Audited Financial Statements

June 30, 2013

NORTH CAROLINA
HOUSING
FINANCE
AGENCY

NORTH CAROLINA HOUSING FINANCE AGENCY
FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2013

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June 30, 2013

The discussion and analysis of the North Carolina Housing Finance Agency's (the Agency) financial performance provides an overview of the Agency's financial activities for the year ended June 30, 2013. The financial statements, accompanying notes, and supplementary information should be read in conjunction with the following discussion.

Overview

The North Carolina Housing Finance Agency was created in 1974 to provide financing for residential housing, both ownership and rental, to North Carolina households with low and moderate incomes. The Agency has issued bonds to finance housing throughout the State of North Carolina. In addition to its bond programs, the Agency administers the United States Department of the Treasury's Hardest Hit Fund®, the Section 8 Program, the HOME Investment Partnerships Program, Low-Income Housing Tax Credits, the North Carolina Housing Trust Fund and other federal and state programs. These programs provide different types of assistance such as rent subsidies, down payment assistance, low-interest mortgage loans, foreclosure prevention mortgage assistance, foreclosure prevention counseling, 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, 2013, with reference to prior fiscal year's results and activities.

The Agency's *Total assets* decreased $144,466,000, or 7.8%, and *Total liabilities* decreased $188,237,000, or 14.4%. The Agency's *Deferred outflow of resources* decreased $2,960,000, or 36.4%. *Total operating revenues* increased $18,052,000, or 5.4%, and *Total operating expenses* increased $28,252,000, or 8.9%.

Although interest rates made modest increases during the fiscal year, they continued to reflect historic lows presenting certain challenges for the Agency. However, the Agency took advantage of the interest rates by refunding bonds at a higher interest rate with those at a lower rate of interest. Because low mortgage interest rates precluded the Agency from issuing bonds for the purchase of new mortgage loans, the Agency turned to sales of mortgage-backed securities (MBS) on the secondary market in order to finance single family homes. In conjunction with this new method of financing single family homes, the Agency introduced its new N.C. Home Advantage Mortgage (HomeAd). Existing FirstHome Program mortgage loans financed with mortgage revenue bonds decreased due to low interest rates, refinances of FirstHome mortgages increased, and the HomeAd Program was introduced on March 1, 2013. As a result, the Agency's purchase of FirstHome Program mortgage loans remained relatively sluggish while the Agency experienced continued payoffs of existing loans, resulting in a decrease of *Mortgage loans receivable, net* of $94,537,000, or 7.3%, a decrease in *Accrued interest receivable on mortgage loans* of $37,000, or 0.4%, and a decrease in *Interest on mortgage loans* of $5,915,000, or 8.4%. A majority of the decrease in *Cash and cash equivalents* of $98,745,000, or 23.8%, was related to the purchase of the FirstHome mortgage loans during the fiscal year. *Mortgage servicing expense* reflected an increase of $307,000, or 9.6%, because a settlement received from servicers in fiscal year 2012 of $557,000 was reflected in that year as a reduction of *Mortgage servicing expense*.

The bond refunding issued in July 2012 caused several guaranteed investment contracts (GICs) to be terminated, bringing the balance of GICs from $20.4 million in fiscal year 2012 to $9 million in fiscal year 2013, a difference of $11.5 million. The Agency compensated for the loss of the GICs by increasing its investments in government securities by $26.5 million. These transactions are the primary reasons for the overall increase of *Investments* of $12,172,000, or 23.2%. The interest rates on the government securities were lower than those of the liquidated GICs, resulting in an overall decrease in *Interest on investments* of $3,589,000, or 47.8%. The modest increases in interest rates in fiscal year 2013 resulted in the *Net decrease in fair value of investments* of $3,597,000, or 397.9%, and a decrease of $2,960,000, or 36.4%, in both *Accumulated decrease in fair value of hedging derivative* and *Derivative instrument—interest rate swap.* The increase in *Accrued interest receivable on investments* of $88,000, or 53%, was attributable to a change in the timing of interest payments for the new government investments compared with the liquidated GICs. Scheduled debt service payments as well as bond calls during the fiscal year produced a decrease in *Bonds payable* of $163,610,000, or 13.5%, a decrease in *Accrued interest payable* of $5,489,000, or 20.4%, and a decrease in *Interest on bonds* of $10,563,000, or 17.9%. Although interest rates reflected a moderate increase during the fiscal year, the decrease in *Other liabilities* of $372,000, or 5.6%, was primarily due to a decrease in the Agency's arbitrage liability since interest rates remain at historic lows.

Federal program awards received and *Federal program expense* increased by $27,629,000, or 12.2%, and $30,700,000, or 13.8%, respectively. These increases are primarily due to increased spending on the Hardest Hit Fund® (HHF). *Unearned revenues* decreased $17,353,000, or 36%, consistent with spending money on the HHF at a faster pace. *Nonfederal program expense* increased by $6,668,000, or 312.9%. Of this increase, approximately $2.5 million resulted from the movement by the General Assembly of all aspects of the State Home Foreclosure Prevention Project (SHFPP) to the Agency in December 2012. The remaining portion of the increase was attributable to amounts spent on the funding of the Agency's down payment assistance programs related to FirstHome and N.C. Home Advantage Mortgage Programs. *State tax credits* increased by $14,893,000, or 48.1%, due to changes in the number of projects awarded and whether these projects are in a low, moderate or high income county. *State program expense* decreased $9,162,000, or 15.5%, because of the amount of state tax credits awarded and the transfer of approximately $2.5 million of SHFPP expenses from *State program expense to Nonfederal expense*.

Other assets, net, decreased by $3,066,000, or 10.6%, primarily due to amortization of deferred bond issuance costs as the related bonds were called. *Accounts payable* increased $1,547,000, or 49.2%, because funds related to the National Foreclosure Mitigation Counseling Program Round Seven were received. *Program income/fees* increased $3,979,000, or 14.6%, as all functions for SHFPP were moved to the Agency in December 2012 and the fees are now reported in this account rather than *State grants received.* The decrease in *Other revenues* of $455,000, or 34.6%, was due to a change in loan loss reserve of $1.17 million in Federal and State Programs and a gain of $691,000 on the sale of mortgage-backed securities related to the Agency's new N.C. Home Advantage Program. *Other expenses* increased $963,000 or 34.4% primarily due to an increase in the mortgage loan loss reserve in the 1998 Home Ownership Program.

State receivables increased $39,659,000, or 81.5%, and *State grants received* increased $23,593,000, or 156%, because of the National Mortgage Settlement of $30,590,000 awarded to the Agency during the fiscal year. The State made cuts of $7,900,000 for the Housing Trust Fund to *State appropriations received*, resulting in the majority of the decrease in *State appropriations received* of $8,467,000, or 87.5%, but it allowed the Agency to use National Mortgage Settlement funds towards the decrease and is reflected in *Transfers in* related to the Housing Trust Fund.

Net position increased $40,811,000, or 7.4%, due to the receipt of federal funds in difficult economic times and as a result of the Agency's proactive management of its funds in a sluggish economy.

Financial Analysis

The following tables summarize the changes in net position between June 30, 2013 and June 30, 2012 (*in thousands)*:

Condensed Statement of Net Position	**2013**	**2012**	**Change**	**%**
Assets**				
Cash and cash equivalents	$315,621	$414,366	$(98,745)	-23.8
Accrued interest receivable on investments	254	166	88	53.0
Accrued interest receivable on mortgage loans	10,328	10,365	(37)	-0.4
Investments	64,733	52,561	12,172	23.2
Mortgage loans receivable, net	1,195,100	1,289,637	(94,537)	-7.3
State receivables	88,325	48,666	39,659	81.5
Other assets, net	25,790	28,856	(3,066)	-10.6
Total Assets	$1,700,151	$1,844,617	$(144,466)	-7.8
Deferred Outflow of Resources				
Accum decrease in fair value of hedging derivative	$5,181	$8,141	$(2,960)	-36.4
Total Deferred Outflow of Resources	$5,181	$8,141	$(2,960)	-36.4

Liabilities**	2013	2012	Change	%
Bonds payable	$1,047,938	$1,211,548	$(163,610)	-13.5
Accrued interest payable	21,366	26,855	(5,489)	-20.4
Accounts payable	4,692	3,145	1,547	49.2
Derivative instrument--interest rate swap	5,181	8,141	(2,960)	-36.4
Unearned revenues	30,823	48,176	(17,353)	-36.0
Other liabilities	6,255	6,627	(372)	-5.6
Total Liabilities	$1,116,255	$1,304,492	$(188,237)	-14.4
Net Position				
Restricted	$573,696	$534,216	$39,480	7.4
Unrestricted	15,381	14,050	1,331	9.5
Total Net Position	$589,077	$548,266	$40,811	7.4

Condensed Statement of Revenues, Expenses and Changes in Net Position

Operating Revenues	2013	2012	Change	%
Interest on investments	$3,914	$7,503	$(3,589)	-47.8
Net (decrease) increase in fair value of investments	(2,693)	904	(3,597)	-397.9
Interest on mortgage loans	64,751	70,666	(5,915)	-8.4
Federal program awards received	253,470	225,841	27,629	12.2
Program income/fees	31,223	27,244	3,979	14.6
Other revenues	859	1,314	(455)	-34.6
Total Operating Revenues	$351,524	$333,472	$18,052	5.4
Operating Expenses				
Interest on bonds	$48,535	$59,098	$(10,563)	-17.9
Mortgage servicing expense	3,502	3,195	307	9.6
Federal program expense	253,761	223,061	30,700	13.8
Nonfederal program expense	8,799	2,131	6,668	312.9
General and administrative expense	28,309	28,132	177	0.6
Other expenses	3,759	2,796	963	34.4
Total Operating Expenses	$346,665	$318,413	$28,252	8.9
Operating Income	$4,859	$15,059	$(10,200)	-67.7
Non-Operating Revenues (Expenses)				
State appropriations received	$1,206	$9,673	$(8,467)	-87.5
State grants received	38,718	15,125	23,593	156.0
State tax credits	45,874	30,981	14,893	48.1
State program expense	(49,846)	(59,008)	9,162	-15.5
Total Non-Operating Revenues (Expenses)	$35,952	$(3,229)	$39,181	1213.4
Change in Net Position	$40,811	$11,830	$28,981	245.0

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

New Business

Fiscal year 2013 showed incremental signs of a recovering economy, although US unemployment rates remained high and the European economic crisis continued. To spur the sluggish recovery, the US Department of the Treasury (Treasury) continued to keep interest rates relatively low, creating both issues and opportunities for the Agency.

