



**BASIC FINANCIAL STATEMENTS AND  
REQUIRED SUPPLEMENTARY INFORMATION**

**Pennsylvania Housing Finance Agency  
Years Ended June 30, 2013 and 2012  
With Report of Independent Auditors**

Ernst & Young LLP

 **ERNST & YOUNG**

CONTENTS

Report of Independent Auditors.....	1
Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	3
Management’s Discussion and Analysis ( <i>Unaudited</i> ).....	5
Audited Basic Financial Statements	
Statements of Net Position.....	12
Statements of Revenues, Expenses and Changes in Net Position .....	13
Statements of Cash Flows.....	14
Notes to Financial Statements.....	16
Required Supplementary Information ( <i>Unaudited</i> )	
Schedule of Funding Progress for the Pennsylvania Housing Finance Agency Employees’ Retirement Plan and Government Excess Benefit Plan.....	54
Schedule of Funding Progress for the Pennsylvania Housing Finance Agency Postemployment Benefits Plan .....	55

## Report of Independent Auditors

Management and Members of the Board of Directors  
Pennsylvania Housing Finance Agency

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the General Fund, Multifamily Housing Program, Single Family Mortgage Loan Program, Insurance Fund & Homeowners Emergency Mortgage Assistance Program (“HEMAP”) of the Pennsylvania Housing Finance Agency (“PHFA”), a component unit of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the PHFA’s basic financial statements as listed in the table of contents.

### ***Management’s Responsibility for the Financial Statements***

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

### ***Auditor’s Responsibility***

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

An audit 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 opinions.

### ***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the General Fund, Multifamily Housing Program, Single Family Mortgage Loan Program, Insurance Fund & Homeowners Emergency Mortgage Assistance Program (“HEMAP”) of PHFA as of June 30, 2013 and 2012, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

### ***Required Supplementary Information***

U.S. generally accepted accounting principles require that Management’s discussion and analysis, the Schedule of Funding Progress for the Pennsylvania Housing Finance Agency Employees’ Retirement Plan and Government Excess Benefit Plan, and the Schedule of Funding Progress for the Pennsylvania Housing Finance Agency Postemployment Benefits Plan on pages 5 - 11 and 54 - 55, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which 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, 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 also have issued our report dated November 18, 2013 on our consideration of the PHFA’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 the 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 PHFA’s internal control over financial reporting and compliance.

### ***Emphasis of Matter***

As discussed in Note 2 to the financial statements, in 2013 PHFA adopted Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. Our opinion is not modified with respect to this matter.

*Ernst & Young* LLP

November 18, 2013

## Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Management and Members of the Board of Directors  
Pennsylvania Housing Finance Agency

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the General Fund, Multifamily Housing Program, Single Family Mortgage Loan Program, Insurance Fund and Homeowners Emergency Mortgage Assistance Program (HEMAP) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the basic financial statements of the Pennsylvania Housing Finance Agency (PHFA), a component unit of the Commonwealth of Pennsylvania, and have issued our report thereon dated November 18, 2013.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered PHFA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PHFA's internal control. Accordingly, we do not express an opinion on the effectiveness of PHFA's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether PHFA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Ernst + Young LLP*

November 18, 2013

# **PENNSYLVANIA HOUSING FINANCE AGENCY**

Management's Discussion and Analysis (*Unaudited*)

June 30, 2013 and 2012

---

*(Amounts rounded to facilitate easy reading)*

## **Management's Discussion and Analysis**

### **Introduction**

The discussion and analysis provided here are designed to furnish an objective and easily readable review of the financial activities of the Pennsylvania Housing Finance Agency ("Agency"). Readers are encouraged to consider the information presented in conjunction with the basic financial statements as a whole, which follow this section.

### **Understanding the Basic Financial Statements**

The basic financial statements are designed to provide readers with a broad overview of the Agency's finances, in a manner similar to a private-sector business. Basic financial statements from the prior period are also presented in order to facilitate an enhanced understanding of the Agency's financial position and results of operations by means of comparability. The basic financial statements include three required statements: The Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position, and the Statements of Cash Flows.

The Statements of Net Position present financial information respective of all of the Agency's assets, liabilities and deferred inflows and outflows of resources, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Agency is improving or deteriorating.

The Statements of Revenues, Expenses and Changes in Net Position reflect revenue and expenses within a given period in order to measure the success of the Agency's operations during that period and to illustrate how the Agency has funded its costs of operations. By presenting the financial performance of the Agency, the change in net position is similar to net profit or loss in a private-sector business.

The Statements of Cash Flows are presented using the direct method, which reports cash receipts and cash payments in three major classes of activities: Operating, Investing, and Financing. Cash receipts and disbursements are presented within these statements in order to illustrate the net increase or decrease in cash and cash equivalents within a given period.

The basic financial statements are accompanied by a set of notes. The notes to the basic financial statements provide additional information necessary to acquire a full understanding of the data presented in the basic financial statements and means to obtain a more comprehensive assessment of factors affecting the Agency's financial condition.

**PENNSYLVANIA HOUSING FINANCE AGENCY**Management's Discussion and Analysis (*Unaudited*)

June 30, 2013 and 2012

*(Amounts rounded to facilitate easy reading)***Condensed Statements of Net Position***(In thousands)*

	2013	2012*	2011*	Percentage Change	
				2013/2012	2012/2011
<b>Assets:</b>					
Mortgage loans receivable	\$ 4,161,642	\$ 4,475,857	\$ 4,805,610	(7%)	(7%)
Capital assets	30,879	31,524	32,439	(2%)	(3%)
Other assets	983,748	1,010,752	1,131,946	(3%)	(11%)
Total assets	<u>5,176,269</u>	<u>5,518,133</u>	<u>5,969,995</u>	(6%)	(8%)
Deferred Outflow of Resources	56,515	93,110	101,607	(39%)	(8%)
<b>Liabilities:</b>					
Current liabilities	341,593	288,329	417,297	18%	(31%)
Long-term liabilities	4,040,188	4,501,911	4,843,855	(10%)	(7%)
Total liabilities	<u>4,381,781</u>	<u>4,790,240</u>	<u>5,261,152</u>	(9%)	(9%)
<b>Net Position</b>					
Net Investment in Capital Assets	10,879	11,524	12,439	(6%)	(7%)
Restricted	178,906	212,255	179,589	(16%)	18%
Unrestricted	661,218	597,224	618,422	11%	(3%)
Total Net Position	<u>\$ 851,003</u>	<u>\$ 821,003</u>	<u>\$ 810,450</u>	4%	1%

\* - Certain reclassifications have been made in the June 30, 2012 and June 30, 2011 financial statements to conform to the June 30, 2013 presentation. At June 30, 2012 and June 30, 2011, asset balances of unamortized underwriters' fees totaling \$17.8 million and \$20.3 million, respectively, had previously been reported as a component of Bonds and Notes Payable. These amounts are now reported as deferred costs of bond issuance within Other Assets to conform to the June 30, 2013 presentation. See **Note 2 – Summary of Significant Accounting Policies** and **Note 9 – Long Term Liabilities** for additional details of this reclassification.

**Discussion and Analysis of Significant Changes in the Statements of Net Position****June 30, 2013 Compared to June 30, 2012****Assets**

Mortgages receivable decreased by \$314 million from a total of \$4.476 billion at June 30, 2012 to \$4.162 billion at June 30, 2013. Part of this decrease is attributable to the satisfaction of more than \$20 million of mortgages within the Multifamily Housing Program as a result of regularly scheduled payments, prepayments and loan forgiveness. The remaining decrease is attributable to the Agency's growing practice of pooling Single Family Mortgage Loan Program mortgages into mortgage-backed securities ("MBSs") and selling the securities. Prior to the Agency's

## **PENNSYLVANIA HOUSING FINANCE AGENCY**

Management's Discussion and Analysis (*Unaudited*)

June 30, 2013 and 2012

---

*(Amounts rounded to facilitate easy reading)*

practice of pooling and selling MBSs via the Government National Mortgage Association (“GNMA”) and the Federal National Mortgage Association (“FNMA”), primary mortgages provided to single family homeowners were funded by the issuance of bonds; the mortgages receivable, in turn, were reflected as assets on the Agency’s Statements of Net Position. Mortgages pooled into MBSs are not reflected on the Agency’s Statements of Net Position. As the practice of utilizing the MBS market continues, the number of new mortgages that would otherwise be recorded as mortgages receivable on the Agency’s Statements of Net Position decreases. Existing mortgages receivable inherently decrease over the course of time as a result of regularly scheduled payments and prepayments, as was the experience during the fiscal year ended June 30, 2013.

Other assets reflected in the condensed Statements of Net Position above include cash, cash equivalents, investments and amounts due from other funds. Cash, cash equivalents and investments decreased by a total of \$86 million from \$864 million at June 30, 2012 to \$778 million at June 30, 2013. \$43 million of this decrease is attributable to the reductions of cash, cash equivalents and investments within the Multifamily Housing Program. Monies held in escrow on behalf of multifamily projects are disbursed to the projects upon satisfaction of their primary mortgages; during the fiscal year ended June 30, 2013, 37 (thirty-seven) Multifamily Housing Program primary mortgages were satisfied as a result of regularly scheduled payments prepayments, thereby reducing the number of primary mortgages in the Agency’s multifamily portfolio from 224 at June 30, 2012 to 187 at June 30, 2013. The remaining decrease in cash, cash equivalents and investments is attributable to reductions of balances within the General Fund and Single Family Mortgage Loan Program. This was caused primarily by the timing of sales of the Agency’s MBSs, whereby a sizeable portion of new mortgages within the Agency’s Single Family Mortgage Loan Program are initially funded by Agency cash; that cash is later replenished when the mortgages are bundled into MBSs and sold. Amounts due from other funds represent transfers of funds between the Agency’s General Fund, Insurance Fund, Multifamily Housing Program and Single Family Mortgage Loan Program that have not been settled at year-end. The balance of amounts due from other funds increased by \$68 million from June 30, 2012 to June 30, 2013. This increase is attributed primarily to the timing of sales of the Agency’s MBSs mentioned previously.

### **Deferred Outflow of Resources**

Deferred outflows of resources represent the anticipated utilization, applicable to future reporting periods, of the net position of interest rate swap agreements (“swaps”) deemed to be effective hedging derivatives. The decrease of nearly \$37 million from June 30, 2012 to June 30, 2013 is the result of the decreasing balances of swaps held by the Agency, brought on by reductions of notional amounts, exercising embedded options during opportune economic conditions and an overall increase in fair values during the fiscal year.

### **Liabilities**

Current liabilities increased by \$54 million from a balance of \$288 million at June 30, 2012 to \$342 million at June 30, 2013. This is attributable to an increase in amounts due from other

## PENNSYLVANIA HOUSING FINANCE AGENCY

Management's Discussion and Analysis (*Unaudited*)

June 30, 2013 and 2012

---

*(Amounts rounded to facilitate easy reading)*

funds – sums which counterbalance amounts due from other funds, discussed previously – totaling \$68 million, offset by reductions in bonds and accrued interest payable due within one year, which was enabled by the Agency's ongoing efforts to reduce bonds payable by applying prepayments received from borrowers and available cash.

Noncurrent liabilities decreased by \$462 million from a balance of \$4.502 billion at June 30, 2012 to \$4.040 billion at June 30, 2013. The decrease was primarily attributable to a net reduction of bonds and notes payable balances equaling \$416 million, enabled by the Agency's practice of redeeming bonds using prepayments received from borrowers and available cash. In addition to the reduction of bonds payable, the Agency experienced a reduction of \$45 million in amounts attributable to its swap liabilities from a balance of \$123 million at June 30, 2012 to \$78 million at June 30, 2013 – the result of reductions of notional balances of the underlying swaps, exercising embedded options during opportune economic conditions and an overall increase in fair values during the fiscal year.

### June 30, 2012 Compared to June 30, 2011

#### **Assets**

Cash, cash equivalents and investment balances decreased to \$864 million at June 30, 2012 from \$980 million at June 30, 2011. The interest rate environment at the time of the fiscal year beginning July 1, 2011 was challenging for the Agency, as it directly affected the Agency's ability to issue bonds that would otherwise result in marketable mortgage interest rates. In response to this challenge, the Agency vigorously undertook a new method of providing mortgage loans and generating liquidity by pooling new production loans into MBSs through GNMA. Sales of MBSs from that process approximates the required funding of new mortgage loan purchases; the effects result in reduced levels of cash and investments when compared to prior years.

The Multifamily Housing Program mortgage loan portfolio decreased to \$452 million at June 30, 2012 from \$468 million at June 30, 2011 and the Single Family Mortgage Loan Program mortgage loan portfolio decreased to \$3.968 billion at June 30, 2012 from \$4.273 billion at June 30, 2011. Both decreases resulted from the effects of scheduled principal payments, prepayments and the increased provision for loan loss, while mortgage loans receivable in the Single Family Mortgage Loan Program also decreased dramatically because of the effects of the Agency's utilization of the secondary market and pooling of new mortgage production into MBSs. During the year ended June 30, 2012, the Agency pooled mortgage loans with principal balances totaling nearly \$197 million – loans that would have otherwise been reported as mortgage loans receivable had they not been pooled into MBSs and sold. The HEMAP mortgage assistance portfolio decreased to \$56 million at June 30, 2012 from \$65 million at June 30, 2011, after adjustments for the provision for loan loss, prepayments and scheduled principal payments.

**PENNSYLVANIA HOUSING FINANCE AGENCY**Management's Discussion and Analysis (*Unaudited*)

June 30, 2013 and 2012

*(Amounts rounded to facilitate easy reading)***Liabilities**

The total outstanding bonds and notes payable balances of the Multifamily Housing Program and Single Family Mortgage Loan Program at June 30, 2012 decreased to \$127 million and \$3.971 billion, respectively, from the previous year. This was the result of scheduled debt payments and early redemptions enabled by mortgage prepayments and excess Agency cash, and resultantly reduced amounts reported as both current and noncurrent liabilities at June 30, 2012 compared to June 30, 2011.

