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DATE: April 26, 2018

TO: Minnesota Housing Board Members

FROM: Mary Tingerthal, Commissioner

SUBJECT: **FINANCE AND AUDIT COMMITTEE MEETING**

A meeting of the **Finance and Audit Committee** has been scheduled for **11:30 a.m.** on **Thursday, April 26** at the offices of Minnesota Housing, 400 Wabasha Street, Suite 400, St Paul, MN 55102 in the **Lake Superior Conference Room on the fourth floor**.

The topics for discussion at this meeting are:

A. Approval and recommendation to Board, revised Debt and Balance Sheet Management Policy
B. Discussion, RSM presentation launching the Financial Audit for FY 2018
C. Other Business (if any)
D. Adjournment

This committee is a committee of the whole and all members are encouraged to attend.

If you have questions, please call Rachel Franco at (651) 296-2172.

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MINNESOTA HOUSING

Finance Committee Item: A.
Date: 4/26/2018

Item: Approval and recommendation to Board, revised Debt and Balance Sheet Management Policy

Staff Contact(s):
Kevin Carpenter, 651.297.4009, kevin.carpenter@state.mn.us
Terry Schwartz, 651.296.2404, terry.schwartz@state.mn.us

Request Type:

☒ Approval	☐ No Action Needed
☒ Motion	☐ Discussion
☐ Resolution	☐ Information

Summary of Request:
Staff is requesting that the Finance and Audit Committee recommend that the Board adopt the proposed changes to the Debt Management Policy.

Fiscal Impact:
None.

Meeting Agency Priorities:
☐ Address Specific and Critical Local Housing Needs
☐ Finance Housing Responsive to Minnesota's Changing Demographics
☐ Preserve Housing with Federal Project-Based Rent Assistance
☐ Prevent and End Homelessness
☐ Reduce Minnesota's Racial and Ethnicity Homeownership Disparity

Attachment(s):
- Revisions to the Debt and Balance Sheet Management Policy
- Clean copy of proposed Debt and Balance Sheet Management Policy

Policy 1 – Debt and Balance Sheet Management

Adopted: 02/22/ 1996

Amended 07/24/2003; 12/05/2008; 07/23/2009; 05/22/2014; 05/28/2015; 07/23/2015; 9/28/2017; _/ 2018

One of the goals of Minnesota Housing (the "Agency") is to raise capital for its programs at the lowest overall cost in a way that maintains and builds long-term sustainability for the Agency. The Agency will also take into consideration the market for mortgage loan rates and the need to maintain asset and debt management flexibility while carefully managing risk.

To achieve this, the Agency will:

1. Establish long-range financial objectives as set forth in Section 1.1. These objectives may change in response to economic and other factors.
2. Hold an annual meeting of the team of finance professionals described in paragraph 1.2 to create plans for raising capital and managing the balance sheet. Key takeaways from this annual meeting will be shared with the Board or Finance and Audit Committee.
3. Manage its ongoing debt issuance to provide for optimal access to capital markets and broad distribution capabilities, both horizontally (geographically) and vertically (both institutional and retail investors).
4. Prepare an Affordable Housing Plan that sets forth a plan and forecast of programmatic financial resources likely to be available over the next year or two.

Agency staff will monitor these plans and the policy and recommend changes when appropriate based on results of the Risk Based Capital Study and other considerations.

1.1 Long Range Financial Objectives

The long-range financial objectives are as follows:

- Maximize the spread between loan and investment rates and cost of capital, where possible, in order to maximize future capital available for the Housing Investment ("Pool 2") and Housing Affordability ("Pool 3") Funds.
- Maintain program flexibility.
- Include perspectives on future liquidity when managing balance sheet; consider

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- Manage net position incorporating rating agencies haircuts and stress tests to maintain or grow risk adjusted net worth
- Effectively manage risk so as to minimize the potential of calling upon the Agency's general obligation or the State's moral obligation pledge to replenish debt service reserves.
- Maintain at least the Agency's Aa1/AA+ general obligation issuer credit ratings; maintain at least the current level of credit ratings for each bond resolution.
- ~~Maintain at least the current level of credit ratings for each bond resolution.~~

1.2 Finance Team

The Agency will maintain a team of finance professionals consisting of internal and external experts for the purpose of managing its borrowing activities. The team will include investment bankers, bond counsel, underwriter's counsel, in-house counsel, a financial advisor, and Agency finance staff. Staff may recommend to the Board the addition of finance team members based on needs of specific financings.

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1.3 Planning and Structuring Bond Issues

When capital is needed for program funding or for other financial management purposes, the finance team will review the financing alternatives in accordance with this policy and determine whether bonds should be issued or other sources of external capital raised or the activity should be internally financed. Any proposed external financing will be reviewed to determine the best method of accessing the financial markets to achieve the goal of issuing debt at the lowest overall interest rates and costs while maintaining desired flexibility and managing risk.