The low mortgage interest rates hindered the Agency's ability to issue tax-exempt debt to finance its single family mortgage loans under its FirstHome Program. To continue funding single family mortgage loans, the Agency rolled out a new program in March 2013 called N.C. Home Advantage Mortgage (HomeAd), which is financed by selling government-insured mortgage-backed securities (MBS) on the secondary market. HomeAd offers competitive fixed-rate, 30-year government insured mortgages loans for homebuyers within approved income and credit score limits. Qualifying homebuyers may also be eligible for a 3% deferred/forgiven down payment assistance loan (HomeAd DPA), a Mortgage Credit Certificate (MCC), and a second mortgage from the Community Partners Loan Pool (discussed below). Although the FirstHome Program was available only to first-time homebuyers, HomeAd is available for both first-time homebuyers as well as move-up buyers on the purchase of a home.

The Agency took advantage of the low interest rates by issuing Series 33 in the 1998 Trust Agreement in July 2012. Series 33 refunded selected series in the 1998 Trust Agreement at higher rates of interest with bonds at lower current market rates. The bond sale is discussed in more detail in the "Debt Administration" section.

The Agency combined the New Homes Loan Pool (NHLP) and the Individual Development Account Loan Pool (IDALP) to create the Community Partners Loan Pool (CPLP) to simplify access to funding for our partners. This pool provides interest-free, deferred-payment second mortgages of 15% of the home sales price or $18,000, whichever is less, for the purchase of newly-constructed or substantially rehabilitated homes. Grants of up to $1,000 are also provided to participants to match their Individual Development Account (IDA) savings. Incentive funding of $4,000 is also available when homes are built to certain SystemVision standards of energy efficiency with an additional $1,000 if the affiliate also meets a major Green Building Certification.

Amidst continued federal budget constraints, the US Congress decreased the overall US Department of Housing and Urban Development (HUD) HOME Investment Partnerships Program (HOME) allocations to $12.1 million in 2013. Prior years' appropriations were $12.5 million in 2012, $19.1 million in 2011 and $21.6 million in 2010. Although there was not a significant decrease in appropriations between 2012 and 2013, the 2013 allocation amount of $12.1 million represents a 44% reduction in appropriations compared to the $21.6 million allocation in 2010 and reflects the lowest appropriation since the Agency began working with the HOME Program in 1992. The significant decrease in appropriations from earlier years reduced the Agency's ability to fund the single family loan pools and rental programs.

For fiscal year 2013, the NC General Assembly eliminated the current year funding of the Housing Trust Fund (HTF) by a nonrecurring cut of $7.9 million. However, a General Assembly provision allowed the Agency to transfer funds from the National Mortgage Settlement (discussed below) to offset the $7.9 million cut. The allocation for the State's matching funds for HOME remained at $1.6 million, the same as the previous two fiscal years.

The federal government and 49 state Attorneys General reached a landmark agreement in February 2012 known as the National Mortgage Settlement which gives relief for distressed borrowers, states and the federal government. The settlement provides benefits to borrowers whose loans are either owned or serviced by the settling banks. In fiscal year 2013, the State of North Carolina received a total of $338 million, and the North Carolina Attorney General's office requested that the Agency disburse $30,590,000 for housing counseling and legal services for distressed homeowners in the State. The Agency has allotted $13,813,000 to housing counseling providers through the Housing Counseling Capacity Building Program and $8,315,000 to legal service providers through the National Mortgage Settlement—Legal Services Program. Both programs will disburse funds over a three-year period.

Neighborworks® America (NW), which receives funding from the Treasury, awarded the Agency $1.4 million for round six and $2.6 million for round seven of the National Foreclosure Mitigation Counseling Program (NFMC) in fiscal year 2013. The Agency has participated in all five previous rounds. NFMC disburses funds to approved housing counseling agencies for counseling sessions attended by homeowners facing foreclosure. NW also awarded funding of $220,000 from the Making Home Affordable Outreach and Intake Project (MHA). This award provides assistance through four participating counseling agencies to help homeowners apply for foreclosure prevention assistance.

Debt Administration

Although historically low interest rates have risen modestly in the last months of fiscal year 2013, they continued to make traditional tax-exempt bond financing difficult. In the absence of a tax-exempt bond issuance to continue financing its mortgage revenue bond FirstHome Program, it offered a new mortgage product starting March 1, 2013 called N.C. Home Advantage Mortgage (HomeAd), which is financed by the sale of mortgage-backed securities on the secondary market. The HomeAd Program is discussed in more detail in the "New Business" section.

The Agency took advantage of low rates through a taxable refunding in July 2012 by issuing Series 33, a taxable issuance under the 1998 Trust Agreement, for $121,670,000. Series 33 refunded Series 2, 3, 4, 8, 10, 12, 13 and 14 in the 1998 Single Family Trust Agreement. The Agency anticipates a present value of over $17 million in debt service savings for the Agency.

On July 1, 2012, the Agency cancelled $3,865,000 of the notional amount of its derivative interest rate swap with Goldman Sachs for Series 18 in the 1998 Single Family Trust Agreement. On the same date, the Agency called an equal amount of bonds, keeping the notional amount of the swap and the bonds outstanding equal. This optional cancellation was available under the existing swap contract and no swap termination charge was incurred.

Apart from scheduled debt service payments, the Agency had six bond calls from July 1, 2012 through June 1, 2013 which totaled $250,200,000. These bond calls included the redemption of the bonds associated with the Series 33 refunding as well as the redemption of the underlying bonds associated with the Goldman Sachs swap cancellation, both referenced above.

Programs

For the year ended June 30, 2013, the Agency made cash disbursements of approximately $280,706,000 in Federal funds for the following programs:

- Community Partners Loan Pool (CPLP)
- Individual Development Account Loan Pool (IDALP)
- Mortgage Payment Program (MPP)
- National Foreclosure Mitigation Counseling Program (NFMC)
- Neighborhood Stabilization Loan Pool (NSLP)
- New Homes Loan Pool (NHLP)
- Rental Production Program (RPP)
- Second Mortgage Refinance Program (SMRP)
- Section 8 New Construction
- Section 8 Contract Administration
- Self-Help Loan Pool (SHLP)
- Single-Family Rehabilitation (SFR)
- Single-Family Rehabilitation Loan Pool (SFRLP)
- Supportive Housing Development Program (SHDP)
- Supportive Housing Predevelopment Loan Program (SHPLP)

For the year ended June 30, 2013, the Agency made cash disbursements of approximately $51,943,000 in State funds for the following programs:

- Affordable Home Ownership Program (AHOP)
- Displacement Prevention Partnership (DPP)
- Home Protection Program (HPP)
- Housing Counseling Capacity Building Program/National Mortgage Settlement (HCCBP)
- Individual Development Account Loan Pool (IDALP)
- Key Program (KEY)
- National Mortgage Settlement-Legal Services (NMS Legal)
- New Homes Loan Pool (NHLP)
- Preservation Loan Program (PLP)
- Rental Production Program (RPP)
- Self-Help Loan Pool (SHLP)

- Single-Family Rehabilitation Loan Pool (SFRLP)
- State Home Foreclosure Prevention Project (SHFPP)
- Statewide Down Payment Assistance Program (SWDAP)
- Supportive Housing Development Program (SHDP)
- Supportive Housing Development Program 400 (SHDP400)
- Supportive Housing Predevelopment Loan Program (SHPLP)
- State Tax Credit (STC)
- Urgent Repair Program (URP)

For the year ended June 30, 2013, the Agency made cash disbursements of approximately $100,875,000 from other funding sources for the following programs:

- Community Partners Loan Pool (CPLP)
- Construction Training Partnership Program (CTP)
- Duke Home Energy Loan Pool (HELP)
- FirstHome Program (FirstHome)
- Individual Development Account Loan Pool (IDALP)
- Multifamily Rental Assistance (MFRA)
- New Homes Loan Pool (NHLP)
- N.C. Home Advantage Mortgage (HomeAd)
- N.C. Home Advantage Down Payment Assistance (HomeAd DPA)
- Single-Family Rehabilitation Loan Pool (SFRLP)
- State Home Foreclosure Prevention Project (SHFPP)
- Statewide Down Payment Assistance Program (SWDAP)
- Supportive Housing Development Program (SHDP)

For the year ended June 30, 2013, the Agency made non-cash disbursements of approximately $42,989,000 in miscellaneous funds for the following programs:

- Low-Income Housing Tax Credit Program (LIHTC)
- Mortgage Credit Certificate (MCC)

The Agency's mission is to create affordable housing opportunities for North Carolinians whose needs are not met by the market. Given the historic lows in market mortgage rates and the overall recession, the Agency has focused its efforts to help homeowners in trouble or those needing additional assistance in buying or rehabilitating their home.

<u>Home Ownership Programs</u> The Agency supported approximately 2,000 homebuyers with disbursements from its Home Ownership Programs in fiscal year 2013.