**Condensed Statements of Revenues, Expenses and Changes in Net Position***(In thousands)*

	<u>2013</u>	<u>2012*</u>	<u>2011*</u>	<u>Percentage Change</u>	
				<u>2013/2012</u>	<u>2012/2011</u>
Operating revenues:					
Mortgage loan interest	\$ 175,240	\$ 202,566	\$ 206,728	(13%)	(2%)
Program income and fees	61,677	43,426	68,085	42%	(36%)
Other income	14,513	40,214	13,815	(64%)	191%
Federal program awards	405,153	476,754	458,333	(15%)	4%
Total operating revenues	<u>656,583</u>	<u>762,960</u>	<u>746,961</u>	(14%)	2%
Operating expenses:					
Interest and financing expenses	156,124	184,079	186,430	(15%)	-
Program expenses	65,306	64,294	62,834	2%	2%
Federal program expenses	405,153	476,754	458,333	(15%)	4%
Total operating expenses	<u>626,583</u>	<u>725,127</u>	<u>707,597</u>	(14%)	2%
Operating income	30,000	37,833	39,364	(21%)	(4%)
Special Item	<u>-</u>	<u>(27,280)</u>	<u>-</u>	(100%)	100%
Change in Net Position	30,000	10,553	39,364	184%	(73%)
Net Position - Beginning of Year	821,003	810,450	771,086	1%	5%
Net Position - End of Year	<u>\$ 851,003</u>	<u>\$ 821,003</u>	<u>\$ 810,450</u>	4%	1%

\* - Certain reclassifications have been made in the June 30, 2012 and June 30, 2011 financial statements to conform to the June 30, 2013 presentation. For the years ended June 30, 2012 and June 30, 2011, net swap payments totaling \$7.6 million and \$5.3 million, respectively, attributable to investment derivative swaps were reported as a component of Interest Expense on Bonds and Notes. These amounts are now reported as a component of Investment Income, net. See **Note 2 – Summary of Significant Accounting Policies** for additional details of this reclassification.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Management's Discussion and Analysis (*Unaudited*)

June 30, 2013 and 2012

---

*(Amounts rounded to facilitate easy reading)*

**Discussion and Analysis of Significant Changes in the Statements of Revenues, Expenses and Changes in Net Position**

June 30, 2013 Compared to June 30, 2012

Operating income equaled \$30 million for the year ended June 30, 2013, down \$7.8 million from \$37.8 million for the year ended June 30, 2012. This reduction is primarily attributable to changes in the fair value of investments held by the Agency at June 30, 2013. Adverse market conditions prompted a net decrease of \$20 million in the fair value of investments for the year ended June 30, 2013, while the fair value of investments reflected an increase of over \$19 million for the year ended June 30, 2012. The changes in the fair value of investments are purely market driven and are presented in order to conform to reporting requirements of the Governmental Accounting Standards Board (GASB), whereby investments are required to be reported at their market values respective of the reporting date and, ultimately, reflect only short-term market activity. Changes in fair values of investments are unrealized and do not represent tangible income or expenses or cash transactions of the Agency. Absent the effects of GASB fair value reporting requirements and its reflection of short-term market activity, investments owned and reported by the Agency at June 30, 2013 have enjoyed a net long-term gain totaling nearly \$43 million since the time of their purchase.

In addition to the decrease in fair values of investments, mortgage loan interest income decreased by \$27.3 million to a total of \$175.2 million for the year ended June 30, 2013, compared to \$202.6 million for the year ended June 30, 2012. The reduction in mortgage loan interest income coincides with the reduction of principal balances associated with existing mortgages receivable, which inherently decrease over the course of time as a result of regularly scheduled payments and prepayments, and the Agency's increasing practice of pooling of mortgages into MBSs and selling the securitized pools, whereby most of the interest received from borrowers is passed through to investors instead of being retained by the Agency, and the underlying mortgages are no longer owned by the Agency.

The notable decrease in operating revenue was lessened by the receipt of \$22.2 million by the Homeowners' Emergency Mortgage Assistance Program ("HEMAP"). The receipt represented the first disbursement of what is to eventually approximate \$60 million over a multi-year period, resulting from Pennsylvania's Act 70 of 2012, also known as the Homeowner Assistance Settlement Act.

The overall decrease in operating income was lessened by a decrease in interest expense on bonds and notes and finance expenses totaling \$30 million, bringing total interest and finance expenses to \$156 million for the year ended June 30, 2013, compared to \$184 million in similar expenses for the year ended June 30, 2012. This decrease is attributable to the redemption of bonds by the use of earnings, excess cash, and prepayments of mortgages received in both the Single Family Mortgage Loan Program and Multifamily Housing Program.

## **PENNSYLVANIA HOUSING FINANCE AGENCY**

Management's Discussion and Analysis (*Unaudited*)

June 30, 2013 and 2012

---

*(Amounts rounded to facilitate easy reading)*

### June 30, 2012 Compared to June 30, 2011

The Agency's net position increased by \$10.5 million for the year ended June 30, 2012, compared to a \$39.4 million increase for the year ended June 30, 2011. The decrease in net income for 2012 compared to 2011 is attributable to the accounting treatment of the Agency exercising options related to its swaps, whereby the Agency recognized a Special Item expense of \$27 million. The Agency took advantage of the economic benefits associated with reducing the semiannual fixed payments to counterparties for 10 (ten) of its swaps at various times during the year ended June 30, 2012. The swaps were amended, whereby the Agency reduced its semiannual fixed rate payment to the swaps' counterparties.

The aforementioned options were embedded within the respective swaps at the time the agreements were entered into, and there existed a cost to the Agency to have these rights embedded. As a result, these options were considered to be an additional element of value within each swap. Exercising these options, however, ultimately changed the critical terms of the associated swap. GASB dictates that such changes trigger a termination of hedge accounting. In the instance of a termination event, amounts previously deferred and reported as an accumulated decrease in the fair value of hedging derivatives, which are deferred outflows of resources, are to be recognized immediately as an item of income or expense – depending on the fair value of the swap at the time of termination.

Gains or losses resulting from termination events occurring during the year ended June 30, 2012 were reported as a Special Item on the Statements of Revenues, Expenses, and Changes in Net Position because they were, at the time, infrequent in occurrence. The Agency maintains contractual rights to exercise options of this nature within nearly all of its swaps. Because similar events occurred in periods subsequent to the year ended June 30, 2012 and are anticipated to occur during the remaining lives of the associated swaps, provided it is economically advantageous for the Agency to exercise the embedded options, these events can no longer be deemed special items. Transactions resulting from termination events in subsequent periods are and will be reported as gains or losses on swap terminations. The amended swaps continued to be effective hedging derivative instruments as of June 30, 2012.

The effects of the termination events described above and the ultimate effects of the resultant Special Item on the Agency's net position represent non-cash transactions. At no time was the Agency required to relinquish or exchange cash or any other monetary assets because of the termination events and resultant Special Item.

### **Additional Information**

This discussion and analysis is intended to provide additional information regarding the activities of the Agency. Additional current or historical audited or unaudited financial information can be found at the Agency's website at [www.phfa.org](http://www.phfa.org).

# PENNSYLVANIA HOUSING FINANCE AGENCY

## Statements of Net Position

June 30, 2013 and 2012

(In thousands of dollars)

	2013						2012					
	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total
<b>ASSETS</b>												
<b>Current assets:</b>												
Cash and cash equivalents	\$ 22,948	\$ 19,019	\$ 276,463	\$ 42,798	\$ 10,638	\$ 371,866	\$ 75,786	\$ 43,888	\$ 238,341	\$ 35,197	\$ 1	\$ 393,213
Restricted cash and cash equivalents	2,609	99,355	37,726	-	-	139,690	1,555	122,037	35,599	-	-	159,191
Investments	170	-	-	-	-	170	119	35	5,006	6,003	-	11,163
Restricted investments	107	4,899	5,703	-	-	10,709	46	446	8,594	-	-	9,086
Accrued interest receivable on investments	96	206	833	71	-	1,206	212	305	933	76	-	1,526
Mortgage loans receivable, net	-	20,150	77,610	-	7,066	104,826	-	28,287	81,684	-	7,244	117,215
Other current assets	2,126	-	1	-	1,823	3,950	1,819	2,968	-	-	2,057	6,844
Due from other funds	126,267	21,808	-	-	-	148,075	49,514	30,123	-	-	-	79,637
Total current assets	154,323	165,437	398,336	42,869	19,527	780,492	129,051	228,089	370,157	41,276	9,302	777,875
<b>Noncurrent assets:</b>												
Investments	34,300	2,292	69,242	2,250	-	108,084	43,149	2,066	116,408	2,092	-	163,715
Restricted investments	666	5,260	141,276	-	-	147,202	115	5,168	122,253	-	-	127,536
Mortgage loans receivable, net	-	411,235	3,598,296	-	47,285	4,056,816	-	423,711	3,886,449	-	48,482	4,358,642
Capital assets, net	30,879	-	-	-	-	30,879	31,523	-	-	-	1	31,524
Other noncurrent assets	23,120	2,008	27,664	-	4	52,796	25,930	1,997	30,910	-	4	58,841
Total noncurrent assets	88,965	420,795	3,836,478	2,250	47,289	4,395,777	100,717	432,942	4,156,020	2,092	48,487	4,740,258
<b>DEFERRED OUTFLOW OF RESOURCES</b>												
Accumulated decrease in fair value of hedging derivatives	563	11,177	44,775	-	-	56,515	1,172	13,247	78,691	-	-	93,110
<b>Total assets and deferred outflows of resources</b>	<b>\$ 243,851</b>	<b>\$ 597,409</b>	<b>\$ 4,279,589</b>	<b>\$ 45,119</b>	<b>\$ 66,816</b>	<b>\$ 5,232,784</b>	<b>\$ 230,940</b>	<b>\$ 674,278</b>	<b>\$ 4,604,868</b>	<b>\$ 43,368</b>	<b>\$ 57,789</b>	<b>\$ 5,611,243</b>
<b>LIABILITIES</b>												
<b>Current liabilities:</b>												
Bonds and notes payable, net	\$ 1,000	\$ 14,872	\$ 65,910	\$ -	\$ -	\$ 81,782	\$ -	\$ 20,324	\$ 61,940	\$ -	\$ -	\$ 82,264
Accrued interest payable	463	2,040	32,391	-	-	34,894	386	2,627	38,313	-	-	41,326
Accounts payable and accrued expenses	2,439	-	1,946	-	465	4,850	1,940	53	2,799	158	514	5,464
Escrow deposits and development reserves	547	19,115	43,567	-	-	63,229	25	28,099	44,500	-	-	72,624
Other current liabilities	58	1,013	6,998	300	394	8,763	54	1,069	5,111	300	480	7,014
Due to other funds	-	-	148,075	-	-	148,075	-	-	79,637	-	-	79,637
Total current liabilities	4,507	37,040	298,887	300	859	341,593	2,405	52,172	232,300	458	994	288,329
<b>Noncurrent liabilities:</b>												
Bonds and notes payable, net	39,000	56,381	3,525,560	-	-	3,620,941	20,000	106,614	3,909,504	-	-	4,036,118
Derivative Instrument - Interest rate swaps	563	8,919	46,209	-	-	55,691	1,172	13,637	82,346	-	-	97,155
Deferred swap borrowing	-	2,424	19,583	-	-	22,007	-	2,747	23,399	-	-	26,146
Development reserves	-	80,990	-	-	-	80,990	-	85,691	-	-	-	85,691
Other noncurrent liabilities	25,694	173,774	34,772	2,963	23,356	260,559	18,599	178,736	30,331	2,740	26,395	256,801
Total noncurrent liabilities	65,257	322,488	3,626,124	2,963	23,356	4,040,188	39,771	387,425	4,045,580	2,740	26,395	4,501,911
<b>Total liabilities</b>	<b>69,764</b>	<b>359,528</b>	<b>3,925,011</b>	<b>3,263</b>	<b>24,215</b>	<b>4,381,781</b>	<b>42,176</b>	<b>439,597</b>	<b>4,277,880</b>	<b>3,198</b>	<b>27,389</b>	<b>4,790,240</b>
<b>NET POSITION</b>												
Net investment in capital assets	10,879	-	-	-	-	10,879	11,523	-	-	-	1	11,524
Restricted for bond resolution or legislation	-	492	135,813	-	42,601	178,906	-	7,636	174,220	-	30,399	212,255
Unrestricted	163,208	237,389	218,765	41,856	-	661,218	177,241	227,045	152,768	40,170	-	597,224
<b>Total net position</b>	<b>174,087</b>	<b>237,881</b>	<b>354,578</b>	<b>41,856</b>	<b>42,601</b>	<b>851,003</b>	<b>188,764</b>	<b>234,681</b>	<b>326,988</b>	<b>40,170</b>	<b>30,400</b>	<b>821,003</b>
<b>Total liabilities and net position</b>	<b>\$ 243,851</b>	<b>\$ 597,409</b>	<b>\$ 4,279,589</b>	<b>\$ 45,119</b>	<b>\$ 66,816</b>	<b>\$ 5,232,784</b>	<b>\$ 230,940</b>	<b>\$ 674,278</b>	<b>\$ 4,604,868</b>	<b>\$ 43,368</b>	<b>\$ 57,789</b>	<b>\$ 5,611,243</b>

The accompanying notes are an integral part of these financial statements.

**PENNSYLVANIA HOUSING FINANCE AGENCY**  
**Statements of Revenues, Expenses and Changes in Net Position**  
**Years Ended June 30, 2013 and 2012**

*(In thousands of dollars)*

	2013						2012					
	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total
<b>Operating revenues:</b>												
Interest income on mortgage loans	\$ -	\$ 15,512	\$ 159,166	\$ -	\$ 562	\$ 175,240	\$ 20	\$ 21,746	\$ 180,167	\$ -	\$ 633	\$ 202,566
Program income and fees	31,753	790	3,310	2,026	23,798	61,677	34,535	672	4,138	1,936	2,145	43,426
Gain on sales of mortgage-backed securities	21,185	-	-	-	-	21,185	14,046	-	-	-	-	14,046
Investment income (loss)	(271)	(2,390)	6,683	323	21	4,366	185	(274)	4,294	548	-	4,753
Swap borrowing income	-	323	446	-	-	769	-	313	821	-	-	1,134
Net increase (decrease) in fair value of investments	(7,514)	293	(12,762)	(63)	-	(20,046)	14,278	107	4,530	265	-	19,180
Net increase in fair value of swaps	-	2,649	2,220	-	-	4,869	-	188	913	-	-	1,101
Gain on swap terminations	-	-	3,370	-	-	3,370	-	-	-	-	-	-
Federal program awards	-	386,373	4,317	-	14,463	405,153	-	420,877	3,558	-	52,319	476,754
<b>Total operating revenues</b>	<b>45,153</b>	<b>403,550</b>	<b>166,750</b>	<b>2,286</b>	<b>38,844</b>	<b>656,583</b>	<b>63,064</b>	<b>443,629</b>	<b>198,421</b>	<b>2,749</b>	<b>55,097</b>	<b>762,960</b>
<b>Operating expenses:</b>												
Interest expense on bonds and notes	821	2,997	140,824	-	-	144,642	739	6,431	159,774	-	-	166,944
Salaries and related benefits	24,951	-	-	-	2,333	27,284	23,672	-	-	-	1,646	25,318
OPEB liability expense	3,578	-	-	-	488	4,066	3,707	-	-	-	506	4,213
Financing expenses	-	426	11,056	-	-	11,482	-	1,480	15,655	-	-	17,135
General and administrative	5,916	2,382	883	600	911	10,692	8,001	2,502	1,638	600	497	13,238
Provision for loan loss	-	4,419	6,751	-	8,448	19,618	-	3,000	5,000	-	10,976	18,976
Early extinguishment of debt	-	-	3,646	-	-	3,646	-	42	2,507	-	-	2,549
Federal program expense	-	386,373	4,317	-	14,463	405,153	-	420,877	3,558	-	52,319	476,754
<b>Total operating expenses</b>	<b>35,266</b>	<b>396,597</b>	<b>167,477</b>	<b>600</b>	<b>26,643</b>	<b>626,583</b>	<b>36,119</b>	<b>434,332</b>	<b>188,132</b>	<b>600</b>	<b>65,944</b>	<b>725,127</b>
<b>Operating income (loss)</b>	<b>9,887</b>	<b>6,953</b>	<b>(727)</b>	<b>1,686</b>	<b>12,201</b>	<b>30,000</b>	<b>26,945</b>	<b>9,297</b>	<b>10,289</b>	<b>2,149</b>	<b>(10,847)</b>	<b>37,833</b>
<b>Special item and transfers:</b>												
Special item; Loss on swap terminations	-	-	-	-	-	-	-	(3,060)	(24,220)	-	-	(27,280)
Interfund transfers	(24,564)	(3,753)	28,317	-	-	-	6,100	(8,830)	2,730	-	-	-
<b>Change in Net Position</b>	<b>(14,677)</b>	<b>3,200</b>	<b>27,590</b>	<b>1,686</b>	<b>12,201</b>	<b>30,000</b>	<b>33,045</b>	<b>(2,593)</b>	<b>(11,201)</b>	<b>2,149</b>	<b>(10,847)</b>	<b>10,553</b>
Total net position - beginning of year	188,764	234,681	326,988	40,170	30,400	821,003	155,719	237,274	338,189	38,021	41,247	810,450
Total net position - end of year	<u>\$ 174,087</u>	<u>\$ 237,881</u>	<u>\$ 354,578</u>	<u>\$ 41,856</u>	<u>\$ 42,601</u>	<u>\$ 851,003</u>	<u>\$ 188,764</u>	<u>\$ 234,681</u>	<u>\$ 326,988</u>	<u>\$ 40,170</u>	<u>\$ 30,400</u>	<u>\$ 821,003</u>