1.4 Annual Bond Financing Needs Planning

At its annual Finance Team meeting, the timing of planned bond sales will be considered based primarily upon housing program needs, but other market and tax compliance factors will also be taken into consideration.

1.5 Procedures for Issuing Bonds

Agency staff will recommend to the Board, by requesting approval of resolutions, a financing approach best suited to the current set of circumstances and consistent with the Agency's desire to issue debt at the lowest overall possible interest rates and costs while managing risks and maintaining the maximum flexibility for asset and debt management. Staff will decide how to proceed from among the recommended approaches. The rationale underlying any financing decision will be included in staff's comments to the Board at the time that the Board's approval for specific bond sales is requested.

Before each bond financing, the finance team will review the immediate capital and/or refunding needs, market conditions, proposed bond structure(s), merits of a negotiated, competitive or privately placed bond issue and expense guidelines. Gross spread will be finalized prior to the commencement of the order period.

Before pricing a bond offering, the financial advisor will provide the Agency with summary information and its recommendations with regard to all pertinent aspects of the financing. For negotiated issues, the pricing will generally be handled by a conference call including Agency staff, the financial advisor and the underwriters. The Chief Financial Officer, in consultation with the Commissioner, will have primary responsibility for making pricing determinations. For long-term debt issuances, a formal post-sale analysis will be prepared by the financial advisor and reviewed with the Board within approximately 45 days of the bond issue. The post-sale analysis should include sufficient information to permit the Board to judge the performance of the investment bankers. If an offering is marketed by negotiated sale, the management fee paid should reflect reimbursement for services rendered on the particular issue in progress and for uncompensated services rendered since the last issue, if any.

1.6 Short-Term Financing Needs

From time to time, depending on conditions in the bond market and the availability of liquid funds to the Agency, it may be necessary for the Agency to borrow money on a short-term basis from a bank or other financial institution or corporation to provide sufficient liquidity for

Agency program and other operational needs. Staff is authorized to determine the need and feasibility of such short-term borrowing, in consultation with the Agency's financial advisor and subject to other authorizations and delegations from the Board and/or Commissioner. The Chief Financial Officer is authorized to cause the Agency to enter into any such short-term borrowing arrangement upon consultation with the Commissioner, the Finance Director and the Agency's financial advisor, in a principal amount, at an interest rate and for a term (not exceeding 18 months) that the Chief Financial Officer determines is sufficient for the Agency's needs and is financially feasible.

Any such borrowing may be secured by collateral comprising mortgage loans or other assets of the Agency to be specifically pledged thereto, but may not be secured by the general obligation of the Agency or be evidenced by a bond or note, unless approved by resolution of the Board. The Chief Financial Officer is authorized, upon consultation with the Commissioner, the Finance Director and the Agency's financial advisor, to cause the Agency to renew or extend any such short-term borrowing if circumstances then warrant. No more than $250,000,000 in principal amount of such borrowings may be outstanding at any one time, unless approved by resolution of the Board. The Agency shall count the outstanding principal amount of any such borrowings against the debt limit set forth in Minnesota Statutes, Section 462A.22, as amended.

1.7 Bond Issuance Review

The overall results of the Agency's debt issuances (other than short-term liquidity and operational financings pursuant to Section 1.6) and the performance of the investment bankers will be reviewed by the Board on no less than a biannual basis. The Agency's financial advisor will prepare the report in cooperation with Agency staff.

1.8 Variable Rate Debt and Interest Rate Swap Management

In order to improve its overall financial position (for example, to lower its cost of capital or reduce its risk in financing the Agency's programs and operations), the Agency may periodically elect to issue variable-rate debt and also periodically elect to enter into interest rate swaps. Because the Agency generally lends at fixed interest rates, issuing variable rate debt creates the potential for a mismatch between its cost of capital and its revenues. In order to manage the mismatch, interest rate swaps may be utilized. An interest rate swap is a financial agreement in which two parties agree over a fixed period of time on a stated notional principal amount to exchange interest payments, one based on a variable interest rate and the other a fixed rate. Interest rate swaps will generally be structured to synthetically achieve a fixed-rate cost of capital that is typically below what can be achieved by issuing traditional fixed-rate debt.

Authorization. For purposes of authorization, all swap transactions shall go through the same process as bond financings including review by the Agency's finance team, which includes at a minimum bond counsel and appropriate external financial advisors and formal approval by the Agency's Board. Minnesota Statutes Section 462A.105 authorizes the Agency to enter into interest rate swaps, referred to in statute as interest rate exchange agreements. The Agency's Board approved a resolution in April 2003 authorizing staff to enter into interest rate swaps and in May 2003 approved a resolution amending the Residential Housing Finance Bonds Resolution to allow for the effective administration of interest rate swaps. Interest rate swaps will be entered into in conjunction with a resolution authorizing the issuance of bonds and usually will be approved simultaneously with a series resolution for the issuance of bonds to which the swap transaction relates. When and if replacement swaps are needed, they will be presented to the Agency's Board for approval by resolution.