The FirstHome Program, funded with tax-exempt mortgage revenue bonds, offers 30-year mortgages to moderate and low-income individuals who have not owned a home in the last three years. Annual household income and home purchase price limits apply to borrowers. The Statewide Down Payment Assistance Program is used in conjunction with the Agency's FirstHome Program to increase the homeowner benefit and to differentiate the Agency's program from other lenders. It offers $8,000 for an interest-free deferred subordinate mortgage to qualified households. This assistance is only available for FHA and VA loans only, and it requires a 650 minimum credit score and $1,000 investment from the borrower's own funds.

The N.C. Home Advantage Mortgage Program discussed in the "New Business" section offers 30-year mortgages to moderate and low-income first-time homebuyers as well as move-up buyers for the purchase of a home. Income limits and credit score limits apply, and up to 3% of deferred, forgiven N.C. Home Advantage Down Payment Assistance is available to any borrower obtaining an N.C. Home Advantage Mortgage.

The Agency helped community-based groups bring home ownership opportunities to lower-income households. The Individual Development Account Loan Pool and the New Homes Loan Pool were combined in fiscal year 2013 to form a new program, the Community Partners Loan Pool, which is discussed in the "New Business" section. The pool offers gap financing as a deferred, 0% interest loan that can be used with an N.C. Home Advantage Mortgage or the Rural Development Section 502 Program. The Self-Help Loan Pool provides interest-free and amortizing mortgage loans for permanent financing of newly-built or foreclosed homes using homebuyer sweat equity. Incentive funding of $4,000 is also available to all loan pools when homes are built to certain SystemVision standards of energy efficiency with an additional $1,000 if the affiliate also meets a major Green Building Certification.

The Mortgage Credit Certificate Program permits first-time homebuyers who are within federal guidelines for family income and acquisition costs to take up to 30% or $2,000 of annual mortgage interest as a federal income tax credit for every year the homebuyer occupies the home. Although the mortgage credit certificate cannot be used with a FirstHome Mortgage, it is available for qualifying first-time homebuyers using the N.C. Home Advantage Mortgage.

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

<u>Housing Preservation Programs</u> The Agency supported approximately 3,100 households with disbursements from its Housing Preservation Programs in fiscal year 2013.

The Single-Family Rehabilitation Loan Pool Program provides deferred, forgivable loans to rehabilitate moderately deteriorated owner-occupied homes, primarily assisting homeowners below 80% of area median income with elderly and/or disabled household members. All units are improved to stringent energy and construction standards.

The Urgent Repair Program provides grants to local governments, regional agencies, and non-profit organizations to correct housing conditions that pose an imminent threat to life, safety, or displacement of low-income homeowners.

The Displacement Prevention Partnership, which operates in partnership with local offices of the Independent Living Rehabilitation Program in the North Carolina Department of Health and Human Services (DHHS), provides accessibility modifications to very low-income households that may be displaced due to severe mobility limitations.

The Rental Production Program provides substantial rehabilitation or acquisition/rehabilitation loans for the production of rental housing, primarily targeting households below 50% of area median income. The Rental Production Program loans are usually gap financing for the projects financed with federal low-income housing tax credits.

<u>Foreclosure Prevention Financing Programs</u> In light of the State’s high unemployment rate, the Agency made use of several programs that target homeowners in financial trouble. The Agency disbursed funds from the N.C. Foreclosure Prevention Fund to over 10,200 households in fiscal year 2013.

The Mortgage Payment Program of the Hardest Hit Fund® (HHF) pays mortgage payments and related expenses for unemployed homeowners up to 18 months while they look for a job or up to 36 months while they complete job training, with a standard maximum assistance of $36,000. The assistance is in the form of a 0% interest deferred loan which will be forgiven if the homeowner continues to live in the home for ten years.

The Second Mortgage Refinance Program of HHF provides assistance to recovered, employed homeowners who have an unaffordable second mortgage due to prior unemployment, under-employment, or other program-eligible financial hardship. The assistance is in the form of a 0% interest, non-recourse, deferred-payment subordinate loan up to $30,000.

<u>Foreclosure Counseling</u> The Agency provided counseling to over 9,000 homeowners with disbursements to local counseling agencies from its Foreclosure Counseling Programs in fiscal year 2013.

The National Foreclosure Mitigation Counseling Program provides federal funds for foreclosure prevention counseling and legal assistance across the State. Counseling sessions are provided on a short-term basis by United States Department of Housing and Urban Development (HUD) approved counseling intermediaries primarily in defined areas of greatest need.

Homeowners facing foreclosure are also assisted by approved housing counseling agencies through the Making Home Affordable Outreach and Intake Project, discussed in “New Business” section. The Agency is in the process of rolling out the program and will begin disbursements in fiscal year 2014.

Through the State Home Foreclosure Prevention Project, every homeowner facing foreclosure is notified of available counseling services. Fees paid by servicers for each registered home foreclosure are used to pay for housing counseling, legal aid, and administrative costs. Counseling agencies throughout the State provide assistance to homeowners and servicers regarding foreclosure alternatives.

The Housing Counseling Capacity Building Program receives funding from the National Mortgage Settlement (discussed in "New Business" section). In fiscal year 2013, the Agency funded 47 organizations with $2.2 million to build human capital, training, technology and marketing capacity of HUD-certified non-profit housing and foreclosure counseling agencies. The Settlement also provided funding of $2.8 million in fiscal year 2013 to establish and administer two law school-based foreclosure and consumer financial transaction clinics and to provide funding to Legal Aid of North Carolina, which disburses the funds to qualified non-profit legal services providers.

Rental Production Programs The Agency supported approximately 5,000 households with disbursements from its Rental Production Programs in fiscal year 2013.

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

Unlike the federal tax credit, the state tax credit is not a tax-shelter equity investment. It is either claimed directly by the property owner in the form of a grant or transferred to the Agency by the North Carolina Department of Revenue. The amount of the transferred state tax credit becomes a secured loan from the Agency to the property owner. In every case to date, the owner has transferred its credit to the Agency because of the federal income tax treatment and the needs of the project. Once the property has reached certain milestones, primarily completion of a certain amount of construction, the loan becomes eligible to close.

The Rental Production Program provides low cost loans for rental housing, mainly targeting households below 50% of area median income. These RPP loans are usually gap financing for the projects financed with federal low-income housing tax credits.

Rental Assistance Programs The Agency supported approximately 25,700 households with disbursements from its Rental Assistance Programs in fiscal year 2013.

The Agency administers the Section 8 Housing Assistance Payment Program on behalf of HUD for properties throughout North Carolina. The Agency contracted with a third-party administrator, Quadel Consulting Corporation, to assist with the administration of this program.

The Agency and DHHS partnered to create the Key Program by providing rental assistance to low income persons with disabilities, including the homeless. Funding is available to all targeted units produced under the Preservation Loan Program, Housing Credit, and the Supportive Housing Development Program; however, it does not provide assistance if rental subsidies are available through another program.

Special Needs Housing Programs The Agency supported over 500 households with disbursements from its Special Needs Housing Programs in fiscal year 2013.

The Supportive Housing Development Program provides funding for emergency, transitional, and permanent housing for children and adults with a wide range of disabilities or special housing needs. Eligible applicants are mission driven non-profit organizations and units of local government.

Additional Information

This discussion and analysis is intended to provide additional information regarding the activities of the Agency. If you have questions about the report or need additional financial information, contact Elizabeth I. Rozakis, Chief Financial Officer, North Carolina Housing Finance Agency, P.O. Box 28066, Raleigh, North Carolina 27611-8066, (919) 877-5687, eirozakis@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 North Carolina Housing Finance Agency (the "Agency"), a public agency and component unit of the State of North Carolina, which comprise the statement of net position as of June 30, 2013, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements.

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina Housing Finance Agency as of June 30, 2013, and the changes in its net position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 10 be presented to supplement the 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 19, 2013 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 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 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 19, 2013

NORTH CAROLINA HOUSING FINANCE AGENCY

STATEMENT OF NET POSITION

AS OF JUNE 30, 2013

(in thousands)		
ASSETS		
Current assets:		
Cash and cash equivalents	$	2,723
Restricted cash and cash equivalents		306,302
Accrued interest receivable on investments		254
Mortgage loans receivable		165,624
Accrued interest receivable on mortgage loans		10,328
State receivables		75,445
Other assets		21,548
TOTAL CURRENT ASSETS	$	582,224
Noncurrent assets:		
Restricted cash and cash equivalents	$	6,596
Investments		3,109
Restricted investments		61,624
Mortgage loans receivable, net		1,029,476
State receivable		12,880
Other assets, net		4,242
TOTAL NONCURRENT ASSETS	$	1,117,927
TOTAL ASSETS	$	1,700,151
DEFERRED OUTFLOW OF RESOURCES		
Accumulated decrease in fair value of hedging derivative	$	5,181
TOTAL DEFERRED OUTFLOW OF RESOURCES	$	5,181
LIABILITIES		
Current liabilities:		
Bonds payable	$	32,620
Accrued interest payable		21,366
Accounts payable		4,692
Unearned revenues		20,836
Other liabilities		119
TOTAL CURRENT LIABILITIES	$	79,633
Noncurrent liabilities:		
Bonds payable, net	$	1,015,318
Derivative instrument - interest rate swap		5,181
Unearned revenues		9,987
Other liabilities		6,136
TOTAL NONCURRENT LIABILITIES	$	1,036,622
TOTAL LIABILITIES	$	1,116,255
NET POSITION		
Restricted	$	573,696
Unrestricted		15,381
TOTAL NET POSITION	$	589,077

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, 2013

(in thousands)