The accompanying notes are an integral part of these financial statements.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Statements of Cash Flows

Years Ended June 30, 2013 and 2012

(In thousands of dollars)

	2013						2012					
	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total
<b>Cash Flows From Operating Activities</b>												
Receipts of mortgage loan payments	\$ -	\$ 36,101	\$ 881,979	\$ -	\$ 7,237	\$ 925,317	\$ -	\$ 77,076	\$ 592,197	\$ -	\$ 6,930	\$ 676,203
Receipts from fees and other income	53,054	889	3,410	2,031	23,798	83,182	48,516	571	4,267	2,165	2,145	57,664
Receipts from interest on mortgages	-	16,291	155,484	-	562	172,337	-	21,746	180,167	-	633	202,546
Receipt (payment) of escrow and development reserves	7,621	(15,746)	8,640	-	-	515	2,394	2,432	(5,703)	-	-	(877)
Payments for mortgages and purchases	-	(20,686)	(592,821)	-	(14,310)	(627,817)	-	(64,514)	(292,411)	85	(8,501)	(365,341)
Payments to employees and suppliers	(30,280)	(2,435)	(1,736)	(535)	(3,322)	(38,308)	(37,155)	(4,893)	(16,463)	-	(4,298)	(62,809)
Net cash provided by (used in) operating activities	30,395	14,414	454,956	1,496	13,965	515,226	13,755	32,418	462,054	2,250	(3,091)	507,386
<b>Cash Flows From Noncapital Financing Activities</b>												
Proceeds from the issuance of bonds and notes	20,000	47,785	367,615	-	-	435,400	-	-	81,705	-	-	81,705
Payments for retirement of bonds and notes	-	(103,470)	(747,589)	-	-	(851,059)	-	(41,815)	(502,300)	-	-	(544,115)
Payments of bonds and notes interest	-	(3,584)	(150,392)	-	-	(153,976)	-	(7,171)	(162,303)	-	-	(169,474)
Payments of financing costs	-	(426)	(11,056)	-	-	(11,482)	-	(1,480)	(15,655)	-	-	(17,135)
Transfers from (to) other funds	(101,317)	4,562	96,755	-	(3,349)	(3,349)	(11,761)	15,732	(3,971)	-	2,734	2,734
Net cash provided by (used in) noncapital financing activities	(81,317)	(55,133)	(444,667)	-	(3,349)	(584,466)	(11,761)	(34,734)	(602,524)	-	2,734	(646,285)
<b>Cash Flows From Capital Financing Activities</b>												
Purchases of capital assets	(519)	-	-	-	-	(519)	(303)	-	-	-	-	(303)
Interest paid on capital debt	(744)	-	-	-	-	(744)	(734)	-	-	-	-	(734)
Net cash used in capital financing activities	(1,263)	-	-	-	-	(1,263)	(1,037)	-	-	-	-	(1,037)
<b>Cash Flows From Investing Activities</b>												
Proceeds from the sale or maturity of investments	470	2,515	29,278	5,782	-	38,045	8,577	35,508	87,264	-	-	131,349
Investment interest receipts	-	-	9,881	323	21	10,225	185	46	11,561	548	-	12,340
Net interest payments on investment derivatives	-	(2,342)	(3,198)	-	-	(5,540)	-	(321)	(7,267)	-	-	(7,588)
Purchases of investments	(69)	(7,005)	(6,001)	-	-	(13,075)	-	(26,005)	(57,279)	(745)	-	(84,029)
Net cash provided by (used in) investing activities	401	(6,832)	29,960	6,105	21	29,655	8,762	9,228	34,279	(197)	-	52,072
Net increase (decrease) in cash and cash equivalents	(51,784)	(47,551)	40,249	7,601	10,637	(40,848)	9,719	6,912	(106,191)	2,053	(357)	(87,864)
Cash and cash equivalents, beginning of year	77,341	165,925	273,940	35,197	1	552,404	67,622	159,013	380,131	33,144	358	640,268
Cash and cash equivalents, end of year	\$ 25,557	\$ 118,374	\$ 314,189	\$ 42,798	\$ 10,638	\$ 511,556	\$ 77,341	\$ 165,925	\$ 273,940	\$ 35,197	\$ 1	\$ 552,404

The accompanying notes are an integral part of these financial statements.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Statements of Cash Flows (continued)

Years Ended June 30, 2013 and 2012

(In thousands of dollars)

	2013						2012					
	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total	General Fund	Multifamily Housing Program	Single Family Mortgage Loan Program	Insurance Fund	HEMAP	Total
<b>Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:</b>												
Operating income (loss)	\$ 9,887	\$ 6,953	\$ (727)	\$ 1,686	\$ 12,201	\$ 30,000	\$ 26,945	\$ 9,297	\$ 10,289	\$ 2,149	\$ (10,847)	\$ 37,833
Investment income recognized	271	2,390	(6,683)	(323)	(21)	(4,366)	(185)	274	(4,294)	(548)	-	(4,753)
Swap borrowing income	-	(323)	(446)	-	-	(769)	-	(313)	(821)	-	-	(1,134)
Net change in fair value of investments	7,514	(293)	12,762	63	-	20,046	(14,278)	(107)	(4,530)	(265)	-	(19,180)
Net change in fair value of swaps	-	(2,649)	(2,220)	-	-	(4,869)	-	(188)	(913)	-	-	(1,101)
Gain on swap terminations	-	-	(3,370)	-	-	(3,370)	-	-	-	-	-	-
Interest expense on bonds and notes	821	2,997	140,824	-	-	144,642	739	6,431	159,774	-	-	166,944
Financing expenses	-	426	11,056	-	-	11,482	-	1,480	15,655	-	-	17,135
Provision for loan loss	-	4,419	6,751	-	8,448	19,618	-	3,000	5,000	-	10,976	18,976
Depreciation	1,163	-	-	-	1	1,164	1,217	-	-	-	1	1,218
Early extinguishment of debt	-	-	3,646	-	-	3,646	-	42	2,507	-	-	2,549
Changes in assets and liabilities:												
Mortgage loans receivable, net	-	16,194	285,476	-	(7,073)	294,597	-	12,562	299,786	-	(1,571)	310,777
Accrued interest receivable on investments	116	99	100	5	-	320	(85)	(101)	129	229	-	172
Other assets	2,503	2,957	3,245	-	234	8,939	(2,154)	(2,358)	(15,571)	-	(1,871)	(21,954)
Accounts payable and accrued expenses	499	(53)	(853)	(158)	(32)	(597)	(838)	(33)	746	156	(1,212)	(1,181)
Escrow deposits and development reserves	522	(13,685)	(933)	223	-	(13,873)	(57)	(6,710)	(5,314)	-	-	(12,081)
Other liabilities	7,099	(5,018)	6,328	-	207	8,616	2,451	9,142	(389)	529	1,433	13,166
<b>Net cash provided by (used in) operating activities</b>	<b>\$ 30,395</b>	<b>\$ 14,414</b>	<b>\$ 454,956</b>	<b>\$ 1,496</b>	<b>\$ 13,965</b>	<b>\$ 515,226</b>	<b>\$ 13,755</b>	<b>\$ 32,418</b>	<b>\$ 462,054</b>	<b>\$ 2,250</b>	<b>\$ (3,091)</b>	<b>\$ 507,386</b>
Net increase (decrease) in fair value of investments	\$ (7,514)	\$ 293	\$ (12,762)	\$ (63)	\$ -	\$ (20,046)	\$ 14,278	\$ 107	\$ 4,530	\$ 265	\$ -	\$ 19,180

Net increases and decreases in the fair value of investments do not result in cash receipts or cash payments.

There were no other material investing, capital or financing activities that did not result in cash receipts or cash payments during the fiscal year.

The accompanying notes are an integral part of these financial statements.

# PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

## 1. Reporting Entity

The Pennsylvania Housing Finance Agency (“Agency”) is a component unit of the Commonwealth of Pennsylvania (“Commonwealth”) as described in Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity*, as amended by GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units* and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an Amendment of GASB Statements No. 14 and No. 34*. The Agency’s financial information is discretely presented in the Commonwealth’s financial statements, but the Agency is not considered part of the Commonwealth’s primary government.

The Agency was created by the General Assembly in 1972 as a means to provide affordable housing for older adults, persons and families of modest means and persons with disabilities. Pursuant to the Housing Finance Agency Law, Act of 1959, P. L. 1688, No. 620 (“Act”), as amended, the Agency is authorized and empowered, among other things, to finance the construction and rehabilitation of housing units for persons and families of low and moderate income, persons with special needs or the elderly who receive assistance from federal government programs.

The Act was amended to authorize the Agency to make or purchase mortgage loans to finance the purchase, construction, improvement or rehabilitation of owner-occupied single-family residences and to finance the construction and rehabilitation of housing units without requiring the housing units to be subsidized or assisted by a federal government program. The initial legislation and subsequent amendments grant the Agency the power to issue debt in order to finance its programs and operations. Debt obligations issued under the provisions of the Act are not a debt or liability of the Commonwealth or any of its political subdivisions or a pledge of the faith and credit of the Commonwealth or of any of its political subdivisions.

The Board of the Agency sets policy and oversees the organization's operations. The Board has 14 members. The Secretary of Banking, (chair), the Secretary of Community and Economic Development, the Secretary of Public Welfare, and the State Treasurer serve by virtue of their offices. Four members of the Board serve at the pleasure of the majority and minority leaders of the State Senate and House of Representatives. Six private citizen members are appointed by the Governor and confirmed by the State Senate, and serve for staggered six-year terms.

## 2. Summary of Significant Accounting Policies

### Basis of Accounting

The Agency presents its financial statements in accordance with United States Generally Accepted Accounting Principles (“U.S. GAAP”), as established by GASB. For financial reporting purposes, the Agency is considered a special-purpose government engaged in business-

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

type activities. The financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when incurred, except those directly related to mortgage loan or program originations, which are deferred, netted against fee income for mortgage loans originated and amortized over the anticipated life of the related mortgage loan or program.

### **Description of Funds**

The accounts of the Agency are structured within separate enterprise funds, each representing a separate accounting entity. The Agency's resources are allocated to these funds based upon legal responsibility, accountability and management designation, summarized as follows:

**General Fund** – Consists of a group of accounts used to record the receipt of income not directly pledged to the repayment of mortgage revenue bonds and the payment of expenses related to the Agency's administrative functions, including salary and related benefits.

**Multifamily Housing Program** – Records the activity related to financing the construction, rehabilitation or operational expenses of multifamily rental housing developments generally designed for persons or families of low and moderate income or the elderly.

**Single Family Mortgage Loan Program** – Records the activity related to providing capital for the purchase and servicing of mortgage loans for owner-occupied single-family residences for persons or families of low and moderate income.

**Insurance Fund** – The Agency provides primary mortgage insurance coverage through this fund for single-family borrowers who are unable to obtain insurance from other sources.

**Homeowners' Emergency Mortgage Assistance Program ("HEMAP")** – Created by Act 91 of 1982 by the Pennsylvania General Assembly to provide emergency mortgage assistance loans to mortgagors facing foreclosure due to circumstances beyond their control. HEMAP's primary operating revenues derive from funding received from the Commonwealth of Pennsylvania, and are reported as a component of Program Income and Fees on the Agency's financial statements.

### **Cash and Cash Equivalents**

Cash includes cash on hand and cash deposits. Cash equivalents are defined as short-term investments with original maturities of three months or less that are readily convertible to known amounts of cash, which include money market investments.

### **Investments**

Investments are reported at fair value. Fair value is determined by reference to published market prices and quotations, where available, at the closing of each reporting period. Changes in fair values are recognized separately within the Statements of Revenues, Expenses and Changes in Net Position.

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### **Restricted Cash, Cash Equivalents and Investments**

Restricted cash, cash equivalents and investments are restricted primarily by escrow agreements, bond resolutions, debt servicing agreements or other contractual agreements. The Agency collects mortgage payments on behalf of mortgagees for whom the Agency acts as a servicer. The Agency holds monies from multifamily property owners and single-family homeowners for payments of real estate taxes, property insurance and operating reserves, and has recorded a corresponding liability related to these balances. The Agency maintains funds, restricted as to their use, in order to comply with bond debt capital reserve fund and self-insurance fund requirements and certain investor or creditor covenants.

### **Mortgage Loans Receivable, Net**

Mortgage loans receivable are reported as the sum of mortgage amounts disbursed plus accrued interest, unamortized origination costs and premiums and unamortized mortgage servicing rights/servicing release premiums, less repayments and an allowance for loan losses.

The current portion of mortgage loans receivable represents the contractual amount due within the forthcoming year.

Mortgage servicing rights/servicing release premiums are amortized over the life of the related loans using the effective interest method, and include servicing rights associated with both mortgages owned by the Agency and mortgages sold by the Agency for which servicing rights were retained. Mortgage servicing rights respective of the servicing rights retained for loans sold by the Agency are reported at the lower of amortized cost or fair value.

The allowance for loan losses is based upon management's evaluation of mortgage loans receivable, and represents an adjustment to ultimately reflect the balances of mortgage loans receivable at an amount deemed collectible. Factors considered by management include the estimated fair values of the properties that represent collateral, mortgage insurance coverage on the collateral, the financial condition of the borrower, government guarantees and the economy as a whole. While management uses available information to estimate levels of potential losses on mortgage loans, future additions to the allowance may be necessary based on changes in economic conditions.

### **Real Estate Owned**

Included within mortgage loans receivable reported within the Single Family Mortgage Loan Program are amounts attributable to real estate owned. During the normal course of business, the Agency acquires and holds for sale single-family real estate as a result of foreclosure, acceptance of a deed in lieu of foreclosure or other defaults of nonperforming mortgage loans. The outstanding balances attributable to these properties are stated at the remaining mortgage balances less an estimated allowance for loss in order to approximate the lower of cost or net realizable value. In addition to recoveries from the sale of real estate owned, recoveries are also received from the U.S. Department of Housing and Urban Development, other federal government programs or private mortgage insurance.

## **PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### **Capital Assets**

The Agency capitalizes assets with an initial cost of \$1 (one-thousand dollars) or more. Depreciation is calculated using the straight-line method over the estimated useful lives, which range from 5 to 45 years. When capital assets are disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recorded as a revenue or expense.