Goals for Swap Transactions. Swap transactions will be used as part of a strategy to use variable-rate debt to reduce the Agency's overall cost of funds. Swap transactions will not be used for speculative purposes. The Agency acknowledges that synthetically fixing the cost of funds by use of interest rate swaps mitigates, but does not eliminate, interest rate risk due to risks factors described in the Risk Analysis section of Board Policy 1.8.

Relationship to Assets. Swap transactions will be entered into based on analysis that staff determines is adequate to indicate an expected positive impact on the Agency's ability to manage its underlying assets and liabilities. The term and structure of any swap agreement should bear a logical relationship to a pool of assets and the underlying liabilities financing or expected to finance the assets.

Risk Analysis. Before making a final decision to proceed with a swap transaction, the Agency shall analyze the risks, costs, and benefits associated with interest rate swaps to ensure that a proper and well-informed decision is being made. Specific risks that should be analyzed and understood are:

- **Amortization.** Amortization risk represents the cost to the Agency of paying interest on debt or making swap payments due to a mismatch between the amounts outstanding of the variable rate liabilities and the notional amount of the swap.
- **Basis.** Basis risk represents the potential difference between the interest rate paid by the agency on its variable rate liabilities and the rate received from the swap contract.
- **Tax.** Tax risk represents a risk that may arise due to a change in the tax code which creates or exacerbates a difference between the interest rate paid by the agency on its variable rate liabilities and the rate received from the swap contract
- **Counterparty.** Counterparty risk is the risk that the swap transaction provider will

not fulfill its obligations as specified in the swap contract.

- **Termination.** Termination risk represents the risk that the swap contract could be terminated by the counterparty due to various events including ratings downgrade, covenant defaults, payment defaults or other default events specified by the contract or Resolution. The Agency will also incorporate consideration of its rights to terminate the swap contract into its assessment of the appropriateness of a specific swap contract.
- **Rollover.** Rollover risk is the risk that the swap contract is not coterminous with the variable rate liabilities, creating the possibility that a replacement contract will be either unavailable or at terms disadvantageous to the Agency.

  Liquidity. Liquidity risk is the risk that the back-up liquidity facilities required by certain types of variable rate debt will not available or financially viable in the future resulting in the need to call the debt or refund it into fixed rate debt thus creating an un-hedged swap position. Liquidity risk exists with the form of variable rate debt known as Variable Rate Demand Obligations (VRDOs). VRDOs are remarketed regularly and the risk exists that there may be an insufficient market to purchase all or some of the bonds on any given remarketing date. To mitigate this risk, a liquidity provider is engaged to purchase unremarketed bonds at a higher rate than could be achieved under a remarketing and with the expectation that the bonds will be repaid on an accelerated timetable. Additional risk exists in that the term of the variable rate debt is generally longer than the term of any related liquidity facility agreement, which requires that the issuer periodically engage replacement liquidity providers during the term of the debt. Potential exists for there not being a replacement liquidity provider willing to provide the service at an acceptable cost at that time.
- **Rating Agency Criteria Risk.** This risk exists because the credit rating agencies may periodically change their criteria for maintaining the Agency's credit ratings over the term of the variable rate debt (or may downgrade the credit of the Agency, liquidity provider or swap counterparty) which may impact the cost of the variable rate debt or impose additional duties or restrictions on the Agency to maintain ratings.

Risk Mitigation. In addition to utilizing interest rate swaps to mitigate the interest rate risk associated with issuing variable-rate debt, the Agency will seek to employ other risk mitigation techniques, either from the outset of a variable rate bond issue or at any stress point during the life of the issue, and will seek to incorporate relevant optionality in any agreements entered into in connection with the debt. Examples of such techniques include but are not limited to: the option to modify the interest rate mode among variable rate alternatives or from variable to fixed; options to terminate the swap at par and at market under certain scenarios acceptable to the Agency; selection of the type of variable rate debt issued and its ability to be called at par; maintaining appropriate levels of liquidity to exercise available options; appropriate managerial oversight of the performance of the variable-rate bond issues and their related swaps; diversification among counterparties and liquidity providers.

Credit Quality. Any swap transaction entered into by the Agency shall be with a swap counterparty whose long term debt obligations, or whose obligations under a swap are fully covered by a swap facility whose long term debt obligations are either: (1) rated at least "Aa3" in the case of Moody's Investors Service, or rated at least "AA-" in the case of Standard & Poor's Corporation, or rated at least the equivalent thereto in the case of any other rating agency, provided that the swap counterparty ratings must be sufficient to maintain the then current ratings of the Agency's long term debt, or (2) secured by a pledge of investment obligations with the ratings and in amounts sufficient to achieve the ratings levels described in this section.