OPERATING REVENUES		
Interest on investments	$	3,914
Net decrease in fair value of investments		(2,693)
Interest on mortgage loans		64,751
Federal program awards received		253,470
Program income/fees		31,223
Other revenues		859
TOTAL OPERATING REVENUES	$	351,524
OPERATING EXPENSES		
Interest on bonds	$	48,535
Mortgage servicing expense		3,502
Federal program expense		253,761
Nonfederal program expense		8,799
General and administrative expense		28,309
Other expenses		3,759
TOTAL OPERATING EXPENSES	$	346,665
OPERATING INCOME	$	4,859
NON-OPERATING REVENUES (EXPENSES)		
State appropriations received	$	1,206
State grants received		38,718
State tax credits		45,874
State program expense		(49,846)
TOTAL NON-OPERATING REVENUES (EXPENSES)	$	35,952
CHANGE IN NET POSITION	$	40,811
TOTAL NET POSITION-BEGINNING	$	548,266
TOTAL NET POSITION-ENDING	$	589,077

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

NORTH CAROLINA HOUSING FINANCE AGENCY

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2013

(in thousands)		
Cash flows from operating activities:		
Interest on mortgage loans	$	64,590
Principal payments on mortgage loans		174,500
Purchase of mortgage loans		(82,669)
Federal program awards received		236,395
Federal program expense		(252,201)
Nonfederal program expense		(8,799)
Federal grant administration income		18,436
Program income/fees		13,738
Other expenses		(28,184)
Other revenues		(3,149)
Net cash provided by operating activities	$	132,657
Cash flows from non-capital financing activities:		
Issuance of bonds	$	121,670
Principal repayments on bonds		(284,075)
Interest paid		(53,143)
Bond issuance costs paid		(1,108)
State appropriations received		1,206
State grants received		12,957
State tax credits		31,976
State program expense		(49,846)
Net cash used in non-capital financing activities	$	(220,363)
Cash flows from investing activities:		
Proceeds from sales or maturities of investments	$	54,933
Purchase of investments		(69,798)
Earnings on investments		3,826
Net cash used in investing activities	$	(11,039)
Net decrease in cash	$	(98,745)
Cash and cash equivalents at beginning of year		414,366
Cash and cash equivalents at end of year	$	315,621
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	4,859
Adjustments to reconcile operating income to net cash (used in) provided by operating activities:		
Interest on investments		(3,914)
Decrease in fair value of investments		2,693
Interest on bonds		48,535
Change in assets and liabilities:		
Decrease in mortgage loans		94,537
Decrease in interest receivable on mortgage loans		37
Increase in other assets		(3,125)
Increase in accounts payable and other liabilities		6,388
Decrease in unearned revenues		(17,353)
Total adjustments	$	127,798
Net cash provided by operating activities	$	132,657

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

NOTES TO FINANCIAL STATEMENTS

Year Ended June 30, 2013

A. AUTHORIZING LEGISLATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Authorizing Legislation The North Carolina Housing Finance Agency (the Agency) is a public agency and component unit of the State of North Carolina (the 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 of America (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 financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, except for Agency funds which do not have a measurement focus. 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. A summary of the Agency's primary programs are as follows:

<u>Agency Programs</u> Direct administrative and operational activities, including operating expenses of various programs, are recorded in Agency Programs. The General Assembly of the State of North Carolina provides state tax credits to the Agency for use in developing housing credit properties. The Agency received $31,976,000 in state tax credits during fiscal year 2013. Under this program, the state tax credit project will receive the credit in the form of a loan or direct refund.

In 2008, the State authorized the formation of the State Home Foreclosure Prevention Project (SHFPP) in response to the foreclosure crisis. Beginning in 2010, State statute requires all parties who wish to initiate a foreclosure against a home in North Carolina must remit a $75 fee to the Office of the Commissioner of Banks. In June 2011, the North Carolina General Assembly passed a bill to transfer the management of the State Home Foreclosure Prevention Project (SHFPP) to the Agency. The fees collected are used to counsel and/or provide legal assistance to homeowners who are at risk of foreclosure. Any excess funds are allocated to the Housing Trust Fund annually. Prior to December 2012, the funds were recorded as *State grants received* in the amount of $2,573,000 and $427,000 in *State program expense* under Federal and State Programs because the NC Commissioner of Banks collected the funds. In December 2012, the North Carolina General Assembly transferred all aspects of SHFPP to the Agency. Subsequent funds in the amount of $3,454,000 were received and recorded as *Program income/fees* under Agency Programs. Expenses of $2,455,000 related to the SHFPP are reflected in *Nonfederal program expense.*

<u>Housing Trust Fund Programs</u> The North Carolina Housing Trust and Oil Overcharge Act created the North Carolina Housing Trust Fund (Housing Trust Fund) and the North Carolina Housing Partnership (Housing Partnership). The purpose of the Housing Trust Fund 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 with respect to the operation of programs within the Housing Trust Fund. The Agency provides staff services to the Housing Partnership and administers the Housing Trust Fund Programs. Traditionally, the State has appropriated funds of which substantially all are to be used to make loans and grants under the

Housing Trust Fund Programs. However, for fiscal year 2013, the General Assembly authorized the Agency to use $7,876,000 of the National Mortgage Settlement for the Housing Trust Fund, which is reflected in *State receivable(s)*. Per the enabling SHFPP legislation (referenced above in Agency Programs), the remainder of the 2013 SHFPP fund in the amount of $2,042,000 was transferred to the Housing Trust Fund. These funds are reported in *Non-Operating Revenues (Expenses)* in the financial statements.

Federal and State Programs The Agency administers seven federal programs. Of the Agency's federal programs, the Section 8 Programs, the Hardest Hit Fund®, and the HOME Investment Partnerships Program (HOME Program) represent 52%, 40%, and 7% respectively. The Agency receives a fee for administering these programs. The HOME Program is matched with funds appropriated by the General Assembly of the State; the amount of matching funds received during the year was $1,608,000. The Agency received $1,206,000 in matching funds from the State, and the State allowed the Agency to replace matching funds with unused Home Protection Program (HPP) Funds in the amount of $402,000, totaling $1,608,000.

The State of North Carolina was awarded $338 million from the National Mortgage Settlement. In fiscal year 2013, the Agency signed a Memorandum of Understanding with the NC Department of Justice to oversee $30,590,000 of these funds, all of which are reflected in *State grants received*. These funds are to be used to help build the capacity of HUD-approved housing counseling agencies in the state as well as to provide funding for legal services. As of June 30, 2013, $5,026,000 was disbursed and reflected in *State program expense* and $25,761,000 was recorded as *State receivables.*

As described in Agency Programs, the State Home Foreclosure Prevention Project was transferred to the Agency in December 2012. Prior to this date, $2,573,000 was recorded as *State grants received* and $427,000 in *State program expense*.

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 homebuyer mortgage loans on single-family residential units.

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 are collateralized under provisions of North Carolina laws and regulations, amounts in pooled cash accounts managed by the 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 statement of net position are restricted for the Agency's debt service payments, bond calls, and for purchasing mortgage loans under the Agency's different programs.

Investments *Investments* are reported at fair value in accordance with GASB Section I50, *Investments* (GASB I50), except for certain mortgage-backed securities. With the exception of the mortgage-backed securities associated with the N.C. Home Advantage Mortgage Program which are purchased and sold on the same day, the Agency intends to hold all securities to maturity.

Mortgage loans receivable, net Mortgage loans are carried at cost less loan loss reserve plus unamortized direct loan origination costs. All direct loan origination costs are amortized over the terms of the mortgages using the effective interest rate method. It is the Agency's policy to provide for potential mortgage loan losses based on a periodic evaluation of the loan portfolios.

State receivables In 2002, the General Assembly converted the State Tax Credit (STC) into a refundable credit providing funds that can be efficiently invested directly in housing credit properties through the Agency. The Agency recorded a $62,564,000 receivable for state tax credits for the fiscal year ended June 30, 2013, representing the remaining 2011 and 2012 outstanding awards. The Agency received state tax credits in the amount of $31,976,000 from the General Assembly for the 2010 outstanding awards (second installment) and the 2011 awards (first installment). These funds are used to provide loans to housing credit properties.

The Agency recorded a $25,761,000 receivable from the NC Department of Justice (DOJ) for the National Mortgage Settlement in fiscal year 2013. This amount represents the remaining balance awarded to the Agency. These funds provide housing counseling and legal services to distressed North Carolina homeowners.

Other assets, net Fixed assets, net of accumulated depreciation, in the amount of $4,242,000 are included in *Other assets, net* in the financial statements. Assets of $5,000 or greater are capitalized and depreciated over a five-year economic useful life using the straight-line method. Recorded in *Other assets* (current) for Federal and State Programs in the amount of $2.4 million includes Quadel Consulting Corporation contract administration, Hardest Hit Fund® advanced expenses and trustee reconciling items, National Foreclosure Mitigation Counseling (NFMC) Round Six Program close-out, and HOME Program loans closed in fiscal year 2013 but reimbursed in fiscal year 2014. Other assets in the amount of $18,773,000 are reflected in the Home Ownership Bond Programs. Included in this amount are mortgage payments collected by servicers that will be remitted to the Agency in fiscal year 2014 and deferred bond issuance costs of approximately $12.3 million (see footnote below).

Deferred bond issuance costs These costs are included as a component of *Other assets, net* and represent unamortized bond issuance costs and losses on refundings. Deferred losses on refundings result from a difference between the reacquisition price and the net carrying amount of the old debt and are amortized on a straight-line basis over the shorter of the life of the old debt or the new debt. Deferred bond issuance costs are amortized on a straight-line basis over the terms of the bonds and are written down to the extent any bond calls are completed. The amortization of deferred bond issuance costs and losses on refunding is included as a component of *Interest on bonds.*

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65), requires that deferred bond issuance costs be treated as expenses of the current period. Because GASB 65 will be effective for the agency's fiscal year ending June 30, 2014, the Agency will be expensing approximately $12.3 million in deferred bond issuance costs in fiscal year 2014.