### **Due From and Due To Other Funds and Interfund Transfers**

In order to meet liquidity requirements of individual funds, the Agency transfers funds to and from the separate enterprise funds. The Agency makes interfund transfers to the extent that such transfers are not otherwise required to meet the Agency's debt obligations and if such transfers are not in violation of the terms of bond resolutions or indentures. Transactions which have not been settled at the year-end are recorded as due to or due from other funds.

### **Other Assets**

Other assets include net pension assets, federal funding receivable, prepaid expenses, deferred costs of bond issuance and advances from the Agency to HEMAP.

### **Deferred Outflow of Resources**

Amounts reported as Accumulated Decrease in Fair Value of Hedging Derivatives represent the anticipated utilization of the net position of interest rate swap agreements deemed to be effective hedging derivatives.

### **Bonds and Notes Payable, Net**

The Agency issues bonds and notes to provide capital for its mortgage programs and other uses consistent with its mission. The resultant debt is secured by mortgage loans, investments, general credit pledges, other assets and revenues within the respective program or accounts established by the associated security agreements. Outstanding bonds and notes are stated at their unpaid balance less any unamortized discounts or premiums and unamortized gains or losses from refunding. The current portion of bonds and notes payable represents the scheduled principal payable within the forthcoming year.

### **Escrow Deposits and Development Reserves**

Escrow deposits represent balances of receipts from single-family homeowners and multifamily developments for anticipated payments of real estate taxes, property insurance and mortgage insurance. Development reserves represent operating reserves for repairs and replacement, property improvements, supportive services and operating deficit reserves.

### **Other Liabilities**

Other liabilities consist mainly of deferred revenues, other post-employment benefit ("OPEB") obligations, deferred federal funding, accrued expenses and advances to HEMAP from the Agency.

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### **Derivative Instrument – Interest Rate Swaps**

The Agency enters into interest rate swap agreements (“swaps”) with various counterparties to hedge the interest rate exposure associated with variable-rate debt and to reduce overall borrowing costs. Swaps are structured whereby the Agency pays a fixed interest rate to a counterparty in exchange for the same counterparty paying a variable interest rate, which is established based upon a common market index, to the Agency. Swaps are stated at fair value. For swaps deemed to be effective hedges, the changes in fair values are reported as accumulated decreases in fair values of hedging derivatives – deferred outflows of resources which equal the values of the corresponding swaps; for swaps deemed to be investments and not considered effective hedges, the changes in fair values are reported as a net increase or decrease in the fair value of swaps and recognized as a revenue or expense.

### **Deferred Swap Borrowing**

These amounts represent unamortized balances of interest rate swap agreements previously reported as hedging derivatives that were reclassified as a result of termination events. Termination events prevent the continued use of hedge accounting and cause the fair values of terminated hedging instruments to be recognized immediately as a revenue or expense, rather than reported as a deferred inflow or outflow of resources. Deferred swap borrowing balances are amortized and recognized as revenue over the remaining lives of the underlying terminated interest rate swap agreements in order to recoup the effects of the termination event over time.

### **Net Position**

Net position is classified in the following three components:

**Net Investment in Capital Assets** – Consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any debt attributable to the acquisition, construction or improvement of those assets.

**Restricted by Bond Resolution or Legislation** – Consists of assets with constraints placed on their use by (1) Agency bond resolutions or external groups, such as creditors or grantors, or (2) laws or regulations of other governments.

**Unrestricted** – Consists of assets that do not meet the definition of Net Investment In Capital Assets or Restricted. This component includes assets designated for specific purposes by the members of the Board.

When both restricted and unrestricted resources are available in a fund, it is the Agency’s policy to use restricted resources to the extent allowed and only use unrestricted resources when needed.

## **PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### **Operating Revenues and Expenses**

The Agency records all revenue from mortgage and loan activity, mortgage servicing, grant program administration, investment income and gains on the sale of pooled loans via the Government National Mortgage Association (“GNMA”) and the Federal National Mortgage Association (“FNMA”) as operating revenues. The costs of providing these programs are recorded as operating expenses. The General Fund records revenue and expenses for salaries, benefits, and other operational revenues and expenses that are not directly related to mortgage loan programs.

### **Interest Income on Mortgage Loans**

Interest received for mortgage loans is based upon the constant yield method. Multifamily Housing and Single Family Mortgage Loan Program loans more than 180 days delinquent in scheduled payments are considered nonperforming mortgage loans, which result in the cessation of recognition of additional interest on such mortgage loans.

### **Gain on Sales of Mortgage-Backed Securities**

The Agency participates in the GNMA and FNMA Mortgage Backed Securities (“MBS”) programs, whereby GNMA or FNMA guarantees securities that are issued by the Agency and backed by pools of mortgage loans. Gains on sales of MBSs are recorded at the time of settlement and represent the difference between the sale price of the MBSs and the carrying value of the underlying pool of mortgages backing them.

### **Investment Income**

Investment Income includes net receipts and payments associated with swaps deemed to be investment derivatives, gains or losses on sales of investment securities and investment interest income.

### **Federal Program Awards and Expenses**

The Agency receives program grants and other federal financial assistance and transfers these monies to various secondary recipients within the Commonwealth of Pennsylvania. The Agency receives administrative fees for the oversight of award distribution, monitoring of subrecipients, reporting to federal agencies and costs for required independent annual audits of the federal awards, which are recorded as program income and fees.

### **Pension Plan and Other Postemployment Benefits Expense**

The Agency is required to measure and disclose amounts for annual pension cost and net pension obligations. Actuarially determined periodic contributions are made by the Agency in order to maintain sufficient assets to pay benefits when due. Pension expenses are recorded as salaries and related benefits.

The Agency is required to measure, recognize and disclose OPEB expenses, related liabilities/(assets) and note disclosures. The Agency does not fund its OPEB liability; rather, the Agency maintains health insurance for its retirees on a pay-as-you-go basis.

## **PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### **Compensated Absences**

Employees earn vacation and illness leave benefits. Upon separation of service, employees are compensated for accumulated leave balances, limited by Agency policy. Compensated absence leave is recorded as an accrued expense in the period earned.

### **Debt Issuance Costs, Discounts and Other Related Costs**

The Agency capitalizes costs related to bond and note issuance, defers and reports those costs as Other Assets and amortizes the costs as a component of interest expense on bonds and notes over the contractual life of the bonds and notes using the effective interest method. Bond discounts and premiums are amortized over the lives of the corresponding bonds using the effective interest method. Gains and losses on debt refundings are deferred and amortized over the shorter of the remaining life of the old debt or the life of the new debt. Net swap agreement payments are recorded as a component of interest expense on bonds and notes.

### **Adopted Accounting Standards**

GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34* modifies certain requirements for inclusion of component units in the financial reporting entity. This includes the concept of financial burden or benefit on the relationship between the primary government and the component unit. The implementation of this standard had no impact on the Agency's 2013 financial statements.

GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance included in Financial Accounting Standards Board ("FASB") pronouncements issued on or before November 30, 1989 which do not conflict with or contradict GASB pronouncements. The implementation of this standard, effective for the Agency's 2013 financial statements, modified certain disclosures and accounting for servicing rights/servicing release premiums.

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* revised financial reporting for certain elements of the financial statements regarding acquisition or the consumption of net position, distinct from assets or liabilities, that are applicable to future reporting periods. The implementation of this standard, effective for the Agency's 2013 financial statements, modified the presentation of items identified in the financial statements as deferred outflows and inflows of resources and revised the identification of the term "Fund Net Assets" to "Net Position."

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### Accounting Standards Issued But Not Yet Adopted

GASB issued the following Statements that will become effective in future reporting periods. Management is currently evaluating the potential impact on the Agency's financial statements.

- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, issued March 2012. This statement is effective for the Agency's fiscal year ending June 30, 2014.
- GASB Statement No. 66, *Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62*, issued March 2012. This statement is effective for the Agency's fiscal year ending June 30, 2014.
- GASB Statement No. 67, *Financial Reporting for Pension Plans – An Amendment of GASB Statement No. 25*, issued June 2012. This statement is effective for the Agency's fiscal year ending June 30, 2014.
- GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*, issued June 2012. This statement is effective for the Agency's fiscal year ending June 30, 2015.
- GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, issued January 2013. This statement is effective for the Agency's fiscal year ending June 30, 2015.
- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, issued April 2013. This statement is effective for the Agency's fiscal year ending June 30, 2014.

### Reclassifications

The following reclassifications have been made to the June 30, 2012 financial statements to conform to the June 30, 2013 presentation:

- \$8,492 attributable to an investment in a bond mutual fund was previously reported as a component of Restricted Cash and Cash Equivalents. This amount is now reported as a component of noncurrent Restricted Investments.
- Amounts reported as Deferred Outflows of Resources were previously classified as assets on the Statement of Net Position; amounts are now reported separately and distinctly.
- \$17.8 million attributable to asset balances of unamortized underwriters' fees had previously been included with liability balances of unamortized bond discounts and premiums, reported as a component of Bonds and Notes Payable, within the General Fund, the Multifamily Housing Program and Single Family Mortgage Loan Program equaling \$64, \$113 and \$17,661, respectively. These amounts are now reported as deferred costs of bond issuance within Other Assets. See **Note 9 – Long Term Liabilities** for additional effects resulting from this reclassification.
- \$14 million attributable to net gains on sales of MBSs were previously reported as Program Income and Fees. These amounts are now reported separately as Gains on Sales of Mortgage-backed Securities.

# PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

- \$7,588 attributable to net swap payments on investment derivative swaps were reported as a component of Interest Expense on Bonds and Notes within the Multifamily Housing Program and Single Family Mortgage Loan Program equaling \$321 and \$7,267, respectively. These amounts are now reported as a component of Investment Income.

### 3. Cash, Cash Equivalents and Investments

#### Cash and Cash Equivalents

The Agency maintains a policy whereby cash and cash equivalents must be held in insured depositories satisfactory to the Agency and must be fully collateralized. Cash and cash equivalents balances for the years ended June 30 were as follows:

	<u>2013</u>	<u>2012</u>
Cash	\$ 59,603	\$ 58,513
Money Markets	451,953	493,891
Total carrying amount cash and cash equivalents	<u>\$ 511,556</u>	<u>\$ 552,404</u>
Bank balance of cash and cash equivalents	<u>\$ 517,183</u>	<u>\$ 558,569</u>

#### *Custodial Credit Risk*

The Agency assumes levels of custodial credit risk for its cash and cash equivalents with financial institutions. Custodial credit risk is the risk that, in the event of a bank failure, the Agency's cash and cash equivalents may not be returned. The Agency has not established a formal custodial credit risk policy for its cash and cash equivalents.

At June 30, 2013, the carrying value of the Agency's cash deposits equaled \$59,603 with a bank balance of \$68,378, of which \$66,878 was uninsured and collateralized in accordance with Act 72 of the Commonwealth of Pennsylvania with securities held by the pledging financial institution, its trust department or agent, but not in the Agency's name.

The carrying value of the Agency's money market investments, reported as cash equivalents, equaled \$451,953 with a bank balance of \$448,805, does not expose the Agency to custodial credit risk.

#### **Investments**

Commonwealth of Pennsylvania statutes and contractual provisions contained within the Agency's bond trust indentures govern the investment policies of the Agency. The Housing Finance Agency Law, Act of December 3, 1959, P. L. 1688 ("Act") and bond indentures provide the authority to invest all Agency funds. In compliance with the Act and bond indentures, it is the policy of the Agency to invest in securities that provide suitable returns, preserve principal, meet liquidity needs and which further the mission of the Agency.

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

Securities include any of the following obligations, to the extent the same are at the time legal for investment of funds of the Agency under the Act, including amendments thereto made, or under other applicable law:

- Direct obligations of or obligations guaranteed by the United States of America;
- Any bond, debenture, note, participation certificate or other similar obligation issued by any of the following agencies: GNMA, Federal Land Bank, Federal Home Loan Banks, Federal Intermediate Credit Banks, Federal Farm Credit Administration, Export-Import Bank and FNMA;
- Any other obligation of the United States of America or any federal agencies which may then be purchased with Agency funds or which are legal investments for savings banks, savings associations, or savings and loan associations in the Commonwealth;
- Public Housing Bonds issued by public agencies or municipalities and fully secured by a pledge of annual contributions under an annual contributions contract or contracts with the United States of America; or temporary notes, preliminary loans notes or project notes issued by public agencies or municipalities, in such case fully secured as to the payment of both principal and interest by a requisition or payment agreement with the United States of America;
- Direct and general obligations of or obligations guaranteed by the Commonwealth, to the payment of the principal of the interest on which the full faith and credit of the Commonwealth is pledged;
- Direct and general obligations of any state of the United States, to the payment of which the full faith and credit of such state are pledged, but only if such obligations are rated not less than "AA" by Standard & Poor's and "Aa" by Moody's Rating Service or, upon the discontinuance of either or both of such services, another nationally recognized rating service;
- Deposits in interest-bearing time or demand deposits, or certificates of deposit, fully secured as provided under the laws of the Commonwealth or by obligations described in the six bullet points above;
- Repurchase agreement with Primary Government Securities Dealers fully collateralized by Investment Securities of the types described in the first three bullet points above provided that such collateral is valued at least monthly and that such collateral as applicable is held by the trustee or a third party;
- Deposits in mutual or money market funds which invest solely in Investment Securities of the types described in the first three bullet points above and with total assets (deposited funds) of five hundred million dollars or greater;
- Commercial paper (except that of the Agency or an affiliate) or finance company paper rated "P-1" by Moody's Investors Service and "A-1+" by Standard & Poor's Corporation;

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

- Non-collateralized certificates of deposit with institutions rated not less than "Aa" by Moody's Investors Service and "AA" by Standard & Poor's Corporation;
- Investment agreements with an entity whose obligations are rated not less than "AA" by Standard & Poor's Corporation and "Aa" by Moody's Investor's Service, or which fully secure such agreements with securities described in the first three bullet points above; and
- Reverse repurchase agreements as applicable to Agency funds.

### ***Credit Risk***

The Agency mitigates its credit risk by limiting investments to those permitted in its deposit and investment policies, diversifying the investment portfolio and prequalifying firms with which the Agency conducts its investment activities.

The credit quality ratings of the Agency's investments for the year ended June 30, 2013, as determined by Moody's Investors Service, are shown below. \$193,352 of U.S. Government Agency Mortgage-Backed Securities, U.S. Government Agency Securities and U.S. Treasury securities, which are explicitly guaranteed by the U.S. Government, are not considered to have credit risk and, therefore, are not included in the summary.

<b>Investment Type</b>	<b>Fair</b>	<b>Credit Ratings</b>		
	<b>Value</b>	<b>Aaa</b>	<b>Ba1</b>	<b>Not Rated</b>
U.S. Government Agency Securities*	\$ 48,785	\$ -	\$ -	\$ 48,785
U.S. Government Agency Mortgage-Backed Securities	11,996	11,996	-	-
Bond Mutual Fund	8,393	-	-	8,393
SLM Corporate Bonds	3,640	-	3,640	-
	<u>\$ 72,814</u>	<u>\$ 11,996</u>	<u>\$ 3,640</u>	<u>\$ 57,178</u>

\* - Amounts are comprised of Tennessee Valley Authority bonds, which are implicitly guaranteed U.S. Government Securities.

