

West Virginia Housing Development Fund

AUDITED FINANCIAL STATEMENTS

For the years ended June 30, 2008 and 2007

Audited Financial Statements

WEST VIRGINIA HOUSING DEVELOPMENT FUND

For the Years Ended June 30, 2008 and 2007

Audited Financial Statements

| | |
|---|----|
| Independent Auditor's Report | 1 |
| Management's Discussion and Analysis | 2 |
| Statements of Net Assets..... | 12 |
| Statements of Revenues, Expenses, and Changes in Net Assets | 13 |
| Statements of Cash Flows | 14 |
| Notes to Financial Statements, an integral part of the Financial Statements..... | 16 |

INDEPENDENT AUDITORS' REPORT

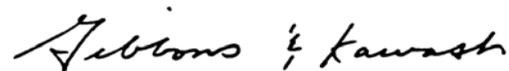
To the Board of Directors
West Virginia Housing Development Fund
Charleston, West Virginia

We have audited the accompanying statement of net assets of the West Virginia Housing Development Fund (the Fund), a component unit of the State of West Virginia, as of June 30, 2008 and 2007, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the West Virginia Housing Development Fund as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 11 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



August 27, 2008

**WEST VIRGINIA HOUSING DEVELOPMENT FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS**

INTRODUCTION

As a public body with statewide responsibility for housing, the West Virginia Housing Development Fund (the Fund) currently operates several programs to provide safe and affordable housing for residents and families in the State of West Virginia (the State). Through June 30, 2008, the Fund has provided assistance for more than 104,000 housing or housing-related units.

The permanent staff of the Fund consists of 102 persons, including professional staff members qualified in the fields of accounting, appraisal, finance, law, mortgage underwriting, mortgage loan servicing, secondary mortgage markets, planning, architecture, cost estimation, construction, inspection, housing management, and marketing. The Fund provides services in these fields for its programs as required and utilizes professional consulting services from time to time to supplement its own staff.

The Fund has 26 bond issues totaling \$756,180,000 par amount outstanding under its Housing Finance Bond Resolution. The Housing Finance Bonds are rated "AAA" by Standard & Poor's Public Ratings Services (S&P), a Division of McGraw-Hill Companies, and "Aaa" by Moody's Investors Service, Inc. (Moody's).

Fitch, Inc. rates the Fund's unsecured, short-term general obligation debt pledge "F-1+". The Fund's unsecured long-term general obligation debt pledge is rated "Aaa" by Moody's and "AAA" by S&P. The Fund is the first and only housing finance agency ever to receive such ratings on its long-term general obligation debt pledge. These ratings are not assigned to any particular issue of debt, but rather represent an overall credit assessment of the Fund's long-term general obligation pledge.¹

The financial transactions of the Fund are recorded in relation to its various programs, which are more fully explained in the Notes to the Financial Statements. These programs consist of the General Account, Housing Finance Bond Program, Other Loan Programs, Land Development Program, Bond Insurance Account, and Federal Programs. These were established in accordance with the West Virginia Housing Development Fund Act (the Act), the bond resolutions or at management's discretion. Restricted net assets of the Fund include the net assets of the Housing Finance Bond Program, the Economic Development Financing Bonds, Land Development Program, Bond Insurance Account, and Federal Programs, which are restricted by the bond resolutions, the Act, or federal regulations.

As management of the Fund, we offer readers of the Fund's financial statements this narrative overview and analysis of the Statements of Net Assets and the Statements of Revenues, Expenses, and Changes in Net Assets as of and for the fiscal years ended June 30, 2008, 2007 and 2006.

¹ An explanation of the Moody's ratings may be obtained by writing to Moody's Investors Service, Inc., 7 World Trade Center, 250 Greenwich Street, New York, New York 10007; an explanation of the S&P ratings may be obtained by writing to Standard & Poor's Public Ratings Services, 55 Water Street, New York, New York 10041; and an explanation of the Fitch rating may be obtained by writing to Fitch, Inc., One State Street Plaza, New York, New York 10004. There is no assurance that such ratings will be maintained for any period of time or that such ratings will not be withdrawn or revised downward by Moody's, S&P, or Fitch if, in their judgment, circumstances so warrant. Such actions, if taken, could have an adverse effect on the market price of bonds issued by the Fund.