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

Unearned revenues *Unearned revenues* are monitoring fees received for the Low-Income Housing Tax Credit and for loans issued under the State Disaster Program. 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 under *Unearned revenues* is funding from the Treasury for the Hardest Hit Fund®. The funds are used for loans to assist homeowners at risk of foreclosure.

Interprogram receivable/(payable) During the normal course of operations, the Agency has numerous transactions among programs in order to provide services. To the extent that certain transactions among programs have not been settled as of June 30, 2013, these balances are recorded as *Interprogram receivable/(payable)*. These interprogram transactions are eliminated in the financial statements.

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

The Agency's Board of Directors annually approves an operating budget that is funded with revenues generated by administrative fees earned on federal programs, interest income earned on investments, and reserves from trust agreements. All of these revenue sources are earmarked to cover operating expenses. The decision to use restricted or unrestricted receipts to fund a payment is transaction-based. For projects funded by tax-exempt bond proceeds and other resources, the bond proceeds are always used first.

As of June 30, 2013, the Agency had $15,381,000 of unrestricted net position. The Agency intends to use net position for potential home ownership mortgage loan losses, to meet rating agencies' requirements, to cover the operating budget, and to support other Agency housing commitments.

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

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

The Agency implemented GASB I50, which requires the Agency to report investments at fair market value. The effect of the adoption on the Agency's financial statements for the past years ended June 30, 2013 and 2012 are as follows (*in thousands*):

	June 30, 2013	June 30, 2012
(Decrease)/Increase in Operating Income	$ (2,693)	$ 904
(Decrease)/Increase in Net Position	$ (1,604)	$ 1,089

Operating Revenues and Expenses One of the Agency's main functions is to borrow funds in the bond market and to use those funds to make home ownership loans. The Agency has the authority to issue bonds to the investing public in order to create a flow of private capital. These funds are used to purchase mortgage loans for qualified housing sponsors and certain qualified individuals. A significant portion of operating income is derived from interest earned on mortgage loans 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, State grants received*, and *State tax credits* from the State of North Carolina are classified in *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. In the event the Home Ownership Bond Programs or Federal and State Programs do not permit payment of general and administrative expenses, expenses are paid from Agency reserve funds. Certain indirect costs were allocated to Federal and State Programs based on an independently prepared cost allocation study. These costs are allocated based on certain parameters such as office square footage, number of approved positions, and number of transactions processed.

Use of estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period (e.g., loan loss reserve). Actual results could differ from those estimates.

B. CASH, CASH EQUIVALENTS, INVESTMENTS, AND SECURITIES LENDING TRANSACTIONS

Cash and cash equivalents As of June 30, 2013, the Agency had deposits in pooled investment accounts of the State Treasurer with a carrying value of approximately $107,769,000 and a bank balance of approximately $108,295,000. 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 the amount of $3,458,000 representing 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 also had deposits with both a carrying value of $207,850,000 and bank balance approximating $207,902,000 on deposit with the Agency's fiduciary agent. Such deposits are collateralized with eligible securities held 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, 2013, the Agency was not exposed to any material custodial credit risk.

Investments The Agency's investments are comprised of repurchase agreements and government securities which include Federal Farm Credit Bank securities, Federal Home Loan Bank securities, Federal Home Loan Mortgage Corporation securities, and mortgage-backed securities (MBS) insured by the Federal National Mortgage Association (FNMA) and the Government National Mortgage Association (GNMA).

Repurchase agreements are collateralized by obligations of the US Government, its agencies, or direct investments of such obligations. The market value of securities subject to such agreements must be maintained at least equal to 100 percent of the principal and accrued interest on the invested funds daily. The Agency invests in repurchase agreements for mostly long-term (generally reserved) investments. On June 30, 2013, approximately $8,971,000 was invested in such long-term agreements having maturity dates ranging from January 1, 2024 to January 1, 2035 at a rate of 4.01%.

In fiscal year 2013, the Agency started a new program called the N.C. Home Advantage Mortgage. The mortgages are made by the lenders, purchased by the Agency's master servicer and securitized into GNMA mortgage-backed securities. The Agency then purchases the mortgage-backed securities from its master servicer, and on the same day, sells the securities to its third-party hedger. Because the MBSs are purchased and sold on the same day, there is no balance of the MBS reflected on the statement of net position as of June 30, 2013.

At June 30, 2013, the Agency held the following investments with the listed maturities at annual rates ranging from 1.25% to 6.90%. Ratings are displayed with the Standard & Poor's rating listed first and the Moody's Investors Service second (*in thousands*):

		Investment Maturities (*In Years*)			
Investments	**Carry Amount**	**Less Than 1**	**1 – 5**	**6 – 10**	**More Than 10**
GNMA MBS's Rated AA+/Aaa	$ 1,346	$ -	$ -	$ 1 ,322	$ 24
FNMA MBS's Rated AA+/Aaa	317	-	-	317	-
Repurchase Agreements- Rated AA-/A2	8,971	-	-	-	8,971
US Agency Rated AA+/Aaa	54,099	-	13,692	40,407	-
Total Categorized	**$64,733**	**$ -**	**$13,692**	**$42,046**	**$8,995**

Interest rate risk Interest rate risk is the risk that changes in the 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.

Credit risk Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The General Statutes of the State 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 North Carolina and meet specified rating and collateral requirements of the various trust agreements. Mortgage-Backed Securities (MBS) are securitized by the Federal National Mortgage Association (FNMA), (Fair Value - $317,000, rated AA+/Aaa), and by the Government National Mortgage Association (GNMA), (Fair Value - $1,346,000, rated AA+/Aaa). The Government National Mortgage Association is a direct obligation of the US Government. Repurchase agreements are fully collateralized by obligations issued by the US Government or its agencies. Government Securities are comprised of Federal Farm Credit Bank, Federal Home Loan Bank and Federal Home Loan Mortgage Corporation Securities which are direct obligations of the Treasury (rated AA+/Aaa). The Government Securities have a Fair Value of $54,099,000.

Concentration of credit risk The Agency has a practice of entering into repurchase agreements with investment providers to minimize the Agency's exposure to a bond rating downgrade should one of the providers have a ratings event. The investments consist of repurchase agreements and obligations of the US Government which represent 14% and 84%, respectively, of the Agency's total investments. Investments in any one issuer that represent 5% or more of total investments as of June 30, 2013 are as follows (*in thousands*):

Investment Issuer	**Amount**
Federal Home Loan Bank	$42,916
FSA Capital Management, repurchase agreement	8,971
Federal Home Loan Mortgage Corporation	6,858
Federal Farm Credit Bank	4,325

Custodial credit risk Custodial credit risk occurs in the event that 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 US 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.

Bond proceeds were used to purchase fully-modified mortgage-backed pass-through certificates of GNMA and mortgage-backed pass-through certificates of FNMA from pools of qualified mortgages originated under the Agency's mortgage revenue bond program guidelines. The securities are based on cash flows from underlying mortgages and are not considered derivatives. In addition to these securities, the Agency purchases and sells other mortgage-backed pass-through certificates of GNMA associated with the Agency's N.C. Home Advantage Mortgage Program; however, those securities are purchased and sold within the same business day, and the Agency does not hold any of those securities as of June 30, 2013.

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 is not at risk for foreign currency risk.

Securities lending transactions GASB Section I60, *Investments—Security Lending (*GASB I60), establishes accounting and financial reporting standards for transactions where governmental entities transfer their securities to broker-dealers and other entities (borrowers) in exchange for collateral (which may be cash, securities, or letters of credit) and simultaneously agree to return the collateral in exchange for the original securities in the future. The Agency does not directly engage in securities lending transactions; however, the State Treasurer does. The State Treasurer is authorized to engage in these types of transactions under North Carolina General Statute 147-69.3e. The types of securities loaned include US 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 lent. 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.

As of June 30, 2013, and during the year then ended, 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, these financial statements do not reflect the risk associated with securities lending transactions as called for in GASB I60.

C. MORTGAGE LOANS RECEIVABLE

Mortgage loans purchased with the proceeds of the various single-family bond issuances have stated interest rates ranging from 3.25% to 10.70%.

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 Department, insured under a private mortgage insurance program, or have a loan-to-value ratio equal to or less than 80%. As of June 30, 2013, all outstanding mortgage loans purchased with mortgage revenue bond proceeds satisfy these requirements. The Agency has an allowance for loan losses in the single-family mortgage loan program of $5,656,000 as of June 30, 2013.

Mortgage loans made with funds from the Agency Programs, Housing Trust Fund Programs, and Federal and State Programs have allowances for loan losses of $5,700, $258,000 and $22,000 respectively, as of June 30, 2013.

For the Home Ownership Bond Programs, the Agency has collateralized $1,101,569,000 in mortgage loans receivable, $135,266,000 in debt service, insurance, and revenue reserves and $6,596,000 in Program Funds to repay $1,043,285,000 single-family bonds payable at June 30, 2013. Proceeds from the bonds issued were used to finance housing throughout the State. The bonds are payable through July 2041 and are paid down from cash collections on mortgage loans receivable, interest receivable on mortgage loans, unexpended bond proceeds, and sale of investments. The Agency expects 100% of the mortgage loans, 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, 2013 is $1,643,099,000 (see page 24 “maturities”). For the current fiscal year, debt service payments in the amount of $337,218,000 were made for the Home Ownership Bond Programs. Principal and interest payments received on mortgage loans for the Home Ownership Bond Programs were $230,763,000 in fiscal year 2013.