Money market investments, reported as cash equivalents, with a book value of \$451,953 is rated Aaa by Moody's Investors Service.

### ***Custodial Credit Risk***

Custodial credit risk is the risk that, in the event of failure of the custodian or counterparty holding the investment, the Agency will not be able to recover the value of the investment. The Agency has not established a formal custodial credit risk policy for its investments. All of the Agency's investment balances are held by bank trust departments, acting as the counterparty, in book-entry form in the Agency's name and, accordingly, are subject to custodial credit risk.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

Money market investments equaling \$451,953, reported as cash equivalents, do not expose the Agency to custodial credit risk.

***Concentration of Credit Risk***

Concentration risk is the risk of loss attributed to the magnitude of the Agency's investment in a single investment issuer. The Agency has a concentration of credit risk with the Tennessee Valley Authority where the value of investments with this issuer is \$48,785 at June 30, 2013, which exceeds 5% of the total value of the investment portfolio.

Agency policy indicates that the proportion of investments in government securities shall not exceed 70% of the portfolio and the proration of investments in certificates of deposit shall not exceed 30% of the portfolio. At June 30, 2013, concentrations in government securities, which represented nearly 100% of the portfolio, exceed the policy. The departure from policy has written approval from the Executive Director, as permitted by the Agency Investment Policy and Guidelines. Concentration limits are not established in the bond indentures and governing agreements for trust investments.

***Interest Rate Risk***

The Agency's investment policy does not limit investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates. For the year ended June 30, 2013, the Agency had investments with the following maturities:

<b>Investment Type</b>	<b>Fair Value</b>	<b>Investment Maturities (in Years)</b>			
		<b>Less than 1</b>	<b>1-5</b>	<b>6-10</b>	<b>More than 10</b>
U.S. Government Agency Mortgage-backed Securities	\$ 193,987	\$ 6,009	\$ 13,970	\$ -	\$ 174,008
U.S. Government Agency Securities	49,307	204	261	50	48,792
U.S. Treasury Securities	10,838	-	10,838	-	-
Bond Mutual Fund	8,393	-	-	-	8,393
SLM Corporate Bonds	3,640	3,640	-	-	-
	<u>\$ 266,165</u>	<u>\$ 9,853</u>	<u>\$ 25,069</u>	<u>\$ 50</u>	<u>\$ 231,193</u>

Investments in mortgage-backed securities are sensitive to interest rate changes because, for example, borrowers have the option to prepay their mortgages. In addition to the amounts listed above, the Agency held money market investments with a fair value of \$451,953, reported as cash equivalents that have maturities of less than one year.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

---

**4. Mortgage Loans Receivable**

Mortgage loans receivable for the years ended June 30 consisted of the following:

	<u>2013</u>	<u>2012</u>
Multifamily Housing Program	\$ 591,269	\$ 623,430
Single Family Mortgage Loan Program	3,649,290	3,941,622
HEMAP	<u>102,454</u>	<u>106,288</u>
	4,343,013	4,671,340
Add:		
Loan premiums	36,291	34,911
Less:		
Loan discounts	2,777	2,777
Allowance for potential loan losses	<u>214,885</u>	<u>227,617</u>
Mortgage loans receivable, net	4,161,642	4,475,857
Less current portion	<u>104,826</u>	<u>117,215</u>
Long-term portion	<u>\$ 4,056,816</u>	<u>\$ 4,358,642</u>

Multifamily Housing Program mortgage loans receivable are collateralized by mortgages on the related projects. The federal government subsidizes certain projects included in the Multifamily Housing Program.

Single Family Mortgage Loan Program loans receivable are secured by liens on the related real property. Private mortgage insurance for single-family mortgage loans is provided by commercial companies, certain federal programs or the Agency's Insurance Fund. Private mortgage insurance is generally required on all mortgage loans where the loan principal amount exceeds 80% of the lesser of the purchase price or the initial appraised value of the property.

HEMAP loans are unsecured, being in a second or third lien position, as those loans are provided to mortgagors facing foreclosure because of circumstances beyond their control.

**Real Estate Owned by the Agency**

Included in the Single Family Mortgage Loan Program are 410 properties with a total mortgage loans receivable balance equaling \$28,199 at June 30, 2013 and 325 properties with a total mortgage loans receivable balance equaling \$20,343 at June 30, 2012. The Agency has acquired and is holding these properties for sale as a result of foreclosure, acceptance of a deed in lieu of foreclosure or other defaults of nonperforming mortgage loans.

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

### Allowance for Potential Loan Loss

The allowances for potential loan losses for the years ended June 30 consisted of the following:

	Multifamily Housing Program		Single Family Mortgage Loan Program		HEMAP	
	2013	2012	2013	2012	2013	2012
Beginning balance	\$ 168,655	\$ 169,000	\$ 8,400	\$ 7,946	\$ 50,562	\$ 45,956
Loss provision	4,419	3,000	6,751	5,000	8,448	10,976
Net charge-offs	(15,968)	(3,345)	(5,475)	(4,546)	(10,907)	(6,370)
Ending balance	<u>\$ 157,106</u>	<u>\$ 168,655</u>	<u>\$ 9,676</u>	<u>\$ 8,400</u>	<u>\$ 48,103</u>	<u>\$ 50,562</u>

### Securitizations and Gains on the Sale of Mortgage-Backed Securities

During the years ended June 30, 2013 and 2012, the Agency securitized mortgage loans with a principal balance of \$426,137 and \$196,610, respectively, into MBSs through GNMA and FNMA. MBSs are either sold to private investors or purchased by the Agency. Ongoing revenue for the Agency is generated by means of servicing the loans pooled into MBSs, which is reported as program income and fees, and by gains derived from the sale price less the value of the underlying mortgages of the MBSs at the time of settlement. Total gains on the sale of MBSs for the years ended June 30, 2013 and 2012 equaled \$21 million and \$14 million, respectively.

### Mortgage-Backed Security Repurchase Reserve

Mortgage loans securitized into MBSs through either GNMA or FNMA (“securitized loans”) are not included in the Agency’s financial statements. If a borrower fails to make a timely payment on a mortgage loan, the Agency must use its own funds to ensure that holders of Agency-issued MBSs receive timely payment. In circumstances of significant borrower delinquency, the Agency will repurchase a securitized loan from its respective MBS. Repurchased mortgage loans are included in the Agency’s financial statements; as a result, the risk of loss associated with these loans is considered in management’s routine evaluation of the allowances for potential loan losses, and the Agency has, therefore, established a repurchase reserve for these securitized loans. Securitized loans repurchased by the Agency totaled \$19,154 and \$6,874 for the years ended June 30, 2013 and 2012, respectively. The Agency’s repurchase reserve for securitized loans equaled \$2,014 and \$1,273 at June 30, 2013 and 2012, respectively. Repurchase reserve amounts are included within the Agency’s allowances for potential loan loss for those respective years.

### Insurance Fund

The Agency provides primary mortgage insurance to certain Single Family Mortgage Loan Program borrowers who are unable to obtain insurance from other sources. The coverage of this insurance ranges from 20% to 35% of the unpaid principal balance, depending on the loan-to-value ratio at origination. At June 30, 2013 and 2012, the total amount of mortgage loans insured by the Insurance Fund equaled \$298,269 and \$404,500, respectively.

# PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

## Insurance Fund Claims Liability

U.S. GAAP requires the basis for estimating the liability for unpaid claims to include the effects of specific incremental claim adjustment expenses and estimated recoveries. In addition, it requires disclosure of whether other allocated or unallocated claim adjustment expenses are included. The Agency establishes the estimated claims payable liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related loss adjustment expenses, based on the Agency's past claim experience. Claims are not discounted and are net of estimated recoveries.

Changes in the Insurance Fund's claim liability consisted of the following for the years ended June 30:

	<u>2013</u>	<u>2012</u>
Beginning balance	\$ 3,040	\$ 2,511
Current year estimated claims payable	600	600
Claim payments	<u>(377)</u>	<u>(71)</u>
Total claim liability	3,263	3,040
Less current portion	<u>300</u>	<u>300</u>
Long-term portion	<u>\$ 2,963</u>	<u>\$ 2,740</u>

## 5. Mortgage Servicing Rights/Service Release Premiums

The Agency pays a fee to its participating lenders to release mortgage servicing rights pertaining to each mortgage loan it purchases for its Single Family Mortgage Loan Program. During the years ended June 30, 2013 and 2012, the Agency capitalized mortgage servicing rights/service release premiums totaling \$6,643 and \$3,126, respectively. Mortgage servicing rights/servicing release premiums are amortized over the life of the related loans using the effective interest method, and include servicing rights associated with both mortgages owned by the Agency and mortgages sold by the Agency by means of MBS securitization. Amortization of mortgage servicing rights/servicing release premiums equaled \$4,801 and \$1,526 for the years ended June 30, 2013 and 2012, respectively. Unamortized mortgage servicing rights/service release premiums totaling \$34,134 and \$32,740 were outstanding at June 30, 2013 and 2012, respectively. Included in these amounts were mortgage servicing rights totaling \$7,679 and \$3,384 at June 30, 2013 and 2012, respectively, which relate to loans sold by the Agency for which the Agency retained the servicing rights.

Mortgage servicing rights retained by the Agency upon the sale of the underlying loan are reported at the lower of amortized cost or fair value, where amortized cost equals the remaining unamortized balance of the service release premium paid and fair value equals the present value of the net estimated future servicing income. For the years ended June 30, 2013 and 2012, no adjustments to the balances of mortgage servicing rights/service release premiums were warranted, as the unamortized balances of the servicing rights were less than the fair values.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)***6. Capital Assets**

Capital assets activity for the year ended June 30, 2013 and a summary of balances were as follows:

	<b>July 01, 2012</b>	<b>Additions</b>	<b>Deletions</b>	<b>June 30, 2013</b>
<b>Nondepreciable Capital Assets:</b>				
Land	\$ 2,454	\$ -	\$ -	\$ 2,454
<b>Depreciable Capital Assets:</b>				
Building	29,845	263	(12)	30,096
Furniture, fixtures and equipment	10,348	276	(212)	10,412
Less accumulated depreciation:				
Building	(5,450)	(554)	-	(6,004)
Furniture, fixtures and equipment	(5,673)	(609)	203	(6,079)
Total depreciable capital assets, net	<u>29,070</u>	<u>(624)</u>	<u>(21)</u>	<u>28,425</u>
<b>Total Capital Assets, net</b>	<u>\$ 31,524</u>	<u>\$ (624)</u>	<u>\$ (21)</u>	<u>\$ 30,879</u>

Capital assets activity for the year ended June 30, 2012 and a summary of balances were as follows:

	<b>July 01, 2011</b>	<b>Additions</b>	<b>Deletions</b>	<b>June 30, 2012</b>
<b>Nondepreciable Capital Assets:</b>				
Land	\$ 2,454	\$ -	\$ -	\$ 2,454
<b>Depreciable Capital Assets:</b>				
Building	29,882	37	(74)	29,845
Furniture, fixtures and equipment	10,229	337	(218)	10,348
Less accumulated depreciation:				
Building	(4,889)	(561)	-	(5,450)
Furniture, fixtures and equipment	(5,237)	(654)	218	(5,673)
Total depreciable capital assets, net	<u>29,985</u>	<u>(841)</u>	<u>(74)</u>	<u>29,070</u>
<b>Total Capital Assets, net</b>	<u>\$ 32,439</u>	<u>\$ (841)</u>	<u>\$ (74)</u>	<u>\$ 31,524</u>

Depreciation expense for the years ended June 30, 2013 and 2012 totaled \$1,163 and \$1,215, respectively.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

**7. Bonds and Notes Payable**

General Fund bonds and notes outstanding for the years ended June 30 consisted of the following:

<b>Description of Bonds and Notes as Issued</b>	<b>Maturity Date</b>	<b>Amounts Outstanding</b>	
		<b>2013</b>	<b>2012*</b>
Variable Rate Building Development Bonds	2034	\$ 20,000	\$ 20,000
General Obligation Note	2023	20,000	-
Total bonds and notes payable		40,000	20,000
Less current portion		1,000	-
Long-term portion		<u>\$ 39,000</u>	<u>\$ 20,000</u>

Multifamily Housing Program bonds outstanding for the years ended June 30 consisted of the following:

<b>Description of Bonds as Issued</b>	<b>Maturity Date</b>	<b>Amounts Outstanding</b>	
		<b>2013</b>	<b>2012*</b>
Residential Development Refunding Bonds			
2002 Issue A/B, 1.80-5.25%	2024	\$ -	\$ 12,565
Rental Housing Refunding Bonds			
Series 2008A/B, variable rate	2021	-	23,360
Series 2008C/D, variable rate	2020	-	51,335
Series 2012, .42-1.57%	2016	42,410	-
Multifamily Development Bonds			
Issue 1998H, 6.30%	2028	-	4,075
Issue 2005K, variable rate	2036	23,190	23,890
Multifamily Development Refunding Bonds			
Issue 1993A, 5.38%	2022	-	5,000
Issue 2003, 3.25-4.80%	2019	5,445	6,775
Subordinate Limited Obligation Bonds			
Issue 1995, 5.50-6.15%	2021	1,584	1,763
		<u>72,629</u>	<u>128,763</u>
Unamortized deferred loss of refundings		<u>(1,376)</u>	<u>(1,825)</u>
Total bonds payable		71,253	126,938
Less current portion		14,872	20,324
Long-term portion		<u>\$ 56,381</u>	<u>\$ 106,614</u>

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

Single Family Mortgage Loan Program bonds and notes outstanding for the years ended June 30 consisted of the following:

<b>Description of Bonds and Notes as Issued</b>	<b>Maturity Date</b>	<b>Amounts Outstanding</b>	
		<b>2013</b>	<b>2012*</b>
<b>Single Family Mortgage Revenue Bonds</b>			
Series 1999 - 65, 3.25-5.25%	2030	\$ -	\$ 20,000
Series 1999 - 67, 4.05-7.51%	2030	14,900	15,830
Series 2000 - 69, 4.35-6.25%	2031	19,795	20,315
Series 2000 - 70, 4.30-5.90%	2032	14,805	15,450
Series 2001 - 72, 3.25-5.35%	2032	40,810	41,905
Series 2002 - 73, 1.75-5.45%	2033	20,075	20,695
Series 2002 - 74, variable rate	2032	-	62,135
Series 2002 - 75, variable rate	2033	30,000	77,030
Series 2003 - 77, variable rate	2033	22,515	59,930
Series 2003 - 78, variable rate	2025	45,780	48,940
Series 2003 - 79, variable rate	2034	57,350	63,805
Series 2004 - 81, variable rate	2034	26,675	66,460
Series 2004 - 82, variable rate	2034	56,720	63,495
Series 2004 - 83, variable rate	2035	33,335	40,055
Series 2004 - 84, variable rate	2034	22,715	27,495
Series 2004 - 85, variable rate	2035	74,825	80,945
Series 2004 - 86, variable rate	2035	33,505	42,335
Series 2005 - 87, variable rate	2035	84,690	87,025
Series 2005 - 88, variable rate	2037	60,410	69,470
Series 2005 - 89, variable rate	2035	56,385	63,485
Series 2005 - 90, variable rate	2036	93,730	97,765
Series 2005 - 91, variable rate	2036	97,255	101,260
Series 2006 - 92, variable rate	2036	109,160	113,095
Series 2006 - 93, variable rate	2037	56,835	69,415
Series 2006 - 94, variable rate	2037	35,925	83,185
Series 2006 - 95, variable rate	2037	54,730	116,030
Series 2006 - 96, 3.60-5.72%	2037	122,300	133,500
Series 2007 - 97, 3.50-5.50%	2037	116,360	127,665
Series 2007 - 98, variable rate	2037	90,540	130,585