USING THIS REPORT

This report consists of a series of financial statements: the Statements of Net Assets, the Statements of Revenues, Expenses, and Changes in Net Assets, and the Statements of Cash Flows. These statements provide information about the activities of the Fund for each period presented.

The financial statements of the Fund are prepared in conformity with accounting principles generally accepted in the United States for state housing finance enterprise funds. The Statements of Net Assets represent the difference between the assets and liabilities of the Fund and include all assets and liabilities using the basis of accounting described above. Over time, increases or decreases in the Fund's net assets are one indicator of whether its financial status is improving, stable, or deteriorating. There are also other factors that should be considered when reviewing the operational results of the Fund, such as changes in the interest rate environment, bond market, changes to state and federal laws governing the Fund's programs, changes to the tax code, and the real estate market in the State. The Statements of Revenues, Expenses, and Changes in Net Assets of the Fund reflect revenues, such as interest on loans, loan-servicing fees, interest on investments, expenses, such as loan fees, program expenses, administrative expenses, and interest on outstanding debt. The Notes to the Financial Statements provide information that is essential to fully understand the data provided in the financial statements.

FINANCIAL HIGHLIGHTS

Following is a comparison of the Fund's condensed Statements of Net Assets at June 30:

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|-------------------|------------------------|-------------------|
| | | (Dollars in thousands) | |
| ASSETS | | | |
| Current assets | \$ 92,703 | \$ 93,912 | \$ 85,898 |
| Noncurrent assets: | | | |
| Mortgage loans & Restricted mortgage loans, net of allowance for losses | 939,067 | 895,274 | 823,648 |
| Restricted Federal Program mortgage loans, net of allowance for losses | 59,940 | 61,648 | 54,555 |
| Restricted cash and cash equivalents | 13,830 | 51,287 | 61,084 |
| Restricted investments | 107,774 | 88,964 | 120,437 |
| Other assets & Restricted other assets, net of allowance for losses | 6,628 | 4,365 | 4,662 |
| Total assets | <u>1,219,942</u> | <u>1,195,450</u> | <u>1,150,284</u> |
| LIABILITIES AND NET ASSETS | | | |
| Current liabilities: | | | |
| Accounts payable and other liabilities | 19,147 | 21,924 | 20,181 |
| Accrued interest payable | 6,275 | 6,580 | 6,050 |
| Bonds payable | 24,835 | 24,925 | 58,795 |
| Noncurrent liabilities: | | | |
| Bonds & notes payable, net | 735,342 | 725,914 | 675,395 |
| Federal program advances | 60,844 | 63,486 | 56,885 |
| Total liabilities | <u>846,443</u> | <u>842,829</u> | <u>817,306</u> |
| Net assets - Restricted | 288,387 | 270,616 | 259,514 |
| Net assets - Unrestricted | 85,112 | 82,005 | 73,464 |
| TOTAL NET ASSETS | <u>\$ 373,499</u> | <u>\$ 352,621</u> | <u>\$ 332,978</u> |

Below is additional discussion of the significant financial statement items and the changes in those items over the prior two years due to recent events and activities of the Fund, current economic factors, and other factors affecting the Fund's financial and programmatic operations.

Current assets

The decrease of \$1,209,000 (1.3%), in Current assets from 2007 to 2008 was primarily due to loan origination disbursements exceeding program receipts.

The increase of \$8,014,000 (9.3%), in Current assets from 2006 to 2007 was primarily due to the increase in cash balances from program receipts in excess of program disbursements.