Appropriate Review. Swap transactions will be submitted to the rating agencies for their review along with all appropriate supporting documents prior to the Agency closing such transactions. There will be procedures established for the ongoing review and management of swap transactions including semi-annual reporting to the Board regarding all variable rate debt and associated counterparties (for example, swap and liquidity providers) . In addition to this general plan, rating agencies will be provided with a summary of each swap transaction in accord with their respective policies.

1.9 Conduit Debt

For purposes of this section, "conduit debt" is a bond or note in which the obligation of the Agency, as issuer of the conduit debt, to pay principal of and interest on that conduit debt, when due, is payable solely from, and secured by payments made by, and assets of, a third-party borrower under a loan, lease or other agreement and derived from revenues of the facilities financed or other assets of that third-party borrower.

Issuance of conduit debt that requires an allocation of the Agency's entitlement allocation of private activity bonding authority from the annual federal volume cap allocated to the state of Minnesota uses a limited resource of the Agency. That bonding authority is a valuable means of financing affordable housing programs because it enables the Agency to operate lending programs of a size far in excess of its own resources in ways that strengthen the Agency's long-term sustainability and financial flexibility. It is therefore acknowledged that the use of bonding authority for conduit debt issuance that requires the use of that bonding authority is generally not in the best financial interest of the Agency. From time to time and under certain conditions, use of bonding authority for conduit debt issuance may be desirable to meet certain state housing needs and may be considered. The following threshold conditions should be present in order for staff to recommend a conduit debt issue:

- Bonding authority used for conduit debt issues does not cause a significant loss of authority available to operate priority programs, in the sole judgment of the Agency.

- The issuance is for preservation of affordable rental units the Agency determines are important units to preserve under its strategic plan.
- Significant barriers to issuance by a different government issuer exist, such as properties located in multiple jurisdictions, making public notice and authorization requirements difficult.
- The Agency has determined not to issue bonds secured by the Agency's general or limited obligation for the project to be financed.
- The Agency assumes no initial or continuing disclosure obligations in connection with the conduit debt issue.
- The Agency assumes no financial obligation in connection with the conduit debt issue.
- If publicly offered, if the conduit debt issue is a long-term issuance, it is expected to be rated in one of the two highest long-term rating categories by at least one nationally recognized rating agency acceptable to the Agency. If the conduit issue is a short-term issuance, it is expected to be rated in the highest short-term rating category by at least one nationally recognized rating agency.
- If privately placed, repayment of the conduit debt issue must, in the judgment of the Agency and the Agency's financial advisor, be financially feasible and appropriately structured, distributed and documented.
- The Agency's bond counsel must be utilized. The Agency will be consulted on selection of other parties (e.g., trustee, financial advisor, bond underwriter, etc.) involved with the proposed transaction.
- All costs of issuance, maintenance and payment of the conduit debt issue, including all Agency out-of-pocket expenses and fees and disbursements of bond counsel and the Agency's financial advisor, and indemnification of the Agency must be paid by the third-party borrower or, if available therefore, may be paid from proceeds of the conduit debt issue.
- Administrative fees to be paid to the Agency as issuer will not be less than, subject to arbitrage restrictions, the sum of (1) an upfront fee of 50 basis points times the original principal amount of the conduit debt issue, plus (2) an on-going fee payable semiannually equal to the greater of (a) one-half of 20 basis points applied to the ~~original~~ then outstanding principal amount of the bonds or (b) a minimum amount to be established for the conduit debt issue. Actual fees will be determined on a case-by-case basis, in the Agency's sole discretion.

Additional Guidelines. The use of investment bankers and/or placement agents other than the Agency's selected investment bankers will not imply any appointment to the Agency's board-selected investment banking team.

Results of marketing conduit debt issues are not subject to Sections 1.03, 1.04 or 1.05 of this Debt Management Policy, including requirements for formal post-sale analysis by the Agency's financial advisor, nor are they includable in the biannual investment banker review required in Section VII even if the conduit debt issue's investment banker is currently appointed to the Agency's banking team.

1.10 Policy on Request for Proposals

A request for proposals will be issued every four years for the Agency's financial advisor and investment bankers. Request for proposals for financial advisor will be solicited in different years than those for investment bankers unless an early contract termination occurs necessitating selection in the same year as the investment bankers.

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Policy 1 – Debt and Balance Sheet Management

Adopted: 02/22/ 1996
Amended 07/24/2003; 12/05/2008; 07/23/2009; 05/22/2014; 05/28/2015; 07/23/2015; 9/28/2017; _/ 2018

One of the goals of Minnesota Housing (the "Agency") is to raise capital for its programs at the lowest overall cost in a way that maintains and builds long-term sustainability for the Agency. The Agency will also take into consideration the market for mortgage loan rates and the need to maintain asset and debt management flexibility while carefully managing risk.