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

Single Family Mortgage Loan Program bonds and notes outstanding for the years ended June 30 consisted of the following: (continued)

<b>Description of Bonds and Notes as Issued</b>	<b>Maturity Date</b>	<b>Amounts Outstanding</b>	
		<b>2013</b>	<b>2012*</b>
Series 2007 - 99, 3.70-5.30%	2038	\$ 40,670	\$ 95,425
Series 2007 - 100, 3.40-5.35%	2038	32,445	65,700
Series 2007 - 101, variable rate	2038	20,600	22,495
Series 2007 - 102, variable rate	2038	48,545	55,425
Series 2008 - 103, 2.00-5.70%	2038	14,930	53,545
Series 2009 - 105, .80-5.00%	2039	117,440	186,480
Series 2009 - 106, .50-4.80%	2040	224,995	236,410
Series 2009 - 107, 3.96%	2041	574,800	596,780
Series 2010 - 108, .375-4.75%	2028	126,175	131,520
Series 2010 - 109, .45-4.50%	2028	90,115	97,280
Series 2010 - 110, .45-4.75%	2039	219,725	233,965
Series 2011 - 112, .375-5.00%	2028	142,635	152,675
Series 2011 - 113, .50-4.85%	2041	78,665	81,120
Series 2012 - 114, .40-3.70%	2042	226,310	-
Series 2013 - 115, .20-4.35%	2043	137,905	-
2007 Note Purchase Agreement, 2.5%	2017	2,500	2,500
2009 Note Purchase Agreement, 2.5%	2019	1,000	1,000
2009 Note Purchase Agreement, 2.5%	2024	2,500	2,500
		<u>3,594,080</u>	<u>3,974,120</u>
Unamortized deferred loss of refundings		(11,262)	(13,102)
Unamortized bond premium		<u>8,652</u>	<u>10,426</u>
Total bonds and notes payable		3,591,470	3,971,444
Less current portion		<u>65,910</u>	<u>61,940</u>
Long-term portion		<u>\$ 3,525,560</u>	<u>\$ 3,909,504</u>

\* - See **Reclassifications** section of **NOTE 2 - Summary of Significant Accounting Policies** respective of unamortized underwriters' fees.

Interest paid on indexed floating-rate tax-exempt bonds is closely correlated with either the Securities Industry and Financial Markets Association Municipal Swap ("SIFMA") rate or the London Interbank Offered Rate ("LIBOR"). Rate resets typically occur quarterly, monthly or weekly.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)***Debt Service Requirements**

The approximate principal and interest payments required on all outstanding bonds and notes over the next five years and thereafter are as follows:

<b>Fiscal Year</b>	<b>General Fund</b>		<b>Multifamily Housing Program</b>		<b>Single Family Mortgage Loan Program</b>		<b>Total</b>
	<b>Principal</b>	<b>Interest</b>	<b>Principal</b>	<b>Interest</b>	<b>Principal</b>	<b>Interest</b>	
2014	\$ 1,000	\$ 404	\$ 14,872	\$ 671	\$ 65,910	\$ 102,454	\$ 185,311
2015	2,350	847	14,467	549	94,730	101,444	214,387
2016	2,365	756	14,198	392	117,290	99,166	234,167
2017	2,380	666	7,320	201	120,910	96,351	227,828
2018	2,400	576	1,433	136	127,945	93,393	225,883
2019-2023	12,260	1,524	4,874	443	732,130	411,427	1,162,658
2024-2028	3,790	76	5,220	294	732,885	309,638	1,051,903
2029-2033	3,455	42	6,550	166	698,255	201,716	910,184
2034-2038	10,000	7	3,695	24	666,460	99,267	779,453
2039-2043	-	-	-	-	237,565	14,583	252,148
	<u>\$ 40,000</u>	<u>\$ 4,898</u>	<u>\$ 72,629</u>	<u>\$ 2,876</u>	<u>\$ 3,594,080</u>	<u>\$ 1,529,439</u>	<u>\$ 5,243,922</u>

**Early Extinguishment of Debt**

During the years ended June 30, 2013 and 2012, the Agency redeemed principal amounts of certain bonds totaling \$705,230 and \$431,750, respectively, prior to their scheduled maturity, through the use of mortgage prepayments and excess funds. Net losses of \$3,646 and \$2,549 on early extinguishments of debt have been recorded as an expense for the years ended June 30, 2013 and 2012, respectively. Losses arise because of the immediate recognition of deferred bond issuance costs and discounts that would have otherwise been amortized over the life of the related bond issues had they not been retired.

**Advance Refunding**

In prior years, the Agency effected an advanced refunding where the proceeds of issued bonds were used to defease outstanding debt of the Agency. The Agency defeased Multifamily Residential Development Bonds, Issue H in prior years. The result is an in-substance defeasance whereby the Agency purchased securities, which were deposited into an irrevocable trust with an escrow agent, to provide for future debt service payments on the refunded bonds. The defeased principal outstanding equaled \$2,725 at June 30, 2013 and 2012.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)***Current Refunding**

During the year ended June 30, 2013, the Agency performed the following refunding activities:

	<u>Series Issued</u>	<u>Series Refunded</u>	<u>Amount Issued/ Refunded</u>	<u>Economic Gain/(Loss)*</u>	<u>Debt Service Payments Decrease/ (Increase)</u>
Rental Housing Refunding Bonds	2012	2008	\$ 47,785	\$ 1,006	\$ 1,024
Single Family Mortgage Revenue Bonds	114	65A	\$ 11,285	\$ 1,794	\$ 2,253
	114	65B	6,440	805	837
	114	74B	60,540	10,018	15,401
	114	75B	45,860	7,116	11,605
	114	79A	5,585	292	300
	Total Series 114:		<u>\$ 129,710</u>	<u>\$ 20,025</u>	<u>\$ 30,396</u>
Single Family Mortgage Revenue Bonds	115	77B	\$ 36,095	\$ (2,727)	\$ (5,748)
	115	81C	36,070	(174)	(386)
	115	86B	6,335	(17)	(39)
	115	89	7,100	125	286
	115	95C	12,665	753	1,209
	115	98C	24,050	1,705	4,140
	115	100C	5,590	414	1,018
	Total Series 115:		<u>\$ 127,905</u>	<u>\$ 79</u>	<u>\$ 480</u>

\* - Represents the difference between the present value of the refunded debt service payments and new debt service payments

The Agency did not refund any bonds during the year ended June 30, 2012.

**Hedging Derivative Instrument Payments and Hedged Debt**

Debt service requirements of the Agency's outstanding variable-rate debt and net swap payments of the associated hedging derivative instruments at June 30, 2013 are displayed in the following schedule. The following incorporates variable rate values at June 30, 2013, which are subject to change in future periods. The net swap payment equals the difference between the fixed rate of interest paid to the counterparties and the variable rate of interest received by the Agency. See Note 8 for further information on derivative instruments.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

<b>Fiscal Year Ending June 30</b>	<b>Hedged Variable Rate Bond Principal</b>	<b>Hedged Variable Rate Bond Interest</b>	<b>Net Swap Payments</b>	<b>Total</b>
2014	\$ 5,805	\$ 2,914	\$ 29,305	\$ 38,024
2015	12,295	2,897	28,469	43,661
2016	22,755	2,870	27,550	53,175
2017	28,160	2,803	26,434	57,397
2018	32,310	2,725	25,274	60,309
2019-2023	217,565	12,243	107,797	337,605
2024-2028	247,455	9,365	75,759	332,579
2029-2033	201,425	5,582	40,492	247,499
2034-2038	162,660	1,179	6,629	170,468
	<u>\$ 930,430</u>	<u>\$ 42,578</u>	<u>\$ 367,709</u>	<u>\$1,340,717</u>

**Conduit Debt Obligations**

The Agency did not issue any conduit debt obligations during the year ended June 30, 2013.

During the year ended June 30, 2012, the Agency issued Series 2011-S Special Limited Obligation Multifamily Housing Development Notes in the amount of \$8,000 to fund the construction and renovation of Cumberland Gardens - Phase 1 in Allentown, Pennsylvania. The notes are special limited obligations of the Agency payable solely from the trust estate pledged by the Allentown public housing authority and secured by the property financed.

In prior years, the Agency issued series 2003J, 2008M and 2008O Special Limited Obligation Bonds to provide financing to local public housing authorities for construction or preservation of affordable housing within the Commonwealth of Pennsylvania. The bonds are secured by the properties financed and are payable solely from income generated by the local public housing authorities. The Agency also issued series 2005A Capital Fund Securitization Revenue Bonds to provide for financial assistance to various local public housing authorities. The bonds are secured by the properties financed and are payable solely from appropriations to be paid by the United States Department of Housing and Urban Development.

These conduit debt obligations do not constitute a debt or pledge of the faith and credit of the Agency and, accordingly, have not been reported in the accompanying financial statements. At June 30, 2013 and 2012, conduit debt outstanding aggregated \$84,129 and \$86,778, respectively.

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### **Bond Covenants**

Significant bond covenants of the Agency include a capital reserve requirement for both the Multifamily Housing Program bonds and Single Family Mortgage Loan Program bonds and a self-insurance requirement for the Single Family Mortgage Loan Program bonds. The capital reserve requirement for the Multifamily Housing Program bonds obliges the Agency to maintain a balance of funds equal to one year's debt service. The capital reserve requirement for the Single Family Mortgage Loan Program bonds obliges the Agency to maintain a balance of funds equal to at least 3% of the aggregate principal amount of all Single Family Mortgage Loan Program bonds outstanding plus one million dollars. The self-insurance requirement for the Single Family Mortgage Loan Program bonds obliges the Agency to maintain a balance of funds equal to the following percentages of outstanding principal amounts of mortgage loans funded from the following respective series:

Series I and J: 2.00%

Series K: 1.10%

Series L through Series 2006-96: 2.00%

The Agency is not expected to fund or maintain the self-insurance requirement under the Single Family Mortgage Loan Program bond indenture in any amount with respect to any series of bonds issued after November 2006.

All bond covenant requirements regarding restricted cash and assets were met at years-ended June 30, 2013 and June 30, 2012.

### **Bonds Authorized But Not Yet Issued**

On June 13, 2013, the Agency Board authorized the issuance of Single Family Mortgage Revenue Bonds Series 2013-116 in an amount not to exceed \$300,000. Series 2013-116 had not been issued as of the date of these basic financial statements.

## **8. Derivatives**

In order to both reduce the Agency's overall cost of borrowing long-term capital and protect against the potential of rising interest rates, the Agency entered into pay-fixed, receive-variable interest rate swap agreements. The objective of the swaps is to hedge against changes in the cash flows of the associated variable-rate bonds series.

Swaps are recorded and reported as either a hedging derivative instrument or investment derivative instrument based upon the effectiveness of the agreements to hedge against interest rate exposure associated with variable-rate debt. The regression analysis method is used to determine whether the swaps are an effective hedge. The fair value of hedging derivative instruments is reported as Derivative Instrument – Interest Rate Swaps and Deferred Swap Borrowing. The changes in fair values are reported as Deferred Outflow of Resources. A swap

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

deemed an ineffective hedging mechanism is considered to be an investment derivative instrument. The fair value of investment derivative instruments is reported Derivative Instrument – Interest Rate Swaps and Deferred Swap Borrowing; however, the changes in fair value are no longer a deferred outflow of resources, but recognized as investment revenue or expense.

Fair values are obtained from mark to market statements provided by a third party and represent mid-market valuations that approximate the current economic value using market averages, reference rates and/or mathematical models. The fair value represents the current price to settle the swaps in the marketplace if the swaps were to be terminated.

Because interest rates have generally decreased since the swaps became effective, all of the Agency's swaps have a negative fair value as of June 30, 2013. Changes in fair values are countered by reductions or increases in total interest payments required under variable-rate bonds. Given that payments on the Agency's variable-rate bonds adjust to changing interest rates, the associated debt does not have corresponding increases in fair value.

Each of the Agency's swaps requires the Agency to post collateral in the event the fair value of the swap falls below specific thresholds of negative worth. As of June 30, 2013, the Agency was not required to post collateral for any of its outstanding swaps.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)***Hedging Derivative Instruments**

The objective of the Agency's hedging derivative instruments is to hedge against changes in the cash flows on the associated variable-rate bonds series. The terms and other information of the Agency's hedging derivative instruments outstanding for June 30, 2013 were as follows:

<b>Bond Series</b>	<b>Notional Amount</b>	<b>Effective Date</b>	<b>Maturity Date</b>	<b>Fixed Rate Paid</b>	<b>Variable Rate Received</b>
1999-67B	\$ 14,700	7/2002	4/2029	5.950%	100% of USD-LIBOR + 50 bps
2001-72C	7,285	9/2001	10/2023	5.695	100% of USD-LIBOR
2003-77B <sup>1</sup>	22,515	4/2013	10/2033	2.470	Enhanced LIBOR
2003-79B <sup>1</sup>	57,350	10/2010	10/2033	3.992	65% of USD-LIBOR + 0.25 bps
2004-81C <sup>1</sup>	26,220	4/2013	10/2034	3.346	Enhanced LIBOR
2004-82B	29,470	5/2004	10/2030	3.643	61% of USD-LIBOR + 0.39 bps
2004-82C <sup>1</sup>	32,195	4/2013	10/2034	3.420	61% of USD-LIBOR + 0.39 bps
2004-83B	12,495	8/2004	10/2019	3.410	65% of USD-LIBOR + 0.25 bps
2004-83C <sup>1</sup>	24,790	4/2012	10/2028	3.830	65% of USD-LIBOR + 0.25 bps
2004-84D <sup>1</sup>	22,715	4/2012	10/2034	3.320	Enhanced LIBOR
2004-85B	11,885	11/2004	4/2019	3.168	65% of USD-LIBOR + 0.25 bps
2004-85C <sup>1</sup>	44,645	4/2013	10/2035	3.291	65% of USD-LIBOR + 0.25 bps
2004-86B <sup>1</sup>	33,505	4/2013	10/2033	3.397	Enhanced LIBOR
VRDB2004	20,000	2/2004	1/2034	3.945	65% of USD-LIBOR + 0.25 bps
2005-87B	23,035	3/2005	10/2023	3.460	65% of USD-LIBOR + 0.25 bps
2005-87C <sup>1</sup>	47,300	4/2013	10/2035	3.328	65% of USD-LIBOR + 0.25 bps
2005-88B	39,290	5/2005	10/2035	3.500	61% of USD-LIBOR + 0.39 bps
2005-88C <sup>1</sup>	27,930	4/2013	10/2035	2.726	61% of USD-LIBOR + 0.39 bps
2005-89 <sup>1</sup>	48,915	4/2013	10/2035	3.605	Enhanced LIBOR
2005-90C <sup>1</sup>	56,585	4/2012	4/2035	3.692	65% of USD-LIBOR + 0.25 bps
2005-91B	70,000	12/2005	10/2036	3.953	Enhanced LIBOR
MF2005-K <sup>1</sup>	23,190	3/2005	1/2036	5.183	100% of USD-LIBOR
2006-92B	42,870	3/2006	10/2036	3.996	65% of USD-LIBOR + 0.25 bps
2006-93B	37,185	5/2006	4/2037	4.266	61% of USD-LIBOR + 0.39 bps
2006-94B	35,165	7/2006	4/2027	4.152	69% of USD-LIBOR
2006-95C <sup>1</sup>	6,850	4/2013	4/2026	3.519	65% of USD-LIBOR + 0.25 bps
2007-98C <sup>1</sup>	17,905	4/2013	10/2037	4.105	61% of USD-LIBOR + 0.39 bps
2007-99C	15,000	9/2007	10/2023	3.885	69% of USD-LIBOR
2007-100C	22,935	4/2013	4/2036	4.131	65% of USD-LIBOR + 0.25 bps

<sup>1</sup> = Indicates embedded options without a payment to the counterparty

USD LIBOR = 1-month London Interbank Offered Rate in American Dollars.

