STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT HOUSING FINANCE AUTHORITY
FOR CALENDAR YEAR ENDED DECEMBER 31, 2004

AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE

Table of Contents

March 3, 2006

AUDITORS' REPORT
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FOR CALENDAR YEAR ENDED DECEMBER 31, 2004

We have made an examination of the books, records and accounts of the Connecticut Housing Finance Authority (CHFA), as provided in Section 1-122 of the General Statutes, for the calendar year ended December 31, 2004. Included in this examination is the State Housing Authority (SHA), a subsidiary of the CHFA established in accordance with Section 8-244b of the General Statutes.

SCOPE OF AUDIT:

This audit was primarily limited to performing tests of the Connecticut Housing Finance Authority's compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to a determination of whether the CHFA has complied with its regulations concerning the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources

We also considered the Connecticut Housing Finance Authority's internal control over its financial operations and its compliance with requirements that could have a material or significant effect on the CHFA's financial operations in order to determine our auditing procedures for the purpose of evaluating the CHFA's financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives. Our consideration of internal control included the five areas identified above.

Our audit included a review of a representative sample of the CHFA's activities during the calendar year in the five areas identified above and a review of such other areas as we considered necessary. The financial statement audit of the Connecticut Housing Finance Authority for the calendar year indicated above, was conducted by the CHFA's independent public accountants.

This report on our examination consists of the "Comments" and "Recommendations" which follow.

COMMENTS

FOREWORD:

The Connecticut Housing Finance Authority, hereinafter referred to as the CHFA or the Authority, operates under the provisions of Chapter 134, Sections 8-241 through 8-265qq of the General Statutes. It was established by the 1972 Session of the General Assembly as the successor to the Connecticut Mortgage Authority, which had been established by the General Assembly in 1969. The CHFA is a body politic and corporate, constituting a public instrumentality and political subdivision of the State. It was created to alleviate the shortage of housing for low and moderate income families, and to encourage the development of a balanced community of all income levels in the urban areas. Under Section 8-244b of the General Statutes, the CHFA established a subsidiary to be known as the State Housing Authority or hereinafter referred to as the SHA. The SHA was created to be the successor to the Connecticut Housing Authority. It was established to assist in ensuring continued occupancy of Authority-financed developments by low and moderate-income persons and families in accordance with the statutory purpose of the Authority.

Funds for financing permanent mortgage loans were obtained by issuing bonds, the interest from which has generally been exempt from Federal income tax to the bondholder, except during the period in which the Mortgage Revenue Bond (MRB) program was temporarily discontinued, from July 1992 through August 1993. The MRB program was extended indefinitely and made permanent in August 1993. In addition, financial market conditions permitted the CHFA to sell certain issues made during the period that were not exempt from Federal income tax. Loans made from the proceeds of such bonds must be secured by a first mortgage lien. Funds derived from the excess of interest income from loans over bond interest expenses are used to pay operating expenses of the CHFA.

Board of Directors and Administrative Officials:

In accordance with Section 8-244, subsection (a), of the General Statutes, the governing body of the Authority consists of 15 directors. Four directors are ex-officio, seven members are appointed by the Governor and four are appointed by the General Assembly. Members of the CHFA Board of Directors as of December 31, 2004, were as follows:

Ex-officio members:

Denise L. Nappier	- State Treasurer
John P. Burke	- State Banking Commissioner
Marc S. Ryan	- Secretary, Office of Policy and Management
James F. Abromaitis	- Commissioner, Dept. of Economic and Community Development

Appointed members:

Leslie Olear, Chairman
Joseph H. Fisher, Vice Chairman
Allen Bacchiochi
Orest T. Dubno
Thomas W. Hynes
Keith D. McNamara
Steven Montesano
Jorge L. Perez
J. Scott Guilmartin
Diane Randall

One vacancy (a gubernatorial appointment) has existed since May 2002.

Gary E. King served as President-Executive Director during the audited period.

In accordance with Section 8-244, subsection (c), of the General Statutes, the governing body of the State Housing Authority (SHA) consists of three directors that are appointed by the board of directors of the CHFA. One of the members is required to be an officer or employee of the CHFA and two members are required to be members of the board of directors of the CHFA. Members of the SHA Board of Directors as of December 31, 2004, were as follows:

Thomas W. Hynes, Chairman
Leslie Olear
Joseph H. Fisher

Significant Legislation:

Section 2 of Public Act 03-133, effective July 1, 2004, authorizes the Auditors of Public Accounts to annually conduct a compliance audit of each quasi-public agency's activities during the preceding agency fiscal year or contract with a person, firm or corporation for any such audit or audits.

