interest rate on the Mortgage Loan and the interest rate on the GNMA Certificate for which it serves as collateral, computed on the same principal amount and for the same period as the interest portion of the installment. With respect to Ginnie Mae II MBS pools issued on and after July 1, 2003, the Master Servicer must ensure that the minimum servicing fee is at least 0.19% (which fee may be increased under GNMA's Targeted Lending Initiative).

It is expected that interest and principal payments on the Mortgage Loans received by the Master Servicer will be the source of payments on the GNMA Certificates. If those payments are less than what is due, the Master Servicer will be obligated to advance its own funds to ensure timely payment of all amounts coming due on the GNMA Certificates. GNMA guarantees such timely payment in the event of the failure of the Master Servicer to pay an amount equal to the scheduled payment (whether or not made by the Mortgagors). If the Master Servicer defaults on its obligations as an issuer of the GNMA Certificates (including loan servicing and certificate payment obligations), GNMA has the right to extinguish the Master Servicer's interest in the Mortgage Loans underlying such GNMA Certificates, in which case such Mortgage Loans will become the absolute property of GNMA (subject only to the unsatisfied rights of the Trustee, as holder of the GNMA Certificates).

Fannie Mae and the Fannie Mae Certificates

The summary and explanation of the Federal National Mortgage Association ("FNMA" or "Fannie Mae"), Fannie Mae's mortgage-backed securities program and the other documents referred to herein do not

purport to be complete. Reference is made to said documents for full and complete statements of their provisions. Said documents and the MBS Program are subject to change at any time by Fannie Mae. At the time of printing this Official Statement, general information regarding Fannie Mae (including, but not limited to, its financial condition and the status of its conservatorship) can be accessed at <http://www.fanniemae.com>. The Agency makes no representations regarding the content or accuracy of the information provided at such web site, and such web site is not part of this Official Statement.

In accordance with the Federal Housing Finance Regulatory Reform Act of 2008 (the "Regulatory Reform Act"), the Federal Housing Finance Agency (the "FHFA") was named as the conservator of Fannie Mae on September 6, 2008. The Agency cannot predict the long-term consequences of the conservatorship of the Fannie Mae and the corresponding impacts, if any, on the Agency and the Fannie Mae Certificates ("Fannie Mae Certificates") held under the Trust Agreement. On March 31, 2003, Fannie Mae registered its common stock with the Securities and Exchange Commission ("SEC"). As a result of this action, Fannie Mae is required to file periodic financial disclosures with the SEC under the Securities Exchange Act of 1934, including Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, together with any required exhibits. These reports and other information can be read and copied at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. The SEC currently maintains a web site (<http://www.sec.gov>) that contains reports, proxy statements and other information that Fannie Mae has filed with the SEC. The Agency makes no representations regarding the content, accuracy or availability of any such reports or information filed by Fannie Mae with the SEC, any information provided at the SEC's web site, or how long Fannie Mae will continue to file reports with the SEC. The SEC's web site is not part of this Official Statement.

Fannie Mae was originally established in 1938 as a United States government agency to provide supplemental liquidity to the mortgage market. Fannie Mae became a stockholder-owned and privately managed corporation in 1968. The Housing and Economic Recovery Act of 2008 ("HERA") established the Federal Housing Finance Agency ("FHFA"), an independent agency of the federal government, as the new supervisory and general regulatory authority for Fannie Mae. Fannie Mae is subject to the supervision and regulation of FHFA to the extent provided in HERA, and the Director of FHFA has general regulatory authority over Fannie Mae to ensure that the purposes of HERA, the authorizing statutes and any other applicable laws are carried out. The Secretary of HUD also exercises general regulatory power over Fannie Mae.

The Agency cannot predict the long-term consequences of the federal conservatorship of Fannie Mae or of the future status of Fannie Mae and cannot predict the impact of any future proposal or legislation on the housing market or the corresponding impact on the Agency, the Fannie Mae Certificates held under the Trust Agreement or the MBS Program.

Fannie Mae operates in the secondary mortgage market by purchasing mortgages and mortgage-related securities, including Fannie Mae mortgage-related securities, from primary market institutions, such as commercial banks, savings and loan associations, mortgage companies, securities dealers and other investors. Fannie Mae provides additional liquidity in the secondary mortgage market by issuing and guaranteeing mortgage-related securities. Fannie Mae also offers fee-based services to its customers, such as issuing and administering a variety of mortgage related securities, providing credit enhancements and offering technology products to aid in originating and underwriting mortgage loans.

Fannie Mae operates various mortgage-backed securities programs pursuant to which Fannie Mae issues securities backed by pools of mortgage loan. The Fannie Mae Certificates described in this Official Statement represent beneficial ownership interests in pools of Mortgage Loans held in trust by Fannie Mae for the benefit of the Trustee, as holder of the Fannie Mae Certificates. The Fannie Mae Certificates are issued by Fannie Mae pursuant to a trust indenture and supplements thereto (generally for certificates issued before June 1, 2007) or a trust agreement and supplements thereto (generally for certificates issued since June 1, 2007).