Mortgage loans & Restricted mortgage loans, net of allowance for losses

The increase of \$43,793,000 (4.9%) in Mortgage loans & Restricted mortgage loans, net of allowance for losses from 2007 to 2008 was primarily due to mortgage loan originations of \$149,207,000, exceeding loan prepayments and repayments of \$99,293,000. Mortgage loan balances in the Housing Finance Bond Program increased approximately \$52,003,000 from 2007 to 2008. Other loans decreased approximately \$8,210,000 over the same period primarily due to the prepayment of a \$12,500,000 economic development project.

The increase of \$71,626,000 (8.7%) in Mortgage loans & Restricted mortgage loans, net of allowance for losses from 2006 to 2007 was primarily due to mortgage loan originations of \$179,442,000, exceeding loan prepayments and repayments of \$103,346,000. Mortgage loan balances in the Housing Finance Bond Program increased approximately \$64,091,000 from 2006 to 2007. Other loans increased approximately \$7,535,000 over the same period.

Restricted Federal Program mortgage loans, net of allowance for losses

This line item consists of the United States Department of Housing and Urban Development's (HUD) HOME Investment Program (HOME) mortgage loans. The fluctuations from year to year represent the net HOME program loans originated during the years presented.

Restricted cash and cash equivalents

The decrease of \$37,457,000 (73.0%) in Restricted cash and cash equivalents from 2007 to 2008 was primarily due to the decrease in the balance of bond proceeds available for the purchase of single family mortgage loans and the purchase of long-term investments in the Bond Insurance Account and the Housing Finance Bond Program. The balance of bond proceeds available for the purchase of single family mortgages is primarily related to the timing of bonds issued for this purpose.

The decrease of \$9,797,000 (16.0%) in Restricted cash and cash equivalents from 2006 to 2007 was primarily due to the decrease in the balance of bond proceeds available for the purchase of single family mortgage loans.

Restricted investments

The increase of \$18,810,000 (21.1%) in Restricted investments from 2007 to 2008 was primarily due to the purchase of long-term investments in the Bond Insurance Account and the Housing Finance Bond Program.

The decrease of \$31,473,000 (26.1%) in Restricted investments from 2006 to 2007 was primarily due to the investment of the Housing Finance Bonds 2006 Series B proceeds in the amount of \$30,000,000 in fiscal year 2006 that matured in fiscal year 2007.

Also contributing to the fluctuations in Restricted investments from year to year is the net effect of investment purchases, redemptions, maturities and amortization and the change in fair value of investments as required by Governmental Accounting Standards Board (GASB) Statement No. 31. This statement requires certain investments to be recorded at fair value and the unrealized gains or losses be reported in the Statements of Changes in Net Assets.

The following summary illustrates the changes in Restricted investments as of June 30:

| | 2008 | 2007 | 2006 |
|--|------------------------|------------------|-------------------|
| | (Dollars in thousands) | | |
| Balance at beginning of fiscal year | \$ 88,964 | \$ 120,437 | \$ 98,356 |
| Sales, maturities and amortization | (23,795) | (34,202) | (6,300) |
| Purchases | 40,197 | 2,408 | 35,398 |
| Increase (decrease) in fair value of investments | 2,408 | 321 | (7,017) |
| Balance at end of fiscal year | <u>\$ 107,774</u> | <u>\$ 88,964</u> | <u>\$ 120,437</u> |

Other assets and Restricted other assets, net of allowance for losses

The increase of \$2,263,000 (51.8%) in Other assets and Restricted other assets, net of allowance for losses from 2007 to 2008 was primarily due to an increase in foreclosed properties of \$2,103,000. Included in this amount is a multifamily loan in the net amount of \$500,000.

The decrease of \$297,000 (6.4%) in Other assets and Restricted other assets, net of allowance for losses from 2006 to 2007 was primarily due to the sale of various foreclosed properties.

Accounts payable and other liabilities

The decrease of \$2,777,000 (12.7%) in Accounts payable and other liabilities from 2007 to 2008 was primarily due to the establishment of an irrevocable trust for the future costs of retiree health care benefits. Assets set aside by the Fund's management and the corresponding liability at June 30, 2007 were transferred to the trust in fiscal year 2008 related to the adoption of GASB 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" (OPEB) for the fiscal year ending June 30, 2008. See Note H – Postemployment Healthcare Plan.

The increase of \$1,743,000 (8.6%) in Accounts payable and other liabilities from 2006 to 2007 was primarily due to a \$1,274,000 increase in escrow funds held on behalf of others and a \$400,000 good faith deposit received in June 2007 for the Housing Finance 2007 Series B Bonds issued in July 2007.

Bonds and notes payable, current and noncurrent

As illustrated in the following schedule, the changes in Bonds and notes payable were due to the early redemption of bonds, scheduled debt service payments, and new bonds and notes issued. The changes in the balance of bonds and notes payable and interest rates generally account for the fluctuations in Accrued interest payable in 2008 and 2007. See Note D – Bonds & Notes payable, current and noncurrent.

| | 2008 | 2007 | 2006 |
|--|------------------------|-------------------|-------------------|
| | (Dollars in thousands) | | |
| Balance at beginning of the fiscal year | | | |
| Bonds payable - current | \$ 24,925 | \$ 58,795 | \$ 73,185 |
| Bonds payable - noncurrent | 725,914 | 675,395 | 634,715 |
| Debt issued: | | | |
| Economic Development Financing Bonds | - | - | 15,000 |
| Housing Finance Bonds (including premium) | 77,003 | 97,289 | 130,000 |
| Other Loan Programs Note payable | 250 | - | - |
| Debt paid: | | | |
| Scheduled Debt Service - Bonds & notes payable | (23,521) | (50,180) | (19,560) |
| Early Redemptions | (43,970) | (30,340) | (99,150) |
| Amortization of bond premiums | (424) | (120) | - |
| Balance at end of the fiscal year | <u>\$ 760,177</u> | <u>\$ 750,839</u> | <u>\$ 734,190</u> |
| Bonds payable - current | \$ 24,835 | \$ 24,925 | \$ 58,795 |
| Bonds & notes payable - noncurrent | 735,342 | 725,914 | 675,395 |
| Total bonds & notes payable | <u>\$ 760,177</u> | <u>\$ 750,839</u> | <u>\$ 734,190</u> |

Federal program advances

The decrease of \$2,642,000 (4.2%) and increase of \$6,601,000 (11.6%) in *Federal program advances* from 2007 to 2008 and from 2006 to 2007, respectively, is due to activity fluctuations in the outstanding balance of Federal Programs mortgage loans as a result of loans originated under the HOME program.

Total Net Assets improved by \$19,643,000 (5.9%) from June 30, 2006 to June 30, 2007. From June 30, 2007 to June 30, 2008, **Total Net Assets** improved another \$20,878,000 (5.9%) as the net financial position of the Fund increased to \$373,499,000 at June 30, 2008.

Following is a comparison of the Fund's condensed Statements of Revenues, Expenses, and Changes in Net Assets for the fiscal years ended June 30:

| | Fiscal Year Ended June 30 | | |
|---|---------------------------|------------------|-----------------|
| | 2008 | 2007 | 2006 |
| | (Dollars in thousands) | | |
| REVENUES | | | |
| Interest on loans | \$ 55,826 | \$ 52,075 | \$ 49,652 |
| Pass-through grant revenue | 53,020 | 59,845 | 55,352 |
| Fee revenue | 7,587 | 8,201 | 6,904 |
| Net investment earnings (non-operating) | 12,683 | 13,259 | 4,103 |
| Other | 630 | 654 | 587 |
| Total Revenues | <u>129,746</u> | <u>134,034</u> | <u>116,598</u> |
| EXPENSES | | | |
| Pass-through grant expense | 53,020 | 59,845 | 55,352 |
| Interest and debt expense (non-operating) | 38,406 | 36,812 | 34,125 |
| Loan fees expense | 6,053 | 5,984 | 5,280 |
| Program expenses, net | 3,028 | 3,477 | 3,877 |
| Administrative expenses, net | 8,361 | 8,273 | 8,576 |
| Total Expenses | <u>108,868</u> | <u>114,391</u> | <u>107,210</u> |
| CHANGES IN NET ASSETS | <u>\$ 20,878</u> | <u>\$ 19,643</u> | <u>\$ 9,388</u> |

Interest on loans

The increase in *Interest on loans* of \$3,751,000 (7.2%) from 2007 to 2008 and \$2,423,000 (4.9%) from 2006 to 2007 were primarily due to an increase in mortgage loan balances from the prior year.

Pass through grant revenue and Pass through grant expense

This line item represents federal funds received and disbursed to sub-recipients under Federal Programs. The decrease of \$6,825,000 (11.4%) from 2007 to 2008 and increase of \$4,493,000 (8.1%) from 2006 to 2007 was due to fluctuations in the volume of activity in the HOME program for the fiscal years.

Fee revenue

The decrease of \$614,000 (7.5%) in *Fee revenue* from 2007 to 2008 was primarily due to a decrease of \$1,443,000 in multifamily prepayment penalties net of an increase of \$217,000 in service fees due to higher mortgage loan balances, an increase of \$400,000 in Low-Income Housing Tax Credit fees and an increase of \$128,000 in fees earned on the sale of loans in the secondary market.

The increase of \$1,297,000 (18.8%) in *Fee revenue* from 2006 to 2007 was primarily due to an increase of \$1,117,000 in multifamily prepayment penalties.

Net investment earnings

Net investment earnings increased \$9,156,000 (223.2%) from 2006 to 2007 and decreased \$576,000 (4.3%) from 2007 to 2008 in the comparison of revenues and expenses above. However, Net investment earnings include unrealized gains and losses in the fair market value of investments for each of the fiscal years presented as required by GASB Statement No. 31. As shown in the schedule below, the Fund's investment earnings, adjusted for the unrealized gains or losses, increased 25.7% from 2006 to 2007 and decreased 20.4% from 2007 to 2008. These fluctuations are due to higher interest rates and higher balances during fiscal year 2007 and lower interest rates during fiscal year 2008.

| | June 30, | | |
|--|------------------------|--------------------|--------------------|
| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
| | (Dollars in thousands) | | |
| Net investment income per operating statement | \$ 12,683 | \$ 13,259 | \$ 4,103 |
| Adjustments for unrealized (gain) loss on fair value of securities | <u>(2,371)</u> | <u>(311)</u> | <u>6,199</u> |
| Interest earned on investments | <u>\$ 10,312</u> | <u>\$ 12,948</u> | <u>\$ 10,302</u> |
| % (Decrease) Increase from prior year | (20.4%) | 25.7% | |

Other revenues

The decrease of \$24,000 (3.7%) in Other revenues from 2007 to 2008 was primarily due to a decrease in gains on the sale of mortgage loans in the secondary market, net of an increase in rental income on foreclosed multifamily properties the Fund manages.

The increase of \$67,000 (11.4%) in Other revenues from 2006 to 2007 was primarily due to an increase in rental income on the Fund's building.

Interest and debt expense

The \$1,594,000 (4.3%) increase in Interest and debt expense from 2007 to 2008 and \$2,687,000 (7.9%) increase in Interest and debt expense from 2006 to 2007 were primarily due to the increase in the balance of bonds outstanding and higher interest rates on new debt issued.

Loan fees expense

The \$704,000 (13.3%) increase in Loan fees expense from 2006 to 2007 and an additional increase of \$69,000 (1.2%) from 2007 to 2008 were primarily due to an increase in servicing fees due to an increase in mortgage loan balances from the prior year.

Program expenses, net

The \$449,000 (12.9%) decrease in Program expenses, net from 2007 to 2008 was primarily due to a decrease in Special Needs disbursements and cost of issuance expenses net of an increase in provision for loan loss expenses.

The \$400,000 (10.3%) decrease in Program expenses, net from 2006 to 2007 was primarily due to a decrease in provision for loan loss expenses.