CHFA Programs:

The CHFA provides financing through several programs at interest rates below those generally available. The two most significant programs are described below. Other programs are described in the CHFA Annual Reports.

The home mortgage program finances the acquisition or rehabilitation of owner occupied existing or newly constructed housing with no more than four living units. The Authority's home mortgage funds are distributed through participating lenders.

Multi-family mortgage loans provide permanent and construction financing for building new and rehabilitated pre-existing multi-family projects. It had been the aim of the Authority to invest a major portion of its multi-family resources in mortgages of projects subsidized under the Federal "Section 8" program, which pays a portion of some tenants' rent as determined by income. While the Section 8 program is no longer available for any new projects, those who were under the program will continue to receive Section 8 subsidies.

Thirty years is the maximum maturity of all home mortgage loans. Prior to 1993, all new home mortgage loans were "growing equity" (GEMS). The CHFA turned to conventional 30-year mortgages in 1993 in response to market conditions. We were informed that future mortgage types offered would be dependent on future market conditions.

Multi-Family Housing:

The Federal "Section 8" program, which is no longer available for any new multi-family housing projects, subsidizes a portion of some tenants' rent as determined by income. Under this program, eligible tenants pay 30 percent of their income as rent. The Federal legislation permits participating projects to be withdrawn after 20 years. However, we were informed that CHFA's regulatory agreements with the owners of such projects generally prohibit such withdrawals. Section 8-253a of the General Statutes permits such prepayments and withdrawals only on a finding by the Authority that there is not an acute need for low and moderate income housing in the area and that rents would not materially escalate.

For multi-family housing mortgage loans made with the proceeds of obligations issued after September 3, 1982, the Tax Equity and Fiscal Responsibility Act of 1982 made two changes which were: 1). The definition of individuals of low and moderate income was changed to be 80 percent of median gross income as determined under Section 8 of the United States Housing Act of 1937 and 2). 20 percent of the housing units in a project (15 percent in targeted areas) were to be occupied by individuals of low or moderate income for a specified period. All of the rental units must remain as rental units for the remaining term of the obligation, or for the specified period if that is longer.

There is a Multi-Family Underwriting Unit that underwrites the financing of multi-family rental housing developments, providing direct construction and/or permanent mortgage loans to private developers and not-for-profit sponsors for construction and/or rehabilitation of rental housing. The staff reviews loan proposals, analyzes sites and financial statements, and performs feasibility analyses to determine a proposal's acceptability. Also, the Multi-Family Technical Services Unit ensures that plans and specifications meet Authority standards and that construction proceeds are disbursed according to approved plans and timetables, and approves proposed changes and observes the integrity of developments. The division also verifies projected costs and reviews appraisals for accuracy and completeness. A Tax Credit Unit is responsible for the administration of State of

Connecticut Low Income Housing Tax Credits (LIHTC's). The Unit underwrites and verifies requests for LIHTC's and conducts ongoing monitoring for verification of unit compliance and tenant eligibility.

Single-Family Housing:

The Authority adopts at various times sales price and family income limitations for eligibility in its home mortgage programs.

The Authority requires first time homeowners to complete an occupancy certificate, in which borrowers must certify their intent to occupy the mortgaged premises, and acknowledge the calling of the loan should the borrower cease to reside on the premises. This occupancy requirement is only enforceable on loans made after 1983.

The Authority also operates an Urban Area Mortgage Program for home mortgages. Under this program, the Authority may finance mortgage loans in certain legislatively designated urban-targeted areas of the State without regard to the borrower's income. However, the Authority may not make such loans if otherwise available on "reasonable terms". Prior to Public Act 95-202, this requirement was deemed satisfied when the applicant provided evidence of refusal for mortgage loans by not less than two financial institutions that are making residential mortgage loans in the area in which the housing is located, and that such refusal was for at least one of the reasons indicated in the CHFA's written procedures. Currently, the requirement that the applicant show refusal by not less than two financial institutions has been eliminated. The CHFA regulations require that all mortgage loans be insured if the down payment is less than twenty percent and that the owners live on the premises. Generally, applicable purchase price limitations apply to targeted area mortgages.