Information regarding the Fannie Mae Certificates is contained in a prospectus (each, a "Single-Family MBS Prospectus") and a prospectus supplement. Each Single-Family MBS Prospectus contains general information about pools issued during its effective period including, but not limited to, the nature of the guaranty, yield considerations, and the mortgage purchase programs. Each prospectus supplement includes

information about the pooled Mortgage Loans backing a particular issue of Fannie Mae Certificates and about the certificates themselves. Copies of Single Family MBS Prospectuses and prospectus supplements are available at Fannie Mae's offices located at 3900 Wisconsin Avenue, N.W., Washington, D.C. 20016. At the time of printing this Official Statement, these documents can be accessed at <http://www.fanniemae.com>. The Agency makes no representation regarding the content, accuracy or availability of any such prospectus or supplement thereto, or any information provided at such web site. Fannie Mae's web site is not part of this Official Statement.

Payments on a Fannie Mae Certificate are required to be made to the Trustee on the 25th day of each month (beginning with the month following the month such Fannie Mae Certificate is issued), or if such 25th day is not a Business Day, on the first business day next succeeding such 25th day. With respect to each Fannie Mae Certificate, Fannie Mae generally is required to distribute to the Trustee an amount equal to the total of (1) the principal due on the Mortgage Loans in the related pool underlying such Fannie Mae Certificate during the period beginning on the second day of the month before the month of such distribution and ending on the first day of such month of distribution (each, a "due period"), (2) the stated principal balance of any Mortgage Loan that was prepaid in full during the month preceding the month of such distribution (including as prepaid for this purpose any Mortgage Loans repurchased by Fannie Mae because of Fannie Mae's election to repurchase the Mortgage Loan after it is delinquent, in whole or in part, with respect to four consecutive monthly installments (or eight consecutive biweekly installments) of principal and interest or because of Fannie Mae's election to repurchase such Mortgage Loan under certain other circumstances as permitted by Fannie Mae's trust indenture or trust agreement), (3) the amount of any partial prepayment of a Mortgage Loan received in the month preceding the month of distribution, and (4) one month's interest, at the fixed pass-through rate, on the principal balance of the Fannie Mae Certificate immediately prior to the distribution date.

Fannie Mae guarantees to holders of the Fannie Mae Certificates, on each distribution date, an amount equal to the borrowers' scheduled principal payments for the related due period, whether or not received, plus an amount equal to one month's interest on the Fannie Mae Certificates at the fixed pass-through rate stated in the prospectus supplement for such certificates. In addition, Fannie Mae guarantees the full and final payment of the unpaid principal balance of the Fannie Mae Certificates on the distribution date in the month of the maturity date specified in the prospectus supplement for the Fannie Mae Certificates. Fannie Mae's guaranty covers any interest shortfalls on the Fannie Mae Certificates arising from reductions in the interest rate of a Mortgage Loan due to application of the Soldiers' and Sailors' Civil Relief Act of 1940, as amended, and similar state laws.

Neither the Fannie Mae Certificates nor payments of principal and interest thereon are guaranteed by the United States government. The Fannie Mae Certificates do not constitute a debt or obligation of the United States or any of its agencies or instrumentalities other than Fannie Mae. Fannie Mae alone is responsible for making payments on its guaranty.

If Fannie Mae was unable to perform its guaranty obligations, the Trustee would receive only the payments that borrowers actually made and any other recoveries on the Mortgage Loans in the pool from sources such as insurance, condemnation and foreclosure proceeds. If that were to happen, delinquencies and defaults on the Mortgage Loans would directly affect the amount of principal and interest that the Trustee would receive each month.

Fannie Mae establishes eligibility criteria and policies for the mortgage loans it purchases, for the sellers from whom it purchases loans, and for the servicers who service Fannie Mae's mortgage loans. Fannie Mae's eligibility criteria and policies are set forth in Fannie Mae's Selling and Servicing Guides (the "Fannie Mae Guides") and updates and amendments to such guides. Fannie Mae amends its Fannie Mae Guides and its eligibility criteria and policies from time to time.

The Charter Act requires that Fannie Mae establish maximum original principal balance dollar limitations for the conventional loans that it purchases. These limitations (referred to as conforming loan limits) typically are adjusted annually. For loans delivered during 2018, Fannie Mae's conforming loan limit for conventional loans secured by first liens on single-unit residences in the State of North Carolina is \$453,100 in all counties other than Camden, Pasquotank, and Perquimans (in which the limit is \$625,500), Currituck, and Gates (in which the limit is \$458,850), and Hyde (in which the limit is \$483,000). Fannie Mae's conforming

loan limit for mortgage loans secured by subordinate liens on single-unit residences is 50% of the amount for first lien loans. In addition, the aggregate original principal balance of all the mortgage loans owned by Fannie Mae that are secured by the same residence cannot exceed the amount of the first lien conforming loan limit. The maximum loan-to-value ratio for FHA-insured and VA-guaranteed mortgage loans Fannie Mae purchases is the maximum established by the FHA or VA for the particular program under which the mortgage was insured or guaranteed. The maximum loan-to-value ratio for HUD guaranteed "Section 184" mortgage loans and RHS guaranteed mortgage loans Fannie Mae purchases is 100%. The Charter Act requires that Fannie Mae obtain credit enhancement whenever it purchases a conventional mortgage loan secured by a single-family residence with a loan-to-value ratio over 80%. The credit enhancement may take several forms, including mortgage insurance issued by an insurer acceptable to Fannie Mae covering the amount in excess of 80%, repurchase arrangements with the seller of the mortgage loans, and seller-retained participation interests. Fannie Mae may impose credit enhancement requirements that are more restrictive than those of the Charter Act.