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- Maintain program flexibility.
- Include perspectives on future liquidity when managing balance sheet; consider expected duration of assets and liabilities to maintain appropriate matching.
- Manage net position incorporating rating agencies haircuts and stress tests to maintain or grow risk adjusted net worth

- Effectively manage risk so as to minimize the potential of calling upon the Agency's general obligation or the State's moral obligation pledge to replenish debt service reserves.
- Maintain at least the Agency's Aa1/AA+ general obligation issuer credit ratings; maintain at least the current level of credit ratings for each bond resolution.

1.2 Finance Team

The Agency will maintain a team of finance professionals consisting of internal and external experts for the purpose of managing its borrowing activities. The team will include investment bankers, bond counsel, underwriter's counsel, in-house counsel, a financial advisor, and Agency finance staff. Staff may recommend to the Board the addition of finance team members based on needs of specific financings.

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Before pricing a bond offering, the financial advisor will provide the Agency with summary information and its recommendations with regard to all pertinent aspects of the financing. For negotiated issues, the pricing will generally be handled by a conference call including Agency staff, the financial advisor and the underwriters. The Chief Financial Officer, in consultation with the Commissioner, will have primary responsibility for making pricing determinations. For long-term debt issuances, a formal post-sale analysis will be prepared by the financial advisor and reviewed with the Board within approximately 45 days of the bond issue. The post-sale analysis should include sufficient information to permit the Board to judge the performance of the investment bankers. If an offering is marketed by negotiated sale, the management fee paid should reflect reimbursement for services rendered on the particular issue in progress and for uncompensated services rendered since the last issue, if any.

1.6 Short-Term Financing Needs

From time to time, depending on conditions in the bond market and the availability of liquid funds to the Agency, it may be necessary for the Agency to borrow money on a short-term basis from a bank or other financial institution or corporation to provide sufficient liquidity for Agency program and other operational needs. Staff is authorized to determine the need and feasibility of such short-term borrowing, in consultation with the Agency's financial advisor and subject to other authorizations and delegations from the Board and/or Commissioner. The Chief Financial Officer is authorized to cause the Agency to enter into any such short-term borrowing arrangement upon consultation with the Commissioner, the Finance Director and the Agency's financial advisor, in a principal amount, at an interest rate and for a term (not exceeding 18 months) that the Chief Financial Officer determines is sufficient for the Agency's needs and is financially feasible.

Any such borrowing may be secured by collateral comprising mortgage loans or other assets of the Agency to be specifically pledged thereto, but may not be secured by the general obligation of the Agency or be evidenced by a bond or note, unless approved by resolution of the Board. The Chief Financial Officer is authorized, upon consultation with the Commissioner, the Finance Director and the Agency's financial advisor, to cause the Agency to renew or extend any such short-term borrowing if circumstances then warrant. No more than $250,000,000 in principal amount of such borrowings may be outstanding at any one time, unless approved by resolution of the Board. The Agency shall count the outstanding principal amount of any such borrowings against the debt limit set forth in Minnesota Statutes, Section 462A.22, as amended.

1.7 Bond Issuance Review

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1.8 Variable Rate Debt and Interest Rate Swap Management

In order to improve its overall financial position (for example, to lower its cost of capital or reduce its risk in financing the Agency's programs and operations), the Agency may periodically elect to issue variable-rate debt and also periodically elect to enter into interest rate swaps. Because the Agency generally lends at fixed interest rates, issuing variable rate debt creates the potential for a mismatch between its cost of capital and its revenues. In order to manage the mismatch, interest rate swaps may be utilized. An interest rate swap is a financial agreement in which two parties agree over a fixed period of time on a stated notional principal amount to exchange interest payments, one based on a variable interest rate and the other a fixed rate. Interest rate swaps will generally be structured to synthetically achieve a fixed-rate cost of capital that is typically below what can be achieved by issuing traditional fixed-rate debt.

Authorization. For purposes of authorization, all swap transactions shall go through the same process as bond financings including review by the Agency's finance team, which includes at a minimum bond counsel and appropriate external financial advisors and formal approval by the Agency's Board. Minnesota Statutes Section 462A.105 authorizes the Agency to enter into interest rate swaps, referred to in statute as interest rate exchange agreements. The Agency's Board approved a resolution in April 2003 authorizing staff to enter into interest rate swaps and in May 2003 approved a resolution amending the Residential Housing Finance Bonds Resolution to allow for the effective administration of interest rate swaps. Interest rate swaps will be entered into in conjunction with a resolution authorizing the issuance of bonds and usually will be approved simultaneously with a series resolution for the issuance of bonds to which the swap transaction relates. When and if replacement swaps are needed, they will be presented to the Agency's Board for approval by resolution.

Goals for Swap Transactions. Swap transactions will be used as part of a strategy to use variable-rate debt to reduce the Agency's overall cost of funds. Swap transactions will not be used for speculative purposes. The Agency acknowledges that synthetically fixing the cost of funds by use of interest rate swaps mitigates, but does not eliminate, interest rate risk due to risks factors described in the Risk Analysis section of Board Policy 1.8.