D. BONDS PAYABLE

Bonds payable activity for the year ended June 30, 2013 was as follows (*in thousands*):

	Beginning Balance	Additions	Reductions	Ending Balance
Bonds payable				
Home Ownership	$ 1,205,690	$ 121,670	$ (284,075)	$ 1,043,285
Bond Premium/(Discount), Net	5,858	1,061	(2,266)	4,653
Total Bonds payable, net	**$ 1,211,548**	**$ 122,731**	**$ (286,341)**	**$ 1,047,938**

Bonds payable as of June 30, 2013 are as follows (*in thousands*):

Issue	Stated Rates (%)	Final Maturity	Principal Amount
Home Ownership Revenue Bonds			
(1998 Housing Revenue Bonds Trust Agreement)			
Series 15	*Variable - 4.95	7/1/2032	$ 19,105
Series 16	*Variable - 5.40	7/1/2032	18,345
Series 17	*Variable - 5.00	7/1/2034	24,230
Series 18	*Variable - 4.45	1/1/2035	17,810
Series 19	4.15 - 5.15	7/1/2035	32,385
Series 20	3.90 - 4.75	7/1/2035	36,405
Series 21	4.20 - 4.75	7/1/2035	32,380
Series 22 A	4.30 - 5.50	1/1/2037	36,830
Series 22 CE	4.30 - 5.25	1/1/2039	54,710
Series 23	3.75 - 5.00	1/1/2037	33,505
Series 24	3.90 - 5.50	1/1/2038	46,340
Series 25	4.25 - 5.75	7/1/2037	36,835
Series 26	3.75 - 5.50	7/1/2038	37,665
Series 27 A	4.55 - 6.00	1/1/2038	28,470
Series 28	3.65 - 5.50	1/1/2039	40,085
Series 29	4.05 - 5.50	7/1/2038	57,600
Series 30	3.65 - 5.50	7/1/2039	42,290
Series 31	3.45 - 5.50	7/1/2038	46,025
Series 32	4.00	1/1/2030	109,020
Series 33	0.50 - 4.32	1/1/2034	111,980
			$ 862,015
Home Ownership Revenue Bonds			
(2009 Housing Revenue Bonds Trust Agreement)			
Series A-1 and Series 1	0.88 - 4.50	7/1/41	$ 81,775
Series A-2 and Series 2	0.60 - 4.25	7/1/41	99,495
			$ 181,270
Total Bonds Outstanding			$1,043,285
Plus Bond Premium/(Discount), Net			$ 4,653
Total Home Ownership Bond Programs			**$1,047,938**

*See Footnote E. “Derivative Instrument-Interest Rate Swap” for variable rate interest calculation methodology.

Series 33 in the 1998 Trust Agreement closed on July 19, 2012, and a majority of the mortgage loans associated with the refunded series was transferred to Series 33. On August 1, 2012 the proceeds of Series 33 in the 1998 Trust Agreement refunded all bonds in the following amounts for the series below (*in thousands*):

Series	**Bonds Refunded**
1998 Trust Agreement, Series 2	$ 6,680
1998 Trust Agreement, Series 3	14,405
1998 Trust Agreement, Series 4	10,305
1998 Trust Agreement, Series 8	175
1998 Trust Agreement, Series 10	8,295
1998 Trust Agreement, Series 12	29,520
1998 Trust Agreement, Series 13	23,310
1998 Trust Agreement, Series 14	28,980
Total	**$121,670**

To the extent provided in the authorizing resolutions, the bonds of each Home Ownership Bond Program are collateralized by the investments and mortgage loans receivable of that program and revenues derived therefrom and do not constitute a general obligation of the Agency. The bond resolutions further provide for the processing of money through specifically designated funds and accounts, periodic reporting, and the performance of other covenants, conditions, agreements, and provisions contained therein.

Maturities Debt service requirements, including sinking fund requirements on term bonds, subsequent to June 30, 2013, are as follows (*in thousands*):

Bonds Outstanding without Interest Rate Swaps

Fiscal Year Ending June 30	**Principal**	**Interest**
2014	$ 31,320	$ 42,040
2015	32,000	40,938
2016	32,180	39,797
2017	32,555	38,609
2018	32,415	37,378
2019-2023	174,900	166,141
2024-2028	206,470	124,539
2029-2033	206,670	76,527
2034-2038	192,980	30,948
2039-2042	46,580	2,328
Total Requirements	**$ 988,070**	**$ 599,245**

Bonds Outstanding with Interest Rate Swaps

Fiscal Year Ending June 30		Principal		Interest
2014	$	1,300	$	44
2015		1,235		43
2016		1,185		42
2017		1,695		41
2018		2,015		39
2019-2023		9,180		174
2024-2028		16,385		128
2029-2033		18,545		55
2034-2035		3,675		3
Total Requirements	**$**	**55,215**	**$**	**569**

Total Bonds Outstanding

Fiscal Year Ending June 30		Principal		Interest
2014	$	32,620	$	42,084
2015		33,235		40,981
2016		33,365		39,839
2017		34,250		38,650
2018		34,430		37,417
2019-2023		184,080		166,315
2024-2028		222,855		124,667
2029-2033		225,215		76,582
2034-2038		196,655		30,951
2039-2042		46,580		2,328
Total Requirements	**$**	**1,043,285**	**$**	**599,814**

Bond redemptions The bond series resolutions 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. Losses on these bond redemptions represent the reduction of the proportionate amount of unamortized deferred bond issuance costs for the bonds redeemed. Such losses are included in *Interest on bonds* for financial statement purposes. Various bond issues are redeemable at the option of the Agency.

For the year ended June 30, 2013, bond redemptions and losses recognized by the Home Ownership Bond Programs were as follows (*in thousands*):

Issue	Amount Redeemed	Loss Recorded
Housing Revenue Bonds (1998 Trust Agreement)	$ 281,075	$ (1,378)
Housing Revenue Bonds (2009 Trust Agreement)	3,000	(9)
Total Home Ownership Bond Programs	**$ 284,075**	**$ (1,387)**

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

Bonds payable as of June 30, 2013 for special facilities are as follows (*in thousands*):

Issue	Bond Type	Bonds Outstanding
2002 Resolution* (Series D)	Multifamily Housing Revenue Bonds	$ 2,185
2013 Resolution	Multifamily Housing Revenue Bonds	8,189
Total		**$10,374**

*This is 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 the reporting period from July 1, 2012, to June 30, 2013, the Agency did not execute or terminate any derivative contracts. The Agency has four, pay-fixed, interest rate swap agreements with three separate financial counterparties (further described herein) each designated as a hedging derivative instrument representing cash flow hedges for the organization (*in thousands*):

Hedgeable Item	Hedging Derivative Instrument	Notional Amount	Classification	Fair Value at June 30, 2013 Liability	Classification	Change in Fair Value Decrease
Series 15C Bonds	Pay-Fixed Interest Rate Swap	$13,905	Hedging Derivative	$(814)	Deferred Outflow of Resources	$557
Series 16C Bonds	Pay-Fixed Interest Rate Swap	$14,220	Hedging Derivative	$(1,509)	Deferred Outflow of Resources	$711
Series 17C Bonds	Pay-Fixed Interest Rate Swap	$16,260	Hedging Derivative	$(2,019)	Deferred Outflow of Resources	$974
Series 18C Bonds	Pay-Fixed Interest Rate Swap	$12,075	Hedging Derivative	$(839)	Deferred Outflow of Resources	$718

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 has entered into interest rate swaps in connection with all of its variable-rate revenue bonds associated with four series in its 1998 Housing Revenue Bond Trust Agreement as a means to manage the future cash flow impact associated with the hedged debt. The intention of the swaps was 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, 2013 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
$13,905[1]	UBS AG	A2/A	5/8/2003	7/1/2032	3.508%	63%L[2] + 0.30%
$14,220[1]	Bank of America, N.A.	A3/A	9/16/2003	7/1/2032	3.810%	63%L[2] + 0.30%
$16,260[1]	Bank of America, N.A.	A3/A	12/11/2003	7/1/2032	3.725%	63%L[2] + 0.30%
$12,075[1]	Goldman Sachs Mitsui Marine	Aa2/AAA	4/20/2004	1/1/2035	3.251%	63%L[2] + 0.30%

[1] The swap contracts contain optionality that allows the Agency the right to change the notional to better match the principal schedule on the bonds.

[2] L represents the USD, 1-Month LIBOR index as published on Telerate page 3750.

Fair value In total, the swaps have a fair value of negative $5,181,000 as of June 30, 2013. 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 basis points. The bonds' variable-rate coupons are remarketed weekly and generally track the variable SIFMA index, which was 0.08% for all four series as of June 30, 2013.

Basis risk and termination risk The swaps expose the Agency to basis risk should the relationship between LIBOR and SIFMA converge, 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 benefit of 18.13 basis points (bps) for Series 15 and 28.31 bps for Series 16, 17 and 18 due to the floating rate formula for its swap contracts when compared to the floating rate on the respective bonds. For all swaps, collateral thresholds have been established if the counterparty ratings reach A2 for Moody's or A for S&P. Series 16C, 17C and 18C 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. The Series 15C swap may be terminated if the counterparty's or the Agency's rating falls below Baa3 as issued by Moody's and BBB- as issued by S&P.

Credit risk Credit risk is the risk that the counterparty will not fulfill its obligations. All of the contracts as of June 30, 2013 reflect liabilities and, therefore, the Agency does not have current credit risk on its contracts. The Agency monitors the ratings of its counterparties to ascertain credit risk.

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

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

Market access risk Market access risk is the risk that the Agency will not be able to enter credit markets as planned or that credit will become more costly. The Agency's current market access risk is limited because of its liquidity agreement with TD Bank which will not expire until January 2015, and the Agency has cancellation features available with each of its swaps except for Series 17C, offering the Agency further flexibility.

Quantitative method of evaluating effectiveness In order to assess the effectiveness of each hedging derivative instrument, the Agency employed the "Synthetic Instrument Method". Under the Synthetic Instrument Method, a hedging derivative instrument is effective if the synthetic price is substantively fixed. The synthetic price as of the evaluation date, June 30, 2013, 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 15C Bonds	0.2620	0.4433	0.1813	3.32%	3.2130 – 3.9627	PASS
Series 16C Bonds	0.1602	0.4433	0.2831	3.52%	3.4290 – 4.2291	PASS
Series 17C Bonds	0.1602	0.4433	0.2831	3.44%	3.3525 – 4.1348	PASS
Series 18C Bonds	0.1602	0.4433	0.2831	2.96%	2.9259 – 3.6086	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, 2013, debt service requirements of the variable-rate debt and net swap payments are as follows (*in thousands*):

Fiscal Year	Variable-Rate Bond		Interest Rate	Total
Ending June 30	Principal	Interest	Swap, Net	Interest
2014	$ 1,300	$ 44	$ 1,740	$ 1,784
2015	1,235	43	1,698	1,741
2016	1,185	42	1,658	1,700
2017	1,695	41	1,621	1,662
2018	2,015	39	1,558	1,597
2019-2023	9,180	174	6,860	7,034
2024-2028	16,385	128	5,002	5,130
2029-2033	18,545	55	2,120	2,175
2034-2035	3,675	3	120	123
Total	**$55,215**	**$569**	**$22,377**	**$22,946**

F. NONCURRENT LIABILITIES

Noncurrent liabilities for the year ended June 30, 2013 was as follows *(in thousands):*

	Beginning Balance	Additions	Deletions	Ending Balance	Due Within One Year
Bonds Payable					
Bonds Payable, Net	$1,205,690	$121,670	$(284,075)	$1,043,285	$32,620
Bonds Premium/(Discount), Net	5,858	1,061	(2,266)	4,653	-
Derivative Instrument—Interest Rate Swap	8,141	-	(2,960)	5,181	-
Unearned Revenues	48,176	102,655	(120,008)	30,823	20,836
Other Liabilities					
Arbitrage Rebate Payable	1,954	-	(465)	1,489	-
Compensated Absences	1,217	108	(15)	1,310	112
Deposits Payable	3,456	2,567	(2,567)	3,456	7
	$1,274,492	**$228,061**	**$(412,356)**	**$1,090,197**	**$53,575**

G. OPERATING LEASE

The Agency leases office space with future minimum lease payments of $642,000 for fiscal year 2014 and $172,000 for three months in fiscal year 2015. Total rent expense for all operating leases amounted to $632,000 for the year ended June 30, 2013. The Agency's lease for its main office will expire September 30, 2014.

H. FEDERAL AWARDS

As a designated Public Housing Authority for the Department of Housing and Urban Development's (HUD) Section 8 Programs, the Agency requisitions Section 8 Program funds and makes disbursements to eligible landlords. For the year ended June 30, 2013, $142,164,000 which was received by the Agency and disbursed to property owners 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, 2013, $18,257,000 was received and disbursed by the Agency and is included in *Federal program awards received*, *Federal program expense* and *Mortgage loans receivable, net* in Federal and State Programs, depending upon the terms of the transaction.

The Agency was selected as a participating entity under a grant agreement with Treasury passed through NeighborWorks® for the National Foreclosure Mitigation Counseling Program (NFMC). NFMC provides funding for the purpose of counseling homeowners at risk of foreclosure. For the year ended June 30, 2013, $1,291,000 was received and disbursed by the Agency and is included in *Federal program awards received* and *Federal program expense* in Federal and State Programs.

The Agency was selected as a participating entity under a grant agreement with the Treasury for the Hardest Hit Fund® (HHF). HHF provides funding for the purpose of providing loans to unemployed homeowners unable to make their mortgage payments and in danger of losing their homes to foreclosure. Loan proceeds will be used to pay the mortgage and related costs such as real estate taxes, homeowner insurance and homeowner dues until the homeowner secures employment or completes training for a new career. For the year ended June 30, 2013, $98,643,000 was received and disbursed by the Agency and is included in *Federal program awards received* and *Federal program expense* in Federal and State Programs.

The Agency was awarded Neighborhood Stabilization Program (NSP) funds through the State of North Carolina, Department of Commerce, Division of Community Assistance. NSP funding is provided to the State through the US Department of Urban Development Community Development Block Grant. NSP provides funding for the purpose of providing zero-interest forgivable loans on foreclosed properties to stabilize neighborhoods in North Carolina. For the year ended June 30, 2013, $283,000 was disbursed by the Agency and is included in *Federal program awards received, Federal program expense* and *Mortgage loans receivable, net* in Federal and State Programs depending upon the terms of the transaction.

The Agency earned fees of $20,120,000 for administering these and other federal programs for the year ended June 30, 2013. Of these fees, $3,343,000 was paid to Quadel Consulting Corporation for the Section 8 Program Contract Administration, and $6,492,000 was paid to counseling agencies for providing counseling services under HHF which is 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 (the System), a cost-sharing multiple-employer defined benefit pension plan administered by the State. The System provides retirement benefits to plan members and beneficiaries. State statute assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly. The Teachers' and State Employees' Retirement System is included in the Comprehensive Annual Financial Report (CAFR) for the State of North Carolina. The State's CAFR includes financial statements and required supplementary information for the System. The report may be obtained from the website for the North Carolina Office of State Controller using the following link: http://www.osc.nc.gov/financial/index.html.

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 current rate is 14.23% of the annual covered payroll. The contribution requirements of plan members and the Agency are established and may be amended by the North Carolina 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, 2013, 2012, and 2011:

	2013	**2012**	**2011**
Retirement Benefit	$624,000	$546,000	$335,000
Percentage of Covered Payroll	8.33%	7.44%	4.93%

J. POST-EMPLOYMENT / DISABILITY BENEFITS

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

Short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (Disability Income Plan), a State-administered plan. Long-term disability benefits are payable from the Disability Income Plan after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five years of contributing membership service in the System earned within 96 months prior to the end of the short-term disability period; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period, after salary continuation payments cease, or after monthly payments for workers' compensation cease, whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of employees' usual occupation; (4) the disability must have been continuous, likely to be permanent and incurred at the time of active employment; and (5) the employee must not be eligible to receive unreduced retirement benefits from the System. 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 the System, the benefits payable from the Disability Income Plan cease, and the employee will commence retirement under the System.

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

The following table represents the three-year trend of the annual contributions made by the Agency to the State post-employment benefit plans. The Agency made 100% of its required contributions for the years ended June 30, 2013, 2012, and 2011:

	2013	2012	2011
Health Care Benefit	$397,000	$367,000	$333,000
Disability Benefit	33,000	38,000	35,000
Death Benefit	12,000	12,000	11,000
Percentage of Covered Payroll			
Health Care Benefit	5.30%	5.00%	4.90%
Disability Benefit	0.44%	0.52%	0.52%
Death Benefit	0.16%	0.16%	0.16%

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

K. RISK MANAGEMENT

The Agency's risk management policies provide for participation in the State's risk management programs. The following types of risk are covered under these programs, as disclosed in the State of North Carolina's Comprehensive Annual Financial Report:

- 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.

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, 2013 for this segment is as follows (*in thousands*):

STATEMENT OF NET POSITION

ASSETS		**Home Ownership**
Current assets:		
Restricted cash and cash equivalents	$	173,349
Accrued interest receivable on investments		236
Mortgage loans receivable		158,854
Accrued interest receivable on mortgage loans		10,217
Other assets		18,773
Interprogram receivable		1,806
TOTAL CURRENT ASSETS	$	363,235
Noncurrent assets:		
Restricted cash and cash equivalents	$	6,596
Restricted investments		55,528
Mortgage loans receivable, net		937,470
TOTAL NONCURRENT ASSETS	$	999,594
TOTAL ASSETS	$	1,362,829
DEFERRED OUTFLOW OF RESOURCES		
Accumulated decrease in fair value of hedging derivative	$	5,181
TOTAL DEFERRED OUTFLOW OF RESOURCES	$	5,181
LIABILITIES		
Current liabilities:		
Bonds payable	$	32,620
Accrued interest payable		21,366
Accounts payable		135
TOTAL CURRENT LIABILITIES	$	54,121
Noncurrent liabilities:		
Bonds payable, net	$	1,015,318
Derivative instrument - interest rate swap		5,181
Other liabilities		1,488
TOTAL NONCURRENT LIABILITIES	$	1,021,987
TOTAL LIABILITIES	$	1,076,108

STATEMENT OF NET POSITION (continued)

	Home Ownership
NET POSITION	
Restricted	$ 291,902
TOTAL NET POSITION	$ 291,902

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

OPERATING REVENUES	
Interest on investments	$ 3,202
Net decrease in fair value of investments	(2,443)
Interest on mortgage loans	63,324
Other revenues	12
TOTAL OPERATING REVENUES	$ 64,095
OPERATING EXPENSES	
Interest on bonds	$ 48,535
Mortgage servicing expense	3,501
General and administrative expense	1,152
Other expenses	3,646
TOTAL OPERATING EXPENSES	$ 56,834
OPERATING INCOME	$ 7,261
NON-OPERATING REVENUES	
Transfers in	$ 6,095
TOTAL NON-OPERATING REVENUES	$ 6,095
CHANGE IN NET POSITION	$ 13,356
TOTAL NET POSITION – BEGINNING	$ 278,546
TOTAL NET POSITION – ENDING	$ 291,902

STATEMENT OF CASH FLOWS

	Home Ownership
Net cash provided by operating activities	$ 149,702
Net cash used in non-capital financing activities	(210,561)
Net cash used in investing activities	(11,762)
Net decrease in cash	$ (72,621)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	252,566
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 179,945

North Carolina Housing Finance Agency

Supplementary Information

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Independent Auditor's Report on Supplementary Information