Fannie Mae is responsible for servicing and administering the mortgage loans it purchases. Fannie Mae may contract with other entities to perform those functions under Fannie Mae's supervision and on Fannie Mae's behalf. The entity with whom Fannie Mae contracts may be the seller that sold the loans to Fannie Mae. Duties generally performed by the servicer include general loan servicing responsibilities, collection and remittance of payments on the mortgage loans, administration of mortgage escrow accounts, collection of insurance claims and foreclosure, if necessary. Fannie Mae remains responsible to certificate holders for all the servicing and administrative functions related to the mortgage loans, even if it hires a servicer. Servicers are required to meet the eligibility standards and performance obligations in the Fannie Mae Guides. Fannie Mae may remove any servicer at any time Fannie Mae considers its removal to be in the certificate holders' best interest.

Freddie Mac and the Freddie Mac Certificates

The following summary of the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac"), the Freddie Mac Guarantor Program, the Freddie Mac Certificates and Freddie Mac's mortgage purchase and servicing standards does not purport to be complete and is qualified in its entirety by reference to Freddie Mac's current Mortgage Participation Certificates Offering Circular, any applicable Offering Circular and Pool Supplements, Freddie Mac's current Mortgage Participation Certificates Agreement, as amended, Freddie Mac's Information Statement, any Information Statement Supplements and any other documents made available by Freddie Mac. Copies of these documents can be obtained from Freddie Mac at 8200 Jones Branch Drive, McLean, Virginia 22102. At the time of printing this Official Statement, the documents mentioned above and general information regarding Freddie Mac (including, but not limited to, its financial condition and the status of its conservatorship) can be accessed at <http://www.freddiemac.com>. However, the Agency makes no representation regarding the content, accuracy or availability of any such document or any information provided at such web site. Such web site is not part of this Official Statement.

On July 18, 2008, Freddie Mac voluntarily registered its common stock with the SEC, thereby subjecting Freddie Mac to reporting requirements applicable to registered securities. In addition, pursuant to the Senior Preferred Stock Purchase Agreement between the Treasury and Freddie Mac, Freddie Mac is required to provide the Treasury with annual reports on Form 10-K, quarterly reports on Form IO-Q, and current reports on Form 8-K. These reports and other information can be read and copied at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. The SEC currently maintains a web site (<http://www.sec.gov>) that contains reports, proxy statements and other information that Freddie Mac has filed with the SEC. The Agency makes no representations regarding the content, accuracy or availability of any such reports or information filed by Freddie Mac with the SEC, any information provided at on the SEC's web site, or how long Freddie Mac will continue to file reports with the SEC. The SEC's web site is not part of this Official Statement.

In accordance with the Regulatory Reform Act, the FHFA was named as the conservator of Freddie Mac on September 6, 2008. The Agency cannot predict the long-term consequences of the conservatorship of the Freddie Mac and the corresponding impacts, if any, on the Agency, the Freddie Mac Certificates held under the Trust Agreement or the MBS Program.

Freddie Mac is a shareholder-owned, government-sponsored enterprise chartered on July 24, 1970, pursuant to the Federal Home Loan Mortgage Corporation Act (Title III of the Emergency Home Finance Act of 1970, as amended (12 U.S.C. §§ 1451-1459) (the "Freddie Mac Act").

Freddie Mac purchases and guarantees a variety of single-family mortgages. Most of these mortgages are conventional mortgages that are not guaranteed or insured by the United States or any of its agencies or instrumentalities. However, Freddie Mac purchases some mortgages that are fully insured by the Federal Housing Administration ("FHA") or guaranteed, in part, by the Department of Veterans Affairs ("VA") (collectively, "FHA/VA mortgages"). Freddie Mac operates a program in which purchases and pools single-family mortgages for the purpose of issuing mortgage participation certificates (including any Freddie Mac Certificates that may be purchased by the Trustee). These mortgage participation certificates represent beneficial ownership interests in pools of mortgages that Freddie Mac has purchased.

Freddie Mac is required to pay principal to the holders of its fixed-rate mortgage participation certificates on the 15th of each month (or, if the 15th is not a business day, the next business day), beginning in the month after the certificate is issued (each, a "Payment Date"). The principal balance of the mortgage pool underlying the certificate may differ from the aggregate principal balance of the underlying mortgages due to delays or errors in processing mortgage information, such as a servicer's failure to file an accurate or timely report of its collections of principal or its having filed a report that cannot be processed. Freddie Mac is required to account for any differences as soon as practicable.

The aggregate principal payment in any month on a fixed-rate mortgage participation certificate reflects: (i) the scheduled principal payments due on the mortgages in the related mortgage pool for the monthly reporting period ending in the current month; (ii) prepayments on the related mortgages as reported by servicers for the monthly reporting period ending in the previous month; and (iii) any adjustments necessary to reconcile the principal balance of the mortgage pool with the aggregate balance of the related mortgages reported to Freddie Mac by servicers. Freddie Mac is required to calculate the scheduled principal due on the related mortgages based upon the actual principal balance, interest rate and remaining term to maturity of each mortgage in the mortgage pool. Its calculation of scheduled principal may not reflect actual payments on the mortgages. Interest will accrue on each Freddie Mac during the calendar month preceding the month of the Payment Date at the interest rate specified for the mortgage participation certificate. The interest rate is set at the time of issuance and does not change. Interest accrues on the principal amount of a certificate as determined by its "pool factor" for the month preceding the month of the Payment Date.