Relationship to Assets. Swap transactions will be entered into based on analysis that staff determines is adequate to indicate an expected positive impact on the Agency's ability to manage its underlying assets and liabilities. The term and structure of any swap agreement should bear a logical relationship to a pool of assets and the underlying liabilities financing or expected to finance the assets.

Risk Analysis. Before making a final decision to proceed with a swap transaction, the Agency shall analyze the risks, costs, and benefits associated with interest rate swaps to ensure that a proper and well-informed decision is being made. Specific risks that should be analyzed and understood are:

- **Amortization.** Amortization risk represents the cost to the Agency of paying interest on debt or making swap payments due to a mismatch between the amounts outstanding of the variable rate liabilities and the notional amount of the swap.
- **Basis.** Basis risk represents the potential difference between the interest rate paid by the agency on its variable rate liabilities and the rate received from the swap contract.
- **Tax.** Tax risk represents a risk that may arise due to a change in the tax code which creates or exacerbates a difference between the interest rate paid by the agency on its variable rate liabilities and the rate received from the swap contract
- **Counterparty.** Counterparty risk is the risk that the swap transaction provider will not fulfill its obligations as specified in the swap contract.
- **Termination.** Termination risk represents the risk that the swap contract could be terminated by the counterparty due to various events including ratings downgrade, covenant defaults, payment defaults or other default events specified by the contract or Resolution. The Agency will also incorporate consideration of its rights to terminate the swap contract into its assessment of the appropriateness of a specific swap contract.
- **Rollover.** Rollover risk is the risk that the swap contract is not coterminous with the variable rate liabilities, creating the possibility that a replacement contract will be either unavailable or at terms disadvantageous to the Agency.

Liquidity. Liquidity risk is the risk that the back-up liquidity facilities required by certain types of variable rate debt will not available or financially viable in the future resulting in the need to call the debt or refund it into fixed rate debt thus creating an un-hedged swap position. Liquidity risk exists with the form of variable rate debt known as Variable Rate Demand Obligations (VRDOs). VRDOs are remarketed regularly and the risk exists that there may be an insufficient market to purchase all or some of the bonds on any given remarketing date. To mitigate this risk, a liquidity provider is engaged to purchase unremarketed bonds at a higher rate than could be achieved under a remarketing and with the expectation that the bonds will be repaid on an accelerated timetable. Additional risk exists in that the term of the variable rate debt is generally longer than the term of any related liquidity facility agreement, which requires that the issuer periodically engage replacement liquidity providers during the term of the debt. Potential exists for there not being a replacement liquidity provider willing to provide the service at an acceptable cost at that time.

- **Rating Agency Criteria Risk.** This risk exists because the credit rating agencies may periodically change their criteria for maintaining the Agency's credit ratings over the term of the variable rate debt (or may downgrade the credit of the Agency, liquidity provider or swap counterparty) which may impact the cost of the variable rate debt or impose additional duties or restrictions on the Agency to maintain ratings.

Risk Mitigation. In addition to utilizing interest rate swaps to mitigate the interest rate risk associated with issuing variable-rate debt, the Agency will seek to employ other risk mitigation techniques, either from the outset of a variable rate bond issue or at any stress point during the life of the issue, and will seek to incorporate relevant optionality in any agreements entered into in connection with the debt. Examples of such techniques include but are not limited to: the option to modify the interest rate mode among variable rate alternatives or from variable to fixed; options to terminate the swap at par and at market under certain scenarios acceptable to the Agency; selection of the type of variable rate debt issued and its ability to be called at par; maintaining appropriate levels of liquidity to exercise available options; appropriate managerial oversight of the performance of the variable-rate bond issues and their related swaps; diversification among counterparties and liquidity providers.

Credit Quality. Any swap transaction entered into by the Agency shall be with a swap counterparty whose long term debt obligations, or whose obligations under a swap are fully covered by a swap facility whose long term debt obligations are either: (1) rated at least "Aa3" in the case of Moody's Investors Service, or rated at least "AA-" in the case of Standard & Poor's Corporation, or rated at least the equivalent thereto in the case of any other rating agency, provided that the swap counterparty ratings must be sufficient to maintain the then current ratings of the Agency's long term debt, or (2) secured by a pledge of investment obligations with the ratings and in amounts sufficient to achieve the ratings levels described in this section.

Appropriate Review. Swap transactions will be submitted to the rating agencies for their review along with all appropriate supporting documents prior to the Agency closing such transactions. There will be procedures established for the ongoing review and management of swap transactions including semi-annual reporting to the Board regarding all variable rate debt and associated counterparties (for example, swap and liquidity providers) . In addition to this general plan, rating agencies will be provided with a summary of each swap transaction in accord with their respective policies.

1.9 Conduit Debt

For purposes of this section, “conduit debt” is a bond or note in which the obligation of the Agency, as issuer of the conduit debt, to pay principal of and interest on that conduit debt, when due, is payable solely from, and secured by payments made by, and assets of, a third-party borrower under a loan, lease or other agreement and derived from revenues of the facilities financed or other assets of that third-party borrower.