Our audits of the financial statements included in the preceding section of this report were 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 audits 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 19, 2013

NORTH CAROLINA HOUSING FINANCE AGENCY

COMBINING STATEMENT OF NET POSITION

AS OF JUNE 30, 2013

	AGENCY PROGRAMS	GRANT PROGRAMS		HOME OWNERSHIP PROGRAMS		
(in thousands)		Housing Trust Fund	Federal and State Programs	1998	2009	Total
ASSETS						
Current assets:						
Cash and cash equivalents	$ 2,723	-	-	-	-	$ 2,723
Restricted cash and cash equivalents	35,111	35,676	62,166	161,096	12,253	306,302
Accrued interest receivable on investments	7	11	-	197	39	254
Mortgage loans receivable	408	1,062	5,300	155,272	3,582	165,624
Accrued interest receivable on mortgage loans	75	12	24	9,484	733	10,328
State receivables	62,564	-	12,881	-	-	75,445
Other assets	375	-	2,400	16,630	2,143	21,548
Interprogram (payable)/receivable	(304)	9,896	(11,398)	1,806	-	-
TOTAL CURRENT ASSETS	$ 100,959	46,657	71,373	344,485	18,750	$ 582,224
Noncurrent assets:						
Restricted cash and cash equivalents	$ -	-	-	-	6,596	$ 6,596
Investments	3,109	-	-	-	-	3,109
Restricted investments	6,096	-	-	50,436	5,092	61,624
Mortgage loans receivable, net	3,614	14,924	73,468	768,258	169,212	1,029,476
State receivable	-	-	12,880	-	-	12,880
Other assets, net	4,242	-	-	-	-	4,242
TOTAL NONCURRENT ASSETS	$ 17,061	14,924	86,348	818,694	180,900	$ 1,117,927
TOTAL ASSETS	$ 118,020	61,581	157,721	1,163,179	199,650	$ 1,700,151
DEFERRED OUTFLOW OF RESOURCES						
Accumulated decrease in fair value of hedging derivative	$ -	-	-	5,181	-	$ 5,181
TOTAL DEFERRED OUTFLOW OF RESOURCES	$ -	-	-	5,181	-	$ 5,181
LIABILITIES						
Current liabilities:						
Bonds payable	$ -	-	-	29,005	3,615	$ 32,620
Accrued interest payable	-	-	-	18,566	2,800	21,366
Accounts payable	395	-	4,162	133	2	4,692
Unearned revenues	1,267	-	19,569	-	-	20,836
Other liabilities	113	-	6	-	-	119
TOTAL CURRENT LIABILITIES	$ 1,775	-	23,737	47,704	6,417	$ 79,633
Noncurrent liabilities:						
Bonds payable, net	$ -	-	-	836,590	178,728	$ 1,015,318
Derivative instrument - interest rate swap	-	-	-	5,181	-	5,181
Unearned revenues	9,987	-	-	-	-	9,987
Other liabilities	4,648	-	-	1,488	-	6,136
TOTAL NONCURRENT LIABILITIES	$ 14,635	-	-	843,259	178,728	$ 1,036,622
TOTAL LIABILITIES	$ 16,410	-	23,737	890,963	185,145	$ 1,116,255
NET POSITION						
Restricted	$ 86,229	61,581	133,984	277,397	14,505	$ 573,696
Unrestricted	15,381	-	-	-	-	15,381
TOTAL NET POSITION	$ 101,610	61,581	133,984	277,397	14,505	$ 589,077

NORTH CAROLINA HOUSING FINANCE AGENCY

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

YEAR ENDED JUNE 30, 2013

	AGENCY PROGRAMS	GRANT PROGRAMS		HOME OWNERSHIP PROGRAMS		
(in thousands)		**Housing Trust Fund**	**Federal and State Programs**	**1998**	**2009**	**Total**
OPERATING REVENUES						
Interest on investments	$ 411	174	127	3,045	157	$ 3,914
Net decrease in fair value of investments	(250)	-	-	(2,140)	(303)	(2,693)
Interest on mortgage loans	72	372	983	57,649	5,675	64,751
Federal program awards received	-	-	253,470	-	-	253,470
Program income/fees	8,857	819	21,547	-	-	31,223
Other revenues	743	-	104	12	-	859
TOTAL OPERATING REVENUES	$ 9,833	1,365	276,231	58,566	5,529	$ 351,524
OPERATING EXPENSES						
Interest on bonds	$ -	-	-	42,904	5,631	$ 48,535
Mortgage servicing expense	1	-	-	3,012	489	3,502
Federal program expense	-	-	253,761	-	-	253,761
Nonfederal program expense	8,799	-	-	-	-	8,799
General and administrative expense	17,322	-	9,835	1,099	53	28,309
Other expenses	1	110	2	3,627	19	3,759
TOTAL OPERATING EXPENSES	$ 26,123	110	263,598	50,642	6,192	$ 346,665
OPERATING (LOSS) INCOME	$ (16,290)	1,255	12,633	7,924	(663)	$ 4,859
NON-OPERATING REVENUES (EXPENSES)						
Transfers in (out)	$ 4,763	9,835	(20,693)	1,873	4,222	$ -
State appropriations received	-	-	1,206	-	-	1,206
State grants received	-	-	38,718	-	-	38,718
State tax credits	45,874	-	-	-	-	45,874
State program expense	(30,572)	(10,347)	(8,927)	-	-	(49,846)
TOTAL NON-OPERATING REVENUES (EXPENSES)	$ 20,065	(512)	10,304	1,873	4,222	$ 35,952
CHANGE IN NET POSITION	$ 3,775	743	22,937	9,797	3,559	$ 40,811
TOTAL NET POSITION - BEGINNING	97,835	60,838	111,047	267,600	10,946	$ 548,266
TOTAL NET POSITION - ENDING	$ 101,610	61,581	133,984	277,397	14,505	$ 589,077

NORTH CAROLINA HOUSING FINANCE AGENCY

COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2013

(in thousands)	AGENCY PROGRAMS	GRANT PROGRAMS Housing Trust Fund	GRANT PROGRAMS Federal and State Programs	HOME OWNERSHIP PROGRAMS 1998	HOME OWNERSHIP PROGRAMS 2009	Total
Cash flows from operating activities:						
Interest on mortgage loans	$ 73	372	978	57,802	5,365	$ 64,590
Principal payments on mortgage loans	396	1,000	5,508	163,217	4,379	174,500
Purchase of mortgage loans	-	(714)	(7,407)	(1,556)	(72,992)	(82,669)
Federal program awards received	-	-	236,395	-	-	236,395
Federal program expense	-	-	(252,201)	-	-	(252,201)
Nonfederal program expense	(8,799)	-	-	-	-	(8,799)
Federal grant administration income	-	-	18,436	-	-	18,436
Program income/fees	9,808	819	3,111	-	-	13,738
Other expenses	(17,198)	-	(4,898)	(5,548)	(540)	(28,184)
Other revenues	4,474	(7,198)	-	(207)	(218)	(3,149)
Net cash (used in) provided by operating activities	$ (11,246)	(5,721)	(78)	213,708	(64,006)	$ 132,657
Cash flows from non-capital financing activities:						
Issuance of bonds	$ -	-	-	121,670	-	$ 121,670
Principal repayments on bonds	-	-	-	(281,075)	(3,000)	(284,075)
Interest paid	-	-	-	(47,664)	(5,479)	(53,143)
Bond issuance costs paid	-	-	-	(1,108)	-	(1,108)
Net transfers	4,763	9,835	(20,693)	1,873	4,222	-
State appropriations received	-	-	1,206	-	-	1,206
State grants received	-	-	12,957	-	-	12,957
State tax credits	31,976	-	-	-	-	31,976
State program expense	(30,572)	(10,347)	(8,927)	-	-	(49,846)
Net cash provided by (used in) non-capital financing activities	$ 6,167	(512)	(15,457)	(206,304)	(4,257)	$ (220,363)
Cash flows from investing activities:						
Proceeds from sales or maturities of investments	$ 16,780	-	-	38,153	-	$ 54,933
Purchase of investments	(16,780)	-	-	(49,882)	(3,136)	(69,798)
Earnings on investments	414	182	127	2,976	127	3,826
Net cash provided by (used in) investing activities	$ 414	182	127	(8,753)	(3,009)	$ (11,039)
Net decrease in cash	$ (4,665)	(6,051)	(15,408)	(1,349)	(71,272)	$ (98,745)
Cash and cash equivalents at beginning of year	42,499	41,727	77,574	162,445	90,121	414,366
Cash and cash equivalents at end of year	$ 37,834	35,676	62,166	161,096	18,849	$ 315,621
Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:						
Operating (loss) income	$ (16,290)	1,255	12,633	7,924	(663)	$ 4,859
Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:						
Interest on investments	(411)	(174)	(127)	(3,045)	(157)	(3,914)
Decrease in fair value of investments	250	-	-	2,140	303	2,693
Interest on bonds	-	-	-	42,904	5,631	48,535
Change in assets and liabilities:						
Decrease (increase) in mortgage loans	390	396	(1,896)	164,210	(68,563)	94,537
Decrease (increase) in interest receivable on mortgage loans	1	-	(5)	382	(341)	37
Decrease (increase) in other assets	3,322	(7,198)	1,168	(219)	(198)	(3,125)
Increase (decrease) in accounts payable and other liabilities	495	-	6,499	(588)	(18)	6,388
Increase (decrease) in unearned revenues	997	-	(18,350)	-	-	(17,353)
Total adjustments	$ 5,044	(6,976)	(12,711)	205,784	(63,343)	$ 127,798
Net cash (used in) provided by operating activities	$ (11,246)	(5,721)	(78)	213,708	(64,006)	$ 132,657

NORTH CAROLINA HOUSING FINANCE AGENCY

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

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

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

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