Mortgage Insurance:

Section 8-251 of the General Statutes currently permits the Authority to purchase or make $750,000,000 of mortgage loans which are uninsured or not guaranteed by a Federal agency, a Federally chartered corporation, a private mortgage insurance company, or the State or the Authority itself. As of December 31, 2004, the Authority had financed or firmly committed to finance approximately $631,381,000 of such mortgage loans. This represents 84 percent of the allowable maximum.

After January 1, 1978, most of the CHFA's multi-family housing was uninsured, although subsidized under HUD's Section 8 Program. Developments covered by Section 8 subsidies were considered to be secure even in the absence of mortgage insurance. As noted earlier in this report, the Section 8 Program has been discontinued. This marked the end of Federal subsidies, but not affected is the existing portfolio of multi-family development loans. New multi-family projects have been at below-market rate rents based on Internal Revenue Service requirements for tax-exempt funding and most are uninsured. The CHFA has been undertaking the risk of such uninsured loans in order to keep costs and, accordingly, rents as low as possible.

RÉSUMÉ OF OPERATIONS:

During the audited period, calendar year ended December 31, 2004, the Authority maintained three funds in accordance with the provisions of Section 8-258 of the General Statutes: a Housing Mortgage General Fund (including its Capital Reserve), an Investment Trust Fund, and a Housing Mortgage Insurance Fund. In addition, the Authority maintained Special Needs Housing Funds, referring collectively to a Special Needs Housing Fund, a Special Needs Housing Capital Reserve Fund, a Special Needs Housing Renewal and Replacement Fund, a Housing Draw Down Fund referring collectively to a Bond Escrow Fund and a Rebate Fund. During the audited period, CHFA assets also consisted of various component units consisting of the aforementioned State Housing Authority and a number of subsidiary corporations created to hold foreclosed real estate. As noted above, we did not audit these funds since they were already audited by the independent public accounting firm of Blum, Shapiro and Company, P.C. Therefore, we will rely on the unqualified opinion expressed by the independent public accountants. Separate comments follow in this report under the caption for each fund mentioned is for informational purposes only. Detailed financial data concerning these funds is presented in the Authority's Annual Reports.

Housing Mortgage General Fund:

With the exception of the initial $50,000 appropriation made by the General Assembly in the 1969-1970 fiscal year, no appropriations have been requested of or made by the General Assembly for the general operations of the Authority. The only exception to this is the $4,000,000 appropriated for the Emergency Mortgage Assistance program. In order to use the services of the State for payrolls and related employee benefits, the CHFA issued wire transfers to the State Treasurer's Office in the total amount of $10,322,340 to provide for such costs, during the State fiscal year ended June 30, 2004. Our examination of the records of the State Comptroller and Treasurer indicated that these amounts were received and deposited as receivable collections against grant agreements deemed appropriated for the purposes of the Authority in accordance with the provisions of Section 3-39a of the General Statutes. Expenditures processed through this contribution account were $10,320,190 for the corresponding period. These expenditures are only a small part of the total operating expenses of the Housing Mortgage General Fund. Most of the revenue received and expenses incurred by the CHFA are applicable to its own General Fund. During the period of this examination, monthly mortgage payments, including principal and interest, were made directly to various financial institutions which acted as servicing agents for the CHFA. The servicers deducted their service fees and wired the balance of their collections to the CHFA's credit at a Hartford bank. The monthly servicing fee for the CHFA's individual home mortgages generally is 1/12 of 3/8 of one percent of the unpaid balance.

Investment Trust Fund:

Under Section 8-258 of the General Statutes, the CHFA established this fund to account for assets which it determined "surplus funds" in accordance with the terms of its General Housing Mortgage Finance Program Bond Resolution of September 27, 1972, hereafter referred to as GBR.

As defined in Section 505, subsection (3), of the GBR, surplus funds represent the monthly excess of pledged receipts over funds required for the payment of operating expenses, principal and interest and the requirements of the Capital Reserve Fund. These amounts are to be deposited

monthly in the General Fund surplus account. Section 506, subsection (1), of the GBR, provides that the amount in the General Fund surplus account may be transferred annually to the Investment Trust Fund. If these requirements and/or options are not executed on time, the amounts in the General Fund surplus account automatically revert to the redemption account. One of theses options, which
is set forth in Section 506, subsection (1) (c) (ii) of the GBR, authorizes the establishment of a separate account which is unrestricted and can be used by the CHFA for any purpose authorized by the General Statutes.