Enhanced LIBOR = 67% of 1-month USD LIBOR

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

The notional amounts, fair value balances and the changes in fair values of hedging derivative instruments outstanding as of June 30, 2013 were as follows:

<b>Bond Series</b>	<b>Notional Amount</b>	<b>Changes in Fair Value</b>		<b>Fair Values at June 30, 2013</b>	
		<b>Classification</b>	<b>Amount</b>	<b>Classification</b>	<b>Amount</b>
1999-67B	\$ 14,700	Deferred outflow	\$ 1,456	Hedging derivative	\$ (3,547)
2001-72C	7,285	Deferred outflow	572	Hedging derivative	(1,395)
2002-75A	-	Deferred outflow	658	Hedging derivative	-
2003-77B	22,515	Deferred outflow	456	Hedging derivative	(207)
2003-79B	57,350	Deferred outflow	3,209	Hedging derivative	(7,181)
2004-81C	26,220	Deferred outflow	1,045	Hedging derivative	(2,080)
2004-82B	29,470	Deferred outflow	928	Hedging derivative	(1,155)
2004-82C	32,195	Deferred outflow	53	Hedging derivative	(846)
2004-83B	12,495	Deferred outflow	391	Hedging derivative	(503)
2004-83C	24,790	Deferred outflow	1,568	Hedging derivative	(3,687)
2004-84D	22,715	Deferred outflow	991	Hedging derivative	(2,014)
2004-85B	11,855	Deferred outflow	348	Hedging derivative	(434)
2004-85C	44,645	Deferred outflow	849	Hedging derivative	(2,896)
2004-86B	33,505	Deferred outflow	1,665	Hedging derivative	(3,177)
VRDB2004	20,000	Deferred outflow	609	Hedging derivative	(563)
2005-87B	23,035	Deferred outflow	693	Hedging derivative	(1,200)
2005-87C	47,300	Deferred outflow	907	Hedging derivative	(3,213)
2005-88B	39,290	Deferred outflow	1,078	Hedging derivative	(2,199)
2005-88C	27,930	Deferred outflow	250	Hedging derivative	(168)
2005-89	48,915	Deferred outflow	1,703	Hedging derivative	(2,496)
2005-90C	56,585	Deferred outflow	1,500	Hedging derivative	(3,206)
2005-91B	70,000	Deferred outflow	2,011	Hedging derivative	(5,528)
MF2005-K	23,190	Deferred outflow	2,391	Hedging derivative	(5,059)
2006-92B	42,870	Deferred outflow	1,247	Hedging derivative	(3,458)
2006-93B	37,185	Deferred outflow	1,060	Hedging derivative	(3,097)
2006-94B	35,165	Deferred outflow	1,317	Hedging derivative	(4,142)
2006-95C	6,850	Deferred outflow	44	Hedging derivative	(301)
2007-98C	17,905	Deferred outflow	1,740	Hedging derivative	(1,079)
2007-99C	15,000	Deferred outflow	765	Hedging derivative	(2,160)
2007-100C	22,935	Deferred outflow	1,547	Hedging derivative	(2,968)
		Total	<u>33,051</u>	Total	<u>(69,959)</u>

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

(In thousands of dollars)

---

### ***Credit Risk***

At June 30, 2013, the Agency was not exposed to credit risk on its swaps because all agreements had negative fair values. The Agency's swaps rely upon the performance of counterparties. If interest rates rise and the fair values of the swaps become positive, the Agency may be exposed to credit risk on those agreements – the risk that the counterparty fails to perform according to contractual obligations.

### ***Basis Risk and Interest Rate Risks***

The Agency is exposed to basis risk to the extent the changes in the index rates associated with the Agency's variable-rate bonds do not exactly offset the changes in the index rates associated with the corresponding swaps. The Agency is exposed to interest rate risk on all of its swaps. As the LIBOR index decreases, the Agency's net payments on the swaps increase.

### ***Rollover Risk***

Rollover risk is the risk that a swap associated with a bond issue does not extend to the maturity of that debt, thereby creating unhedged variable-rate debt. The following swaps expose the Agency to rollover risk:

<b><u>Associated Bond Issue</u></b>	<b><u>Debt Maturity Dates</u></b>	<b><u>Swap Termination Dates</u></b>
2001-72C	10/2032	10/2023
2004-83B	10/2025	10/2019
2004-85B	10/2031	04/2019
2005-87B	10/2031	10/2023
2005-88C	04/2037	10/2035
2005-90C	04/2036	04/2035
2007-100C	10/2036	04/2036

### ***Termination Risk***

The Agency maintains the option to terminate its swaps at anytime, while the Agency or the counterparty may terminate a swap if either party fails to perform under the terms of the agreement. If a swap has a negative fair value at the time of termination, the Agency would be liable to the counterparty for an amount equal to that negative fair value. In certain instances, the Agency has embedded par termination rights within its swaps which enable it to exercise terminations without liability for negative fair value.

### ***Investment Derivative Instruments***

The balances of the variable rate bonds associated with swaps 2004-84C, 2008-104#1, 2008-104#2, 2008-104#4, RH2008A&B, RH2008C and RH2008D were either redeemed in total or refunded by fixed-rate bonds; therefore, the associated swaps are no longer a hedge against variable rate debt. As a result, these swaps are considered investment derivative instruments.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

The terms and other relevant information respective of the aforementioned investment derivative instruments outstanding at June 30, 2013 were as follows:

<b>Bond Series</b>	<b>Notional Amount</b>	<b>Effective Date</b>	<b>Maturity Date</b>	<b>Fixed Rate Paid</b>	<b>Variable Rate Received</b>
2004-84C	6,425	9/2004	4/2018	3.115	Enhanced LIBOR
2008-104#1	3,495	12/2007	10/2013	4.471	100% of USD-LIBOR
2008-104#2	3,975	3/2007	10/2014	4.922	100% of USD-LIBOR
2008-104#4	15,615	9/2007	4/2015	5.149	100% of USD-LIBOR
RH2008A&B <sup>1</sup>	22,470	12/2011	1/2021	3.407	67% of 1Week USD-LIBOR
RH2008C <sup>1</sup>	30,135	6/2003	7/2020	3.457	70% of USD-LIBOR
RH2008D <sup>1</sup>	18,080	6/2011	7/2020	3.440	70% of USD-LIBOR

USD LIBOR = 1-month London Interbank Offered Rate in American Dollars.

Enhanced LIBOR = 67% of 1-month USD LIBOR

Because of early redemptions of the associated variable-rate debt, swap 2004-82B had an outstanding notional amount in excess of the related hedged variable-rate bond balance at June 30, 2013. The portion of the swap's notional amount in excess of the outstanding variable-rate debt is considered an investment derivative instrument for financial reporting purposes.

The terms and other information of hedging derivative instruments that have notional amounts exceeding their related outstanding debt at June 30, 2013 were as follows:

<b>Bond Series</b>	<b>Notional Amount Exceeding Outstanding Debt</b>	<b>Effective Date</b>	<b>Maturity Date</b>	<b>Fixed Rate Paid</b>	<b>Variable Rate Received</b>
2004-82B	2,145	5/2004	10/2030	3.643	61% of USD-LIBOR+ 39bps

<sup>1</sup> = Indicates embedded options without a payment to the counterparty

USD LIBOR = 1-month London Interbank Offered Rate in American Dollars.

bps = Basis points

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

The changes in fair value of the investment derivatives for the year ended June 30, 2013 are shown below and are presented as a net increase (decrease) in fair value of swaps on the Statements of Revenues, Expenses and Changes in Net Position.

<b>Bond Series</b>	<b>Notional Amount</b>	<b><u>Changes in Fair Value</u></b>		<b><u>Fair Values at June 30, 2013</u></b>	
		<b>Classification</b>	<b>Amount</b>	<b>Classification</b>	<b>Amount</b>
2004-81B	\$ -	Investment revenue	\$ 13	Investment derivative	\$ -
2004-82B	2,145	Investment revenue	47	Investment derivative	(65)
2004-84C	6,425	Investment revenue	199	Investment derivative	(245)
2005-88B	-	Investment revenue	46	Investment derivative	-
2008-104#1	3,495	Investment revenue	510	Investment derivative	(75)
2008-104#2	3,975	Investment revenue	315	Investment derivative	(158)
2008-104#4	15,615	Investment revenue	1,089	Investment derivative	(893)
RH2008A,B	22,470	Investment revenue	834	Investment derivative	(1,995)
RH2008C	30,135	Investment revenue	1,137	Investment derivative	(2,687)
RH2008D	18,080	Investment revenue	679	Investment derivative	(1,602)
		Total	<u>4,869</u>	Total	<u>(7,720)</u>

***Credit Risk***

At June 30, 2013, the Agency was not exposed to credit risk because all of its swaps had negative fair values.

***Interest rate risk***

The Agency is exposed to interest rate risk on all of its swaps. As the LIBOR index decreases, the Agency's net payments on the swaps increase.

**Termination Events**

At various times during the year ended June 30, 2013 the Agency exercised options, which had been embedded within effective hedging derivative instruments, in efforts to take advantage of the economic benefits associated with reducing the semiannual fixed payments to counterparties for 7 (seven) of its swaps. Swaps 2003-77B, 2004-81C, 2004-82C, 2004-85C, 2005-87C, 2005-88C, and 2006-95C were amended during the year ended June 30, 2013.

The aforementioned options were embedded within the respective swaps at the time the agreements were entered into, and there existed a cost to the Agency to have these rights embedded. As a result, these options were considered to be an additional element of value within each swap. Exercising these options, however, ultimately changed the critical terms of the associated swap. U.S. GAAP dictates that such changes trigger a termination of hedge accounting. In the instance of a termination event, amounts previously deferred and reported as an accumulated decrease in the fair value of hedging derivatives are to be recognized as an item of income or expense – depending on the fair value of the swap at the time of termination.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

Simultaneously, the fair values of swaps at the time of termination are to be reclassified from Derivative Instrument – Interest Rate Swaps to Deferred Swap Borrowings. The balance of the deferred swap borrowings are then amortized and recognized as a component of operating income over the lives of the underlying swaps in order to recoup the effects of termination events over time. Amortization of deferred swap borrowing balances for the years ended June 30, 2013 and 2012 equaled \$769 and \$1,134, respectively.

Deferred swap borrowing activity for the years ended June 30, 2012 and 2013 reflected the following:

	<b>Multifamily Housing Program</b>	<b>Single Family Mortgage Loan Program</b>	<b>Total</b>
Deferred Swap Borrowing Balance at June 30, 2011	\$ -	\$ -	\$ -
Interest Rate Swap Values at Time of Termination	(3,034)	(34,953)	(37,987)
Gain/(Loss) on 2011/2012 Swap Terminations	(26)	10,733	10,707
Amortization	313	821	1,134
Deferred Swap Borrowing Balance at June 30, 2012	\$ (2,747)	\$ (23,399)	\$ (26,146)
Gain on 2012/2013 Swap Terminations	-	3,370	3,370
Amortization	323	446	769
Deferred Swap Borrowing Balance at June 30, 2013	<u>\$ (2,424)</u>	<u>\$ (19,583)</u>	<u>\$ (22,007)</u>

Gains or losses resulting from termination events occurring during the year ended June 30, 2012 were reported as special items on the Statements of Revenues, Expenses, and Changes in Net Position because they were infrequent in occurrence. The Agency maintains contractual rights to exercise options of this nature within nearly all of its swaps. Because similar events occurred during the year ended June 30, 2013 and are anticipated to occur during the remaining lives of the associated swaps, provided it is economically advantageous for the Agency to exercise the embedded options, these events can no longer be deemed special items. As a result, amounts deriving from termination events occurring during the year ended June 30, 2013 are reported as gains on swap terminations. Gains on swap terminations during the year ended June 30, 2013 totaled \$3,370. The equivalent transactions reported as a special item for the year ended June 30, 2012 totaled \$27,280.

Consistent with the year ended June 30, 2012, the amended swaps continued to be effective hedging derivative instruments as of June 30, 2013.

The effects of the termination events described above and the ultimate effects on the Agency's net position represent non-cash transactions. At no time did the Agency either receive, relinquish or exchange cash or any other monetary assets as a result of swap termination events.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)***9. Long-Term Liabilities**

Long-term liability activity for the year ended June 30, 2013 was as follows:

	<b>Beginning</b>			<b>Ending</b>	<b>Due Within</b>
	<b>Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance</b>	<b>One Year</b>
Bonds payable, net	\$4,112,382	\$ 418,255	\$ 853,914	\$3,676,723	\$ 81,782
Notes payable	6,000	20,000	-	26,000	-
Development reserves and escrow deposits	158,315	299,903	313,999	144,219	63,229
Other liabilities	263,815	418,125	412,319	269,621	8,763
<b>Total net long-term liabilities</b>	<b>\$4,540,512</b>	<b>\$1,156,283</b>	<b>\$1,580,232</b>	<b>\$4,116,563</b>	<b>\$ 153,774</b>

Long-term liability activity for the year ended June 30, 2012 was as follows:

	<b>Beginning</b>			<b>Ending</b>	<b>Due Within</b>
	<b>Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance</b>	<b>One Year</b>
Bonds payable, net *	\$4,592,511	\$ 81,087	\$ 561,216	\$4,112,382	\$ 82,264
Notes payable	6,000	-	-	6,000	-
Development reserves and escrow deposits	174,166	290,473	306,324	158,315	72,624
Other liabilities	245,057	435,061	416,303	263,815	7,014
<b>Total net long-term liabilities</b>	<b>\$5,017,734</b>	<b>\$ 806,621</b>	<b>\$1,283,843</b>	<b>\$4,540,512</b>	<b>\$ 161,902</b>

\* - Consistent with the reclassification of unamortized balances of underwriters' fees at June 30, 2012, described in **Note 2 – Summary of Significant Accounting Policies**, \$20.3 million of unamortized underwriters' fees previously reported as unamortized bond discounts and premiums have been reclassified from a component of Bonds Payable, Net to Deferred Costs of Bond Issuance, a component of Other Noncurrent Assets, at July 1, 2011 for purposes of this schedule and consistency of presentation.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

---

**10. Restricted and Designated Net Position**

The Multifamily Housing and the Single Family Mortgage Loan Program's June 30, 2013 net position restrictions equaling \$492 and \$135,813, respectively, are restricted pursuant to the Agency's agreements with its bondholders; provisions are present within certain Multifamily Housing Program bond issues and the Single Family Mortgage Loan Program bond indenture.