Freddie Mac guarantees to each holder of each mortgage participation certificate (i) the timely payment of interest at the applicable interest rate for the certificate; (ii) the timely payment of scheduled principal on the underlying mortgages; and (iii) the full and final payment of principal on the underlying mortgages by the Payment Date that falls in the latest month in which Freddie Mac reduces the related "pool factor" to zero.

The obligations of Freddie Mac under its guarantees of mortgage participation certificates are obligations of Freddie Mac only. Such certificates, including the interest thereon, are not guaranteed by the United States and do not constitute debts or obligations of the United States or any agency or instrumentality of the United States other than Freddie Mac. If Freddie Mac were unable to satisfy its obligations under its guarantees, distributions on the mortgage participation certificate would consist solely of payment and other recoveries on the related mortgage. Accordingly, delinquencies and defaults on the mortgages would affect distributions on the certificates.

The Freddie Mac Act limits the maximum original principal amount of single-family mortgages that Freddie Mac may purchase. These limits are referred to as "conforming loan limits." For loans delivered during 2018, Fannie Mae's conforming loan limit for conventional loans secured by first liens on single-unit residences in the State of North Carolina is \$453,100 in all counties other than Camden, Pasquotank, and Perquimans (in which the limit is \$625,500), Currituck, and Gates (in which the limit is \$458,850), and Hyde (in which the limit is \$483,000). The conforming loan limit for second-lien mortgages is 50 percent of the limit for first-lien mortgages on one-family dwellings. When Freddie Mac purchases both the first-lien and second-lien mortgage

on the same property, the Freddie Mac Act provides that the total amount Freddie Mac may purchase may not exceed the applicable conforming loan limit.

The Freddie Mac Act also prohibits Freddie Mac from purchasing first-lien conventional single-family mortgages if the outstanding principal balance at the time of purchase exceeds 80 percent of the value of the real property securing the mortgage unless Freddie Mac have a level of credit protection (such as mortgage insurance from an approved mortgage insurer, a seller's agreement to repurchase or replace any mortgage that has defaulted) or the retention of at least a 10 percent participation interest in the mortgages by the seller. This requirement does not apply to FHA/VA mortgages.

The single-family mortgages purchased and guaranteed by Freddie Mac generally are subject to the credit, appraisal, underwriting and other purchase policies and guidelines set forth in Freddie Mac's *Single-Family Seller/Servicer Guide*. Freddie Mac may modify these guidelines or grant waivers for certain mortgages that it purchases. Freddie Mac services or supervises the servicing of the mortgages it purchases. In performing its servicing responsibilities, Freddie Mac may employ servicing agents or independent contractors. Each such servicer generally is required to perform all activities concerning the calculation, collection and processing of mortgage payments and related borrower inquiries, as well as all mortgage administrative responsibilities, including claims collection, workouts, foreclosures and reports. Servicers service mortgages, either directly or through approved subservicers, and receive fees for their services. Freddie Mac monitors a servicer's performance through periodic and special reports and inspections to ensure it complies with its obligations.

The interest rates of the mortgages in a mortgage pool underlying a fixed-rate mortgage participation certificate are within a range from (i) the certificate interest rate plus any minimum required servicing fee through (ii) 2.5% above the certificate interest rate. Subject to certain adjustments, Freddie Mac will retain from monthly interest payments on each mortgage a management and guarantee fee, which equals any interest received by Freddie Mac from the servicer over the amount of interest payable to holders of the certificate.

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APPENDIX F

SUMMARY OF THE SERIES 40 PROGRAM ACCOUNT AND PROGRAM LOANS

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SUMMARY OF THE SERIES 40 PROGRAM ACCOUNT AND PROGRAM LOANS

As described in the Official Statement, in connection with the issuance of the Series 40 Bonds, although the Agency plans to use Series 40 Bond proceeds deposited to the Series 40 Program Account to purchase only Program Securities, the Fortieth Supplemental Trust Agreement permits (under the conditions described in the Official Statement) the use of Series 40 Bond proceeds and certain Prepayments of Series 40 Program Obligations, to purchase new Program Loans.

This Appendix F describes the provisions of the Trust Agreement and the Fortieth Supplemental Trust Agreement regarding the requirements for existing and any new Program Loans and the insurance or guaranty programs associated therewith.

The Series 40 Program Account and Program Loan Requirements

Each Program Loan deposited to the credit of the Series 40 Program Account shall be secured by a Mortgage on the property financed thereby. Unless the Series 40 Program Loan is a Series 40 DPA Loan, the unpaid principal amount of a new Program Loan purchased with amounts in the Series 40 Program Account shall not exceed, at the time of the purchase thereof by the Agency, 80% of the Market Value of the property subject to the Mortgage unless the Program Loan is insured or guaranteed in one of the following ways:

- (1) if the Program Loan is an FHA Insured Program Loan, a VA Guaranteed Program Loan, or a USDA Guaranteed Program Loan, the applicable insurance or guaranty of the agency or instrumentality administering the insurance or guarantee program in an amount equal to the maximum coverage permitted for such Program Loan under the regulations of such agency or instrumentality; or
- (2) if the Program Loan is a PMI Insured Program Loan, a private mortgage insurance policy issued by a qualified insurer in an amount so that the principal amount of the Program Loan is not greater than 80% of the Market Value of the property secured thereby plus the maximum amount payable under such private mortgage insurance policy in the event of a default by the Borrower thereunder.