Housing Mortgage Insurance Fund:

As provided for under Section 8-258, subsection (d), of the General Statutes, the CHFA is authorized to also establish a Housing Mortgage Insurance Fund. This fund shall consist of mortgage insurance premium receipts; money or assets received from loan defaults or delinquencies (including sales, lease or rental of real property); moneys lent or paid by the State for inclusion in this fund; and any other moneys available to the Authority which it determines to include therein. Loans and advances may be made from said funds as provided by Section 8-250 (purpose and powers of the Authority).

Connecticut Housing Finance Authority Bonds:

In accordance with the provisions of Sections 8-250, subsection (12), and 8-252 of the General Statutes, the Authority is authorized to issue bonds as, in its opinion, are necessary to provide sufficient funds for carrying out the purposes of the Authority. Except for bonds issued between July 1992 and August 1993, the period in which the Mortgage Revenue Bond Program was discontinued, most of the CHFA's bonds have been tax-exempt. The tax-exempt bonds are not backed by the full faith and credit of the State of Connecticut. However, the State, on or before December 1, of each year without further legislative approval, must appropriate from the State General Fund whatever amount is certified by the Chairman of the Authority as necessary to restore the Capital Reserve Fund to the required minimum capital reserve. Such amounts must be repaid by the Authority and credited to the State's General Fund as soon as possible from any moneys in excess of the amounts which the Authority determines will keep it self-supporting. The CHFA has determined that such amounts may be paid from the Surplus Account. As of December 31, 2004, the amount on deposit in the Bond Resolution Capital Reserve Fund, valued in accordance with the Act, was $547,244,000, which was in excess of the Bond Resolution Capital Reserve Fund minimum requirement of $230,620,000. The amount on deposit in the Indenture Capital Reserve Fund, valued in accordance with the Act, was $3,439,000, which was in excess of the Indenture Capital Reserve Fund minimum requirement of $3,225,000. For both of these capital reserve funds, the minimum is the amount of debt service due in the following year and the maximum is the greatest amount of debt service due in
any succeeding year.

As disclosed in the CHFA's Housing Mortgage Finance Program bond issues were made prior to this examination and bonds totaling $10,335,285,000 had been issued prior to December 31, 2003,

with $3,154,030,000 outstanding as of that date. Four Housing Mortgage Finance bonds were issued during the period of this examination totaling $375,000,000. Bonds retired during this period were

$809,165,000. As of December 31, 2004, $2,719,865,000 of Housing Mortgage Finance Program Bonds were outstanding. As of December 31, 2003, $45,590,000 of Special Needs Housing Mortgage Finance Program Special Obligation bonds were outstanding. During the audited period, $550,000 were retired. As of December 31, 2004, $45,040,000 of these bonds were outstanding. During the audited period a new type of bond called the Housing Draw Down Bonds, which replaced the Convertible Option Bonds, was issued totaling $359,948,000. These bonds remained outstanding as of December 31, 2004. The CHFA was able to maintain its "top tier" rating of “AAA” from Standard and Poor’s Corporation and "Aaa" from Moody's Investor Services. Detailed bond information is included in the CHFA's annual reports.

Temporary Investments:

Temporary investments are those made with funds not needed for immediate use. The nature of such investments is limited by Section 8-250, subsection (18), of the General Statutes to obligations issued by or guaranteed by the United States of America or the State of Connecticut or to obligations which are legal investments for savings banks in this State. This area was reviewed by the CHFA's independent public accountants, and the CHFA was found to be in compliance with the applicable limitations.

Authority Staffing Levels:

According to the CHFA's monthly personnel status reports, the number of full-time employees increased by approximately three percent from December 2003 to December 2004, as shown below:

	Pay Period Ended Dates	
	12/31/03	12/31/04
Total number of employees	101	104

Personal services costs, including fringe benefits, increased by $1,455,511 (13.8 percent) for the year under review due to merit increases and increased costs of fringe benefits.