Issuance of conduit debt that requires an allocation of the Agency’s entitlement allocation of private activity bonding authority from the annual federal volume cap allocated to the state of Minnesota uses a limited resource of the Agency. That bonding authority is a valuable means of financing affordable housing programs because it enables the Agency to operate lending programs of a size far in excess of its own resources in ways that strengthen the Agency’s long-term sustainability and financial flexibility. It is therefore acknowledged that the use of bonding authority for conduit debt issuance that requires the use of that bonding authority is generally not in the best financial interest of the Agency. From time to time and under certain conditions, use of bonding authority for conduit debt issuance may be desirable to meet certain state housing needs and may be considered. The following threshold conditions should be present in order for staff to recommend a conduit debt issue:

- Bonding authority used for conduit debt issues does not cause a significant loss of authority available to operate priority programs, in the sole judgment of the Agency.
- The issuance is for preservation of affordable rental units the Agency determines are important units to preserve under its strategic plan.
- Significant barriers to issuance by a different government issuer exist, such as properties located in multiple jurisdictions, making public notice and authorization requirements difficult.
- The Agency has determined not to issue bonds secured by the Agency’s general or limited obligation for the project to be financed.
- The Agency assumes no initial or continuing disclosure obligations in connection with the conduit debt issue.
- The Agency assumes no financial obligation in connection with the conduit debt issue.
- If publicly offered, if the conduit debt issue is a long-term issuance, it is expected to be rated in one of the two highest long-term rating categories by at least one nationally recognized rating agency acceptable to the Agency. If the conduit issue is a short-term issuance, it is expected to be rated in the highest short-term rating category by at least one nationally recognized rating agency.
- If privately placed, repayment of the conduit debt issue must, in the judgment of the Agency and the Agency’s financial advisor, be financially feasible and appropriately structured, distributed and documented.

- The Agency's bond counsel must be utilized. The Agency will be consulted on selection of other parties (e.g., trustee, financial advisor, bond underwriter, etc.) involved with the proposed transaction.
- All costs of issuance, maintenance and payment of the conduit debt issue, including all Agency out-of-pocket expenses and fees and disbursements of bond counsel and the Agency's financial advisor, and indemnification of the Agency must be paid by the third-party borrower or, if available therefore, may be paid from proceeds of the conduit debt issue.
- Administrative fees to be paid to the Agency as issuer will not be less than, subject to arbitrage restrictions, the sum of (1) an upfront fee of 50 basis points times the original principal amount of the conduit debt issue, plus (2) an on-going fee payable semiannually equal to the greater of (a) one-half of 20 basis points applied to the – then outstanding principal amount of the bonds or (b) a minimum amount to be established for the conduit debt issue. Actual fees will be determined on a case-by-case basis, in the Agency's sole discretion.

Additional Guidelines. The use of investment bankers and/or placement agents other than the Agency's selected investment bankers will not imply any appointment to the Agency's board-selected investment banking team.

Results of marketing conduit debt issues are not subject to Sections 1.03, 1.04 or 1.05 of this Debt Management Policy, including requirements for formal post-sale analysis by the Agency's financial advisor, nor are they includable in the biannual investment banker review required in Section VII even if the conduit debt issue's investment banker is currently appointed to the Agency's banking team.

1.10 Policy on Request for Proposals

A request for proposals will be issued every four years for the Agency's financial advisor and investment bankers. Request for proposals for financial advisor will be solicited in different years than those for investment bankers unless an early contract termination occurs necessitating selection in the same year as the investment bankers.

Item: Discussion, RSM presentation launching the Financial Audit for FY 2018

Staff Contact(s):
Terry Schwartz, 651-296-2404, terry.schwartz@state.mn.us
Debbi Larson, 651-296-8183, debbi.larson@state.mn.us

Request Type:

☐ Approval	☒ No Action Needed
☐ Motion	☒ Discussion
☐ Resolution	☐ Information

Summary of Request:
Representatives from RSM US LLP, the Agency's external audit firm, will discuss audit planning for the 2018 engagement. The discussion will include engagement terms, audit timing and scope and risk factors that include fraud and key transactions.

Fiscal Impact:
None.