Each private mortgage insurance policy described in (2) above shall be issued by a private mortgage insurance company approved by Fannie Mae or Freddie Mac to insure mortgage loans purchased by them. The Agency shall not purchase a Program Loan insured by a private mortgage insurance company if the purchase of a Program Loan insured by such insurer would have an adverse effect on the ratings then in effect on the Series 40 Bonds.

The Agency shall require that the existing insurance or guarantee of Program Loans deposited to the Series 40 Program Account, and the insurance or guarantee required for new Program Loans shall remain in effect for so long as the Program Loan is held under the Trust Agreement and insurance or guaranty coverage is available with respect to such Program Loan under the insurance or guaranty program or policy with respect to such Program Loans. The insurance policy or guaranty may be cancelled or permitted to terminate as required by applicable law.

Insurance and Guarantee Programs

The Trust Agreement provides that the Supplemental Trust Agreement authorizing the issuance of a Series of Bonds for the Program shall specify any requirements for the Program Obligations to be purchased with the proceeds of the Bonds of such Series, including how such Program Obligations must be insured, guaranteed or otherwise secured.

The Fortieth Supplemental Trust Agreement provides that the Series 40 Program Loans must be secured by a mortgage on the property financed thereby and must be, except for Series 40 DPA Loans, insured or guaranteed in one of the following ways: (a) if the Program Loan is an FHA Insured Program Loan, a VA

Guaranteed Program Loan, or a USDA Guaranteed Program Loan (as each of such terms is defined below), the applicable insurance or guarantee of the agency or instrumentality administering the insurance or guarantee program in an amount equal to the maximum coverage permitted for such Program Loan under the regulations of such agency or instrumentality; or (b) if the Program Loan is a Fannie Mae or Freddie Mac Conventional Private Mortgage Insured Program Loan, unless the Market Value of the property subject to the Mortgage is greater than 80% of the principal amount of the Series 40 Program Loan, a private mortgage insurance policy issued by a qualified insurer in an amount so that the principal amount of the Program Loan is not greater than 80% of the Market Value of the property secured thereby plus the maximum amount payable under such private mortgage insurance policy in the event of a default by the Borrower thereunder.

FHA Mortgage Insurance. Program Loans insured by FHA in the manner described below, are herein defined as "FHA-Insured Program Loans." Sections 203 and 221 of the National Housing Act, as amended (the "Housing Act"), authorize the Federal Housing Administration ("FHA") of the Department of Housing and Urban Development ("HUD") to insure certain mortgage loans. Such mortgage loans must be in conformance with the maximum mortgage loan amount limitations and minimum down payment requirements specified in the Housing Act and regulations promulgated thereunder. In addition, the mortgagor under either of these programs must establish to the satisfaction of FHA that his or her income is adequate to meet the periodic payments required in the mortgage loan.

FHA administers the Section 203(k) loan program for the acquisition and rehabilitation of single family properties. Eligible borrowers obtain one mortgage loan to finance both the acquisition and the rehabilitation of the property. The mortgage amount may include funds for the purchase of the property, the costs incidental to closing the transaction, and the completion of the proposed rehabilitation. The mortgage proceeds allocated for the rehabilitation are escrowed at closing. Following loan closing, the FHA reviews the submission and, if found acceptable, issues a Mortgage Insurance Certificate to the lender. At this point, the lender is submitting a fully-insured Program Loan to the Agency for purchase.

Under the provisions of Section 184 of the Housing and Community Development Act of 1992, as amended ("Section 184"), HUD has the authority to guarantee loans for the construction, acquisition, rehabilitation, or refinancing of 1- to 4-family homes to be owned by Native Americans (as defined in Section 184) on eligible land (as defined in Section 184). Loans guaranteed under Section 184 must bear a fixed rate of interest and be in a principal amount not in excess of 97.75% of the appraised value of the property, excluding closing costs (98.75% if the appraised value is \$50,000 or less), but in no event in excess of 150% of the FHA loan limit for the area. The HUD guarantee under Section 184 is 100% of unpaid principal and interest plus reasonable fees and expenses for loans processed through foreclosure by the holder of the guarantee certificate of 100% of unpaid principal and interest for loans assigned to HUD without foreclosure.

All mortgages are subject to a mortgage insurance premium. The premium must be included in the proposed monthly housing expense for underwriting purposes.

Under the terms of either of the foregoing FHA insurance programs, a failure to make a mortgage payment (or to perform any other obligation under the mortgage), if continued for thirty (30) days, constitutes a default which would entitle the mortgagee to claim insurance benefits. The Housing Act gives authority to the Secretary of HUD (the "Secretary") to settle claims for insurance benefits under mortgages insured under Sections 203 and 221 either in cash or debentures.

Insurance benefits are paid on foreclosure and conveyance of title. Benefit payments made by FHA on conveyed properties are equal to the unpaid principal amount of the mortgage loans plus certain tax, insurance and other payments made, and a portion of any foreclosure expenses incurred by the mortgagee, as well as interest from date of default at a rate equivalent to the debenture interest rate (which may be less than the interest rate of the insured mortgage), less certain amounts received or retained in respect of the mortgaged property.