The Agency has designated certain amounts of the unrestricted net position of the Agency's various programs for purposes indicated in the following table. These designations of net position are not binding and may be changed by the Agency.

<b>General Fund:</b>	<b>2013</b>	<b>2012</b>
Homeownership Choice to fund housing opportunity in urban areas	\$ 7,500	\$ 15,000
Special Initiatives to provide below market rate financing	-	11,850
Single Family Insurance to fund special hazard losses by homeowners	16,500	16,500
Homebuyer Counseling for education of first-time homebuyers	1,500	3,000
Multifamily Insurance for Agency insured or coinsured developments	10,000	10,000
Total	<u>\$ 35,500</u>	<u>\$ 56,350</u>
<b>Multifamily Housing Program:</b>		
Penn HOMES Program to lower development costs for apartments	\$ 75,000	\$ 70,900
Preservation from physical deterioration, financial or social distress	3,000	3,000
Energy Efficiency Improvements - energy usage reduction initiatives	250	-
Total	<u>\$ 78,250</u>	<u>\$ 73,900</u>
<b>Single Family Mortgage Loan Program:</b>		
Closing Cost Assistance	\$ 5,000	\$ 19,500
Utility Company Initiative to provide energy efficiency improvements	500	\$ -
Additional Single Family Insurance to reduce the risk of default on loans	2,455	2,455
Total	<u>\$ 7,955</u>	<u>\$ 21,955</u>
<b>Insurance Fund:</b>		
Risk Retention to provide single family mortgage insurance	<u>\$ 41,856</u>	<u>\$ 40,170</u>

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

---

**11. Interfund Balances and Interfund Transfers**

To meet liquidity requirements of the individual funds and programs, the Agency transfers monies among its funds and programs for mortgage related activities, debt service payments or to reimburse the General Fund for payments of shared services. Amounts due to or from other funds result mainly from the timing difference between when services are provided and when reimbursements are made. Interfund balances and transfers are summarized below for the years ended June 30, 2013 and 2012:

<b>Due from other funds:</b>	<b><u>2013</u></b>	<b><u>2012</u></b>
General Fund	\$ 126,267	\$ 49,514
Multifamily Housing Program	21,808	30,123
	<u>\$ 148,075</u>	<u>\$ 79,637</u>
<b>Due to other funds:</b>		
Single Family Mortgage Loan Program	<u>\$ 148,075</u>	<u>\$ 79,637</u>
<b>Interfund transfers in:</b>		
General Fund	\$ -	\$ 6,100
Single Family Mortgage Loan Program	28,317	2,730
	<u>\$ 28,317</u>	<u>\$ 8,830</u>
<b>Interfund transfers out:</b>		
General Fund	24,564	-
Multifamily Housing Program	3,753	8,830
	<u>\$ 28,317</u>	<u>\$ 8,830</u>

**12. Pension Plans**

**Plan Description**

Substantially all eligible full-time employees are participants in the Pennsylvania Housing Finance Agency Employees' Retirement Plan ("Plan") or Government Excess Benefit Plan ("Excess Plan"), which are both defined benefit single employer plans. The Plan and Excess Plan do not issue stand-alone statements.

Full-time employees become eligible for participation in the Plan after completion of one year of service. A participant's benefits vest upon the completion of five years of service. Under the provisions of the Plan, participants with prior military service may receive credit for their time of service providing they contribute funds equivalent to the cost of their pension benefits accumulated during their military service. A participant is eligible for normal retirement after attainment of age 65, or age 55 and completion of 30 years of service, or at any age after completion of 35 years of service. The Plan also provides early and late retirement provisions

## PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

---

and death and disability benefits. The normal retirement pension is payable monthly during the participant's lifetime with payments ceasing upon the participant's death.

All participants in the Plan who will receive retirement benefits in an amount that is less than the benefits otherwise payable under the terms of the Plan due to limitations on benefits imposed by Internal Revenue Code ("IRC") Section 415 shall automatically participate in the Excess Plan. Participation in the Excess Plan will cease for any year in which the retirement benefits from the Plan do not exceed the limitation imposed by IRC Section 415, provided such funding has been transferred to the Plan. Pension payments under the Excess Plan are paid in the same form as the pension benefits payable under the Plan.

### **Funding Policy**

Employees hired on or after January 01, 2009 contribute 3% of compensation to the Plan. Employees hired on or before December 31, 2008 do not contribute to the Plan or Excess Plan. Contribution requirements and benefit provisions of the Plan and Excess Plan are established and may be amended by the Members of the Board.

### **Annual Pension Cost and Net Pension Asset**

The Plan and Excess Plan's funding policy provides for actuarially determined periodic contributions at rates that, for individual employees, increase gradually over time so that sufficient assets will be available to pay benefits when due.

The Agency's annual pension costs and net pension assets of the Plan and Excess Plan for the years ended June 30 were as follows:

	<u>2013</u>	<u>2012</u>
Annual required contribution (ARC)	\$ 3,082	\$ 2,961
Interest on net pension asset	(281)	(183)
Adjustment to ARC	425	276
Annual pension cost	3,226	3,054
Contributions made	<u>(4,253)</u>	<u>(4,365)</u>
Increase in net pension asset	(1,027)	(1,311)
Net pension asset beginning of year	<u>(3,981)</u>	<u>(2,670)</u>
Net pension asset end of year	<u>\$ (5,008)</u>	<u>\$ (3,981)</u>

The net pension asset is included within other noncurrent assets of the General Fund.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

---

**Three-Year Trend Information for the Plan and Excess Plan**

<u>Calendar Year Ended</u>	<u>Annual Pension Cost ("APC")</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension (Asset)</u>
December 31, 2012	\$ 3,226	132%	\$ (5,008)
December 31, 2011	3,054	143	(3,981)
December 31, 2010	2,880	138	(2,670)

**Funded Status and Funding Progress**

As of January 1, 2013, the most recent actuarial valuation date, the Plan and Excess Plan were 73.3% funded. The actuarial accrued liability for benefits was \$72,630, and the actuarial value of assets was \$53,212, resulting in an unfunded actuarial accrued liabilities ("UAAL") of \$19,418. The covered payroll (annual payroll of active employees covered by the Plan and Excess Plan was \$16,588 and the ratio of the UAAL to the covered payroll was 117.1%.

The Schedule of Funding Progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of Plan and Excess Plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**Actuarial Methods and Assumptions**

In the actuarial valuation as of January 01, 2013, the aggregate actuarial cost method is used. The actuarial assumptions include a 7.5% investment rate of return, projected salary increases of 4.5% per year and no post-retirement benefit increases. Both the rate of return of investments and projected salary increases include a moderate rate of inflation component based on historical averages. The actuarial value of assets is determined using techniques that spread the effects of short-term volatility in the market value of investments smooth over a five-year period. Because the aggregate actuarial cost method does not identify or separately amortize the UAAL, information about the Plan and Excess Plan's funded status and funding progress has been prepared using the entry age actuarial cost method for that purpose.

**13. Postemployment Benefits Other than Pensions****Plan Description**

The Agency sponsors a single-employer defined benefit plan, which includes the Pennsylvania Housing Finance Agency Postemployment Benefits Plan ("OPEB Plan") to provide certain other postemployment health care benefits ("OPEB") to all former employees who are members of the Employees' Retirement Plan currently receiving retirement income. Such benefits are available to members' spouses during the life of the retiree. Specific details of the Plan include the provision of limited hospitalization, major medical insurance, physician services and prescription drug coverage. The Agency is under no statutory or contractual obligation to provide these

# PENNSYLVANIA HOUSING FINANCE AGENCY

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

postretirement healthcare benefits. Because the Plan consists solely of the Agency's commitment to provide OPEB through the payment of premiums to insurance companies on behalf of its eligible retirees, no stand-alone financial report is either available or generated for the OPEB Plan.

## **Funding Policy**

The Agency currently funds OPEB on a pay-as-you-go basis by purchasing commercial health insurance. Premiums paid for the OPEB Plan are partially funded by retirees desiring such coverage in accordance with rates established by the Agency. Contribution requirements and benefit provisions of the OPEB Plan are established by and may be amended by the Board.

For the year ended June 30, 2013, contribution rates for OPEB Plan members equaled 5% of the insurance premium per participant per month. OPEB Plan members receiving benefits paid \$36, which was used to offset the Agency's total outlays to insurance carriers for premiums equaling \$717. As a result, the Agency's net outlay for OPEB insurance premiums equaled \$681.

For the year ended June 30, 2012, contribution rates for OPEB Plan members equaled 5% of the insurance premium per participant per month. OPEB Plan members receiving benefits paid \$32, which was used to offset the Agency's total outlays to insurance carriers for premiums equaling \$637. As a result, the Agency's net outlay for OPEB insurance premiums equaled \$605.

## **Annual OPEB Cost and Net OPEB Obligation**

The calculation of the Agency's annual OPEB cost is based upon the actuarially determined annual required contribution ("ARC") of the Agency. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period of 30 years.

The Agency's annual OPEB costs and net OPEB obligation for the years ended June 30 were as follows:

	<u>2013</u>	<u>2012</u>
Annual required contribution (ARC)	\$ 5,042	\$ 5,042
Interest on net OPEB obligation	783	526
Adjustment to ARC	<u>(1,042)</u>	<u>(718)</u>
Annual OPEB expense	4,783	4,850
Contributions made	<u>(717)</u>	<u>(637)</u>
Increase in net OPEB obligation	4,066	4,213
Net OPEB obligation beginning of year	<u>17,501</u>	<u>13,288</u>
Net OPEB obligation end of year	<u>\$ 21,567</u>	<u>\$ 17,501</u>

OPEB obligations are included as other noncurrent liabilities of the General Fund and HEMAP.

**PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

*(In thousands of dollars)*

---

**Three-Year Trend Information for OPEB**

<b>Fiscal Year Ended</b>	<b>Annual OPEB Cost</b>	<b>Percentage of Annual OPEB Cost Contributed</b>	<b>Net OPEB Obligation</b>
June 30, 2013	\$ 4,783	15%	\$ 21,567
June 30, 2012	4,850	13	17,501
June 30, 2011	4,166	14	13,288

**Funded Status and Funding Progress**

As of July 1, 2011, the most recent actuarial valuation date, the OPEB Plan was not funded. This resulted in an actuarial accrued liability for benefits and unfunded actuarial accrued liability (“UAAL”) of \$43,472. The covered payroll (annual payroll of active employees covered by the OPEB Plan) equaled \$15,900, and the ratio of the UAAL to the covered payroll equaled 273.4%. Amounts determined regarding the funded status of the OPEB Plan and the annual required contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The Schedule of Funding Progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information illustrating whether the actuarial values of Plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**Actuarial Methods and Assumptions**

Projection of benefits for financial reporting purpose are based on the substantive OPEB Plan as understood by the Agency and OPEB Plan members and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the Agency and OPEB Plan members to that point. There are no legal or contractual funding limitations that would potentially affect the projection of benefits for financial accounting purposes. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

For the actuarial valuation dated July 1, 2011, the entry age normal cost method was used. Because the Agency funds its OPEB on a pay-as-you-go basis, the OPEB Plan has no assets (investments) used specifically for paying the post-retirement medical benefits; therefore, the actuarial assumptions included a 4.5% discount rate, which approximates the expected rate of return on non-pension investments held by the Agency, a moderate inflation rate based on historical averages and an annual healthcare cost trend rate of 8% in 2011, decreasing by 0.5% per year to 5.5% in 2016 and thereafter. The UAAL is amortized as a level dollar amount over thirty years on an open basis.

## **PENNSYLVANIA HOUSING FINANCE AGENCY**

Notes to Financial Statements

June 30, 2013 and 2012

---

*(In thousands of dollars)*

### **14. Significant Contingencies and Commitments**

#### **Federally Assisted Programs**

In the normal course of operations, the Agency receives funding from various federal government agencies. These funds are to be used for designated purposes only. If a grantor determines that funds have not been used for their intended purpose, the grantor may request a refund of monies advanced or refuse to reimburse the Agency for its related disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the Agency's grant programs is predicated upon the grantor's historical satisfaction that the funds provided are being spent as intended and the grantors' intent to continue their programs.

#### **Risk Management**

The Agency is exposed to various risks of loss from theft of, damage to or the destruction of assets; injuries to staff or visitors; loss related to torts, errors and omissions and employee dishonesty. All risks are managed through the purchase of various commercial insurance policies. The Agency bears a \$1 deductible per claim for commercial property coverage and a \$100 deductible per claim for fidelity bond coverage. There have been no settlements, actual losses in excess of coverage or decrease in insurance coverage within the last three years.

#### **Litigation**

In the normal course of business, the Agency may be involved in various claims or suits. In the opinion of the Agency's management, the amount of such losses that might result from claims or suits, if any, would not materially affect the Agency's financial position.

#### **Commitments**

Outstanding commitments by the Agency to make or acquire Single Family Mortgage Program and HEMAP loans were approximately \$31,231 and \$9,500, respectively, at June 30, 2013.

### **15. Significant Effects of Subsequent Events**

Subsequent events have been evaluated through November 18, 2013, the date these basic financial statements were issued. Nothing requiring disclosure in these basic financial statements was noted.

**REQUIRED SUPPLEMENTARY INFORMATION**

**PENNSYLVANIA HOUSING FINANCE AGENCY****Schedule of Funding Progress for the Pennsylvania Housing Finance Agency Employees' Retirement Plan and Government Excess Benefit Plan***(In thousands of dollars)*

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets ( a )</b>	<b>Actuarial Accrued Liability (AAL) - Entry Age ( b )</b>	<b>Unfunded AAL (UAAL) ( b - a )</b>	<b>Funded Ratio ( a / b )</b>	<b>Covered Payroll ( c )</b>	<b>UAAL as a Percentage of Covered Payroll ( b - a )/( c )</b>
01/01/2013	\$ 53,212	\$ 72,630	\$ 19,418	73.3%	\$ 16,588	117.1%
01/01/2012	49,073	67,072	17,999	73.2	15,697	114.7
01/01/2011	44,969	61,750	16,781	72.8	15,566	107.8

**PENNSYLVANIA HOUSING FINANCE AGENCY**

## Schedule of Funding Progress for the Pennsylvania Housing Finance Agency Postemployment Benefits Plan

---

*(In thousands of dollars)*

<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets ( a )</b>	<b>Actuarial Accrued Liability (AAL) - Entry Age ( b )</b>	<b>Unfunded AAL (UAAL) ( b - a )</b>	<b>Funded Ratio ( a / b )</b>	<b>Covered Payroll ( c )</b>	<b>UAAL as a Percentage of Covered Payroll ( b - a )/( c )</b>
07/01/2011	\$ -	\$ 43,472	\$ 43,472	- %	\$ 15,900	273.4%
07/01/2009	-	36,652	36,652	-	15,320	239.2
07/01/2007	-	28,072	28,072	-	13,382	209.8

Ernst & Young LLP

Assurance | Tax | Transactions | Advisory

**About Ernst & Young**

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

For more information, please visit [www.ey.com](http://www.ey.com)

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. This Report has been prepared by Ernst & Young LLP, a client serving member firm located in the United States.