Meeting Agency Priorities:
☐ Address Specific and Critical Local Housing Needs
☐ Finance Housing Responsive to Minnesota's Changing Demographics
☐ Preserve Housing with Federal Project-Based Rent Assistance
☐ Prevent and End Homelessness
☐ Reduce Minnesota's Racial and Ethnicity Homeownership Disparity

Attachment(s):
- RSM US LLP presentation

PRESENTATION TO THE AUDIT COMMITTEE MINNESOTA HOUSING FINANCE AGENCY

Audit Planning Communication

April 26, 2018

Engagement team

- Public sector
  - Corey Topp—Client service partner
  - Bart Rodberg—Public sector senior director
  - Drew Erickson—Public sector supervisor
- Financial institutions
  - Hank Donatell—Partner
  - Dave Antonson—Senior manager
  - Michelle Graf—In-charge
- Information technology
  - Goktug Aksan—Manager

Summary of engagement terms

- Our audit procedures are designed to the following:
  - Provide reasonable assurance that the financial statements are free of material misstatement.
  - Satisfy the requirements of *Government Auditing Standards*.
  - Satisfy the audit requirements imposed by the Single Audit Act and the Subpart F of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).
  - Address management's initial selection of, and changes in, significant accounting policies or their application; methods used to account for significant unusual transactions; and the effect of significant accounting policies in emerging areas.
  - Focus on accounting estimates that are particularly sensitive to the financial statements based on their significance and level of management judgment.
  - Communicate any disagreements with management about matters that could be significant to the financial statements.

Summary of engagement terms (continued)

- Our audit procedures are designed to the following (continued):
  - Alert the Audit Committee of any significant errors, fraud or illegal acts identified during our audits.
  - Communicate adjustments, whether or not recorded by Minnesota Housing, that could, either individually or in the aggregate, have a significant effect on the Minnesota Housing's financial reporting process.
  - Communicate significant deficiencies and material weaknesses identified through our review of internal control over financial reporting.
- We will make the Audit Committee aware of significant written communications between RSM US LLP and Minnesota Housing during the year.
- We do not anticipate any scope limitations, which would cause us to qualify our audit opinions.
- Minnesota Housing will be considered to be a low-risk auditee for purposes of the performance of the Uniform Guidance audit.

Auditor's independence

Commitment to independence

- RSM US LLP employs a comprehensive, multifaceted approach to maintaining independence.
- Key components are as follows:
  - Culture that stresses the importance of independence
  - Pervasive consultation and monitoring processes
  - Strong policies that are clearly communicated
  - Chief ethics and compliance officer reports to CEO and Board of Directors
  - Training for all partners, principals and professionals
  - Restricted entity list and electronic tracking of personal financial holdings
  - Annual representations from partners, principals and employees
  - Internal inspection and audit process for compliance with policies
  - Disciplinary process for noncompliance
- 2011 Revision of Government Auditing Standards

Audit services scope

- Communication to the Audit Committee
- Financial report
- Single audit report
- Control deficiencies and business improvement suggestions
- Information systems analysis

Audit timing

Audit activities	Timing
Planning meeting with management	March 7, 2018
Audit Committee meeting to discuss audit plan	April 26, 2018
Audit planning and preliminary procedures	May 2018
Internal control procedures	June 2018
Test of controls and compliance (Uniform Guidance audit)	June 2018
Final audit fieldwork and reporting	August 2018
Final reports due for mailing with Board agenda items	August 23, 2018
Board of Directors meeting to present 2018 audit results	August 30, 2018

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Audit strategies

- Audit efficiencies
  - Information technology
  - Engagement team
  - Timing
- Concurring reviewer
  - Timing of involvement

Key transactions/risks

- Financial statements
  - Revenue recognition
  - Management override of controls
  - Information system assessment
  - Loans receivable
  - Interest rate swap agreements
- Significant accounting matters discussed with management
  - Accounting for Housing Infrastructure Bonds
- Single Audit
  - Scrutiny by regulators and funding sources
  - One major program for 2018
    - Performance-Based Contract Administrator Program CFDA 14.327

Fraud risk factors

- As required by AU Section 316, RSM US LLP, with the assistance of management and the Audit Committee, will compile a listing of potential fraud risk factors specific to Minnesota Housing.
- Major criteria considered are the following:
  - Areas more likely susceptible to fraud
  - Materiality
  - Financial performance versus budget and prior year
  - Revenue recognition policies and procedures
  - Significant judgments and estimates
  - Management structure and any changes
  - General systems environment
  - Current market and industry conditions
  - Understanding of business and history of errors

Adoption of accounting standards

Required to be adopted in 2018

- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*
- GASB Statement No. 81, *Irrevocable Split-Interest Agreement*
- GASB Statement No. 82, *Pension Issues (an amendment of GASB Statements No. 67, 68, and 73)*
- GASB Statement No. 85, *Omnibus 2017*
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*

Required to be adopted in future years

- 2019 – GASB Statement No. 83, *Certain Asset Retirement Obligations*
- 2019 – GASB Statement No. 88, *Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*
- 2020 – GASB Statement No. 84, *Fiduciary Activities*
- 2021 – GASB Statement No. 87, *Leases*

Exposure drafts: financial reporting model, revenue and expense recognition

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General comments and feedback

Thank you for allowing us to serve Minnesota Housing Finance Agency

Our goal is to not only meet, but exceed, your expectations.

Your feedback is important to us in achieving that goal.

Presented by: Corey Topp, Hank Donatell, Bart Rodberg and Dave Antonson

THANK YOU FOR YOUR TIME AND ATTENTION

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