When any property which is to be conveyed to FHA has been damaged by fire, earthquake, flood or tornado, it is generally required, as a condition of payment of an insurance claim, that such property be repaired by the mortgagee prior to such conveyance.

To obtain title to and possession of the property under foreclosure, the Agency will pursue its rights under the power of sale contained in the mortgage subject to the constraints of applicable state law and HUD. HUD requires that absent the consent of the mortgagor, at least three full monthly installments be due and unpaid under the mortgage before the mortgagee may initiate any action leading to foreclosure of the mortgage. HUD also requires a face-to-face conference between the mortgagee and the mortgagor in an effort to cure the delinquency without foreclosure. These requirements do not apply where the mortgagor has voluntarily abandoned the mortgaged property or the property has been vacant for over 60 days, or the mortgagor has indicated in writing that he or she has no intention of fulfilling his or her obligations under the mortgage, in which case the mortgagee may immediately initiate foreclosure proceedings (subject to applicable state law notice provisions).

VA Guarantee. Program Loans that are guaranteed as to payment by the United States Veterans Administration in the manner described in this Section are herein referred to as "VA Guaranteed Program Loans." The Serviceman's Readjustment Act of 1944, as amended, permits a veteran (or, in certain instances, his or her spouse) to obtain a VA Guaranteed Program Loan covering mortgage financing of the purchase of a one-to-four family dwelling unit at interest rates agreed upon by the purchaser and the mortgagee. The program has no mortgage loan limits (other than that the amount may not exceed the property's reasonable value as determined by the VA), requires no down payment from the purchaser and permits the guarantee of VA Guaranteed Program Loans with terms of up to 30 years.

The guarantee provisions for VA Guaranteed Program Loans are as follows: (a) for home and condominium loans of \$45,000 or less, 50 percent of the loan is guaranteed (for loans with an original principal balance of \$45,000 and not more than \$56,250, the guarantee will not exceed \$22,500); (b) for home and condominium loans of more than \$56,250 but less than or equal to \$144,000, 40 percent of the loan is guaranteed subject to a maximum guarantee of \$36,000; (c) for home and condominium loans of more than \$144,000, 25 percent of the principal amount of the loan is guaranteed, up to a maximum loan amount of \$417,000; and (d) for loans for manufactured homes, 40 percent of the loan is guaranteed (with a maximum guarantee of \$20,000) (modular homes are treated in the same manner as traditional homes). The Agency does not allow purchases of manufactured homes that are not permanently affixed and are not considered real property.

The liability on the guarantee is reduced or increased pro rata with any reduction or increase in the amount of the indebtedness, but in no event will the amount payable on the guarantee exceed the amount of the original guarantee. Notwithstanding the dollar and percentage limitations of the guarantee, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of mortgaged premises is greater than the original guarantee as adjusted. The VA may, at its option and without regard to the guarantee, make full payment to a mortgage holder of unsatisfied indebtedness on a mortgage upon its assignment to the VA.

USDA Guarantee. Program Loans guaranteed by the United States Department of Agriculture, Rural Development are herein referred to as "USDA-Guaranteed Program Loans." Title V of the Housing Act of 1949 permits USDA to provide mortgage guarantees for single family rural housing loans. A USDA guarantee constitutes an obligation supported by the full faith and credit of the United States.

The maximum loss payment under a USDA guarantee will be the lesser of:

(1) Any loss of an amount equal to 90 percent of the principal amount actually advanced to the mortgagor, or

(2) An amount up to 35 percent of the principal amount actually advanced to the mortgagor, plus any additional loss sustained by the lender of an amount up to 85 percent of the remaining 65 percent of the principal amount actually advanced to the mortgagor.

Loss includes only (1) principal and interest evidenced by the note; (2) any loan subsidy due and owing; and (3) any principal and interest indebtedness on USDA approved protective advances for protection and preservation of collateral. Interest is covered by the guarantee to the date of the final loss settlement when the

lender conducts liquidation of collateral in an expeditious manner. Net proceeds received from liquidation of the collateral will be used in calculating the amount of loss sustained. If the lender acquires the collateral, the net proceeds from collateral for calculating loss shall be determined by the USDA as follows: (i) the USDA will have the collateral appraised at its current market value as of the date of acquisition by the lender, then (ii) deduct from such appraised value an estimate of liquidation costs which will include an allowance for the estimated time the property will be held by the lender. The USDA will pay its claim based on an appraisal after foreclosure has occurred rather than upon the sale of the property.

Private Mortgage Insurance. Program Loans that are insured by a policy of private mortgage insurance in the manner described in this Section are herein referred to as "Private Mortgage Insured Program Loans."

The Fortieth Supplemental Trust Agreement provides that a "Private Mortgage Insured Program Loan" is any Program Loan purchased with the proceeds of the Series 40 Bonds that is insured by a private mortgage insurance company that has been approved by Fannie Mae or Freddie Mac to insure mortgage loans purchased by them. The federal Homeowners Protection Act of 1998 requires the automatic termination of private mortgage insurance for any mortgage loan incurred after July 1999 if payments are current on the loan and the loan to value ratio is 78% or less. In addition, borrowers who are current on their mortgage loan payments are entitled to termination of private mortgage insurance requirements upon request if the loan to value ratio is 80% or less. For purpose of determining the loan to value ratio, the value of the subject property is the lesser of the contract sales price and the appraised value at the time the mortgage loan is made. The Agency will not require (and cannot require) borrowers to maintain private mortgage insurance after the borrower is entitled to termination of the private mortgage insurance in accordance with federal law.

The Fortieth Supplemental Trust Agreement provides that at the option of the Agency, the insurance policy on a Private Mortgage Insured Program Loan may be cancelled or permitted to terminate as required by applicable law. The Agency makes no representation regarding the financial condition of any of the entities that have issued policies of Private Mortgage Insured Program Loans under the Trust Agreement. Information regarding specific private mortgage insurance companies should be obtained from the respective company.

Uninsured and Non-Guaranteed Loans. In addition to FHA Insured Program Loans, VA Guaranteed Program Loans, USDA Guaranteed Program Loans and Private Mortgage Insured Program Loans, the Fortieth Supplemental Trust Agreement provides that the Agency may purchase any other Program Loan so long as, at the time of purchase of the Program Loan by the Agency, the unpaid principal amount of the Program Loan does not exceed 80% of the Market Value of the property that is subject to the Mortgage securing such Program Loan, except or in conjunction with a Series 40 DPA Loan.

Other Loan and Guarantee Programs. Future supplemental trust agreements may permit the Agency to purchase Program Obligations having insurance and guarantee features different from those described above.

Standard Hazard Insurance

Each mortgagor is required to obtain and maintain for the mortgaged property a standard hazard and casualty insurance policy in an amount which is not less than (i) the maximum insurable value of the mortgaged property or (ii) the unpaid principal amount of the Program Loan. The standard hazard and casualty insurance policy is required to be written by an insurance company qualified to do business in the State and having a current general policyholder's rating in Alfred M. Best's Insurance Reports of B and a financial size category of Class VIII or better.

In general, a standard homeowner's form of fire with extended coverage policy insures against physical damage to or destruction of the improvements on the property by fire, lightning, explosion, smoke, windstorm, hail, riot, strike, and civil commotion, subject to the conditions and exclusions particularized in each policy. Policies typically exclude physical damage resulting from the following: war, revolution, governmental action, floods and other water-related causes, earth movement (including earthquakes, landslides and mudslides), nuclear reactions, wet or dry rot, vermin, rodents, insects or domestic animals, theft, and, in certain cases, vandalism.

Flood insurance is required to be obtained and maintained by mortgagors whose mortgaged property is in an area designated by HUD as having special flood hazards and for which flood insurance is available under the National Flood Insurance Program. The limit of flood insurance must be the lowest of (i) the unpaid principal balance of the Program Loan, (ii) the full insurable value of the mortgaged property, and (iii) the maximum amount of flood insurance available.

Servicing Agreements

For the Program Loans associated with the FirstHome Mortgage program, the Agency and each Agency-approved Servicer (the "FirstHome Servicer") have entered into a servicing agreement for the servicing of Program Loans purchased by the Agency (the "FirstHome Servicing Agreements"). Each FirstHome Servicing Agreement provides for an annual servicing fee in an amount no more than $3/8^{\text{th}}$ of 1% of the principal balance, computed monthly, of each non-delinquent Program Loan serviced thereunder for which payments of principal and interest have been received by the FirstHome Servicer.

The FirstHome Servicing Agreements will require the FirstHome Servicers to perform all services and duties customary to the servicing of mortgages, including, among other things, inspecting the mortgaged premises when payments by a mortgagor have become delinquent or upon request of the Agency, collecting all payments due with respect to each Program Loan, and applying properly and rendering an accounting to the Agency of all sums collected from a mortgagor for payment of principal and interest, taxes, assessments and hazard and mortgage insurance premiums. In the event a mortgagor fails to make a payment when due or in the event of any default on a Program Loan, each FirstHome Servicer must give notice to the Agency and, in the event of default, is also obligated, unless otherwise notified by the Agency, to take all actions necessary and proper to collect the applicable mortgage insurance and to enforce the applicable contractual provisions, including, if necessary, instituting foreclosure proceedings and managing the mortgaged property. Agency-approved foreclosure and related expenses shall be borne by the Agency.

Under FirstHome Servicing Agreements the FirstHome Servicers must deposit all funds received on account of Program Loans being serviced in segregated accounts in a state or national bank or savings and loan association acceptable to the Agency and in which deposits are insured by the Federal Deposit Insurance Corporation, which may be the FirstHome Servicer, and in segregated accounts in the Federal Home Loan Bank, and must hold the accounts as trustee for the Agency and the various mortgagors. From the funds so deposited the FirstHome Servicer must pay, when due, mortgage and hazard insurance premiums, taxes and assessments. Once a month or at any time when the amount on deposit exceeds the insured amount, the FirstHome Servicer is to remit to the Trustee the total amount of all payments of principal and interest. Prepayments of the Program Loans, proceeds of mortgage insurance, condemnation proceeds, proceeds resulting from action taken with respect to a defaulted Program Loan, and proceeds of hazard insurance that will not be used to restore or rehabilitate the mortgaged property shall be remitted as they are received.

The FirstHome Servicing Agreements will require FirstHome Servicers to maintain hazard and casualty insurance on each of the mortgaged premises in an amount sufficient to ensure that the Agency will not become a co-insurer under the terms and conditions of the applicable policy or policies. The FirstHome Servicer must also comply, as to each Program Loan, with all rules and requirements of the Agency and the applicable rules and requirements of the insurance or guarantee program with respect to Program Loans, and must at all times keep such insurance in full force and effect. See "Standard Hazard Insurance" above. In addition, each FirstHome Servicer must maintain blanket bond coverage as customarily used in the mortgage banking industry, including among other provisions, fidelity coverage and insurance against losses resulting from the errors and omissions of the FirstHome Servicer.

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APPENDIX G

**PROJECTED PERCENTAGES OF INITIAL PRINCIPAL BALANCE OUTSTANDING
AND PROJECTED WEIGHTED AVERAGE LIVES OF THE SERIES 40 PAC BONDS**

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APPENDIX G

PROJECTED PERCENTAGES OF INITIAL PRINCIPAL BALANCE OUTSTANDING AND PROJECTED WEIGHTED AVERAGE LIVES OF THE SERIES 40 PAC BONDS

Set forth in the table below are projected percentages of initial principal balance outstanding and projected weighted average lives for the Series 40 PAC Bonds under various prepayment speeds. "Projected percentages of initial principal balance outstanding" refers to the principal balance of a security that will be outstanding on a specified date expressed as a percentage of the initial principal amount of such security. The "projected weighted average life" of a security refers to the average amount of time, measured here in years, that is projected to elapse from the date of delivery of such security to the date of projected payment to the investor of each dollar paid to reduce the principal of such security (assuming no losses). The projected weighted average life of a security is determined by (a) multiplying each projected reduction, if any, of the outstanding amount of such security by the number of years from the date of delivery of such security to the related redemption date or maturity date, (b) adding the results and (c) dividing the sum by the initial outstanding amount of such security. The calculation of the projected weighted average life of the Series 40 PAC Bonds set forth below requires the making of certain hypothetical assumptions. See "REDEMPTION OF SERIES 40 BONDS – Projected Weighted Average Lives of the Series 40 PAC Bonds" in the Official Statement.

Projected Percentages of Initial Principal Balance Outstanding and Weighted Average Lives of \$35,535,000 Series 40 PAC Bonds Due July 1, 2047

Payment Date	Prepayment Assumption									
	0 PSA	25 PSA	50 PSA	75 PSA	100 PSA	150 PSA	200 PSA	300 PSA	400 PSA	500 PSA
Initial Percentage	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
July 1, 2019	100.0%	100.0%	99.8%	99.7%	99.7%	99.7%	99.7%	99.7%	99.7%	99.7%
July 1, 2020	100.0%	98.2%	96.1%	94.2%	93.1%	93.1%	93.1%	93.1%	93.1%	93.1%
July 1, 2021	100.0%	94.5%	88.8%	83.2%	79.7%	79.7%	79.7%	79.7%	79.7%	79.7%
July 1, 2022	100.0%	90.0%	79.8%	70.0%	63.5%	63.5%	63.5%	63.5%	63.5%	63.5%
July 1, 2023	100.0%	85.6%	71.4%	57.8%	48.8%	48.8%	48.8%	48.8%	48.8%	48.8%
July 1, 2024	100.0%	81.5%	63.6%	46.6%	35.6%	35.6%	35.6%	35.6%	35.6%	35.6%
July 1, 2025	100.0%	77.7%	56.3%	36.4%	23.9%	23.9%	23.9%	23.9%	23.9%	23.9%
July 1, 2026	100.0%	74.1%	49.7%	27.2%	13.5%	13.5%	13.5%	13.5%	13.5%	13.5%
July 1, 2027	100.0%	70.7%	43.6%	19.1%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
July 1, 2028	100.0%	67.7%	38.2%	11.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2029	100.0%	64.9%	33.3%	5.6%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2030	100.0%	62.4%	29.1%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2031	100.0%	60.3%	25.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2032	100.0%	58.6%	23.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2033	100.0%	57.3%	21.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2034	100.0%	56.3%	19.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2035	100.0%	55.8%	19.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2036	100.0%	55.6%	19.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2037	100.0%	55.6%	19.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2038	100.0%	55.6%	19.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2039	100.0%	55.6%	19.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2040	100.0%	55.6%	19.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2041	92.3%	49.2%	14.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2042	77.9%	37.5%	4.8%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2043	62.7%	25.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2044	46.6%	13.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2045	29.6%	0.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2046	11.6%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
July 1, 2047	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
First Payment or Redemption Date	1/1/2037	7/1/2019	7/1/2019	7/1/2019	7/1/2019	7/1/2019	7/1/2019	7/1/2019	7/1/2019	7/1/2019
Last Payment or Redemption Date	7/1/2047	1/1/2046	7/1/2043	1/1/2031	7/1/2028	7/1/2028	7/1/2028	7/1/2028	7/1/2028	7/1/2028
Weighted Average Life Optional Call Not Exercised	25.6	17.0	10.1	5.9	5.0	5.0	5.0	5.0	5.0	5.0
Optional Call at 01/01/2028 Exercised	9.1	7.9	6.8	5.7	5.0	5.0	5.0	5.0	5.0	5.0
Weighted Average Life Date Optional Call Not Exercised	6/15/2044	11/10/2035	12/26/2028	10/8/2024	11/13/2023	11/13/2023	11/13/2023	11/13/2023	11/13/2023	11/14/2023
Optional Call at 01/01/2028 Exercised	1/1/2028	10/18/2026	8/19/2025	7/18/2024	11/12/2023	11/12/2023	11/12/2023	11/12/2023	11/12/2023	11/12/2023