Other Examinations:

As noted previously in this report, the CHFA has been subject to annual audits by independent public accountants (IPAs) covering its financial operations, its loan servicing function, and the Section 8 Federally assisted housing payments program under the United States Housing Act of 1937. The following summarizes the findings that arose from the IPA audit for the calendar year ended December 31, 2004. These findings were reported to the Board of Directors in a letter dated March 15, 2005:

- Management should review the Sarbanes-Oxley Act to determine which aspects of its requirements are already being addressed by the Authority and which of the other requirements make sense for the Authority to adopt.

Status: Management review of the Sarbanes-Oxley Act is scheduled to be completed by December 31, 2005.

- Management should fill the Controller position as soon as possible with an individual that has commensurate technical skills and the capacity to perform.

Status: This position was filled July 2005.

CONDITION OF RECORDS

There were no recommendations developed as a result of this examination.

RECOMMENDATIONS

Our prior audit included three recommendations. The status of those recommendations is presented below.

Status of Prior Audit Recommendations:

- The Connecticut Housing Finance Authority should revise the Teacher's Mortgage Assistance Program's procedures to ensure that Program requirements are adhered to by all applicants. The Superintendent of Schools now signs a "Statement of Eligibility" form for the applicant. In addition, the program description on CHFA's website indicates that this form must be submitted with the mortgage application. Thus, this matter has been resolved.

- The Connecticut Housing Finance Authority should perform a complete review of all documents used in the lending process to determine if they are in compliance with statutory requirements. Section 8-262a of the General Statutes allows the CHFA to determine that any application or document submitted with respect to any program of or program administered by CHFA is signed under penalty of false statement. If there is any inconsistency with any other statutory provision then this section of the Statute will be deemed controlling. Thus, this matter has been resolved.

- The Connecticut Housing Finance Authority should consider a mechanism to obtain expenditure reports from recipients of Interest Earned on Real Estate Broker Escrow or Trust Accounts grants. The Treasurer now sends requests to all grant recipients requesting information on the disposition of the grants. Thus, this matter has been resolved.

Current Audit Recommendations:

There were no recommendations developed as a result of this audit examination.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 and Section 1-122 of the General Statutes, we have conducted an audit of the Connecticut Housing Finance Authority's activities for the calendar year ended December 31, 2004. This audit was primarily limited to performing tests of the CHFA's compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to a determination of whether the CHFA has complied with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds and the distribution of loans, grants and other financial resources, and to understanding and evaluating the effectiveness of the CHFA's internal control policies and procedures for ensuring that the provisions of certain laws, regulations, contracts and grants applicable to the CHFA are complied with. The financial statement audit of the CHFA, for the calendar year indicated above, was conducted by the CHFA's independent public accountants.

We conducted our audit in accordance with the requirements of Section 2-90 and Section 1-122 of the General Statutes. In doing so, we planned and performed the audit to obtain reasonable assurance about whether the CHFA complied in all material respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance

Compliance with the requirements of laws, regulations, contracts and grants applicable to the CHFA is the responsibility of the CHFA's management.

As part of obtaining reasonable assurance about whether the CHFA complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the CHFA's financial operations for the calendar year ended December 31, 2004, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources

Our examination included reviewing all or a representative sample of the CHFA's activities in those areas and performing such other procedures as we considered necessary in the circumstances. The results of our tests disclosed no instances of noncompliance.

Internal Control

The management of the CHFA is responsible for establishing and maintaining effective internal control over its financial operations and compliance with the requirements of laws, regulations, contracts and grants applicable to the CHFA. In planning and performing our audit, we considered the CHFA's internal control over its financial operations and its compliance with the requirements that could have a material or significant effect on the CHFA's financial operations in order to determine our auditing procedures for the purpose of evaluating the CHFA's financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives. Our consideration of internal control included, but was not limited to, the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources

Our consideration of the internal control over the CHFA's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be material or significant weaknesses. A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants that would be material in relation to the CHFA's financial operations or noncompliance which could result in a significant unauthorized, illegal, irregular or unsafe transactions to the CHFA being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control that we consider to be material or significant weaknesses.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited. Users of this report should be aware that our audit does not provide a legal determination of the CHFA's compliance with the provisions of the laws, regulations, contracts and grants included within the scope of this audit.

CONCLUSION

In conclusion, we wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Connecticut Housing Finance Authority during the course of our examination.

Wendell Hinds
Associate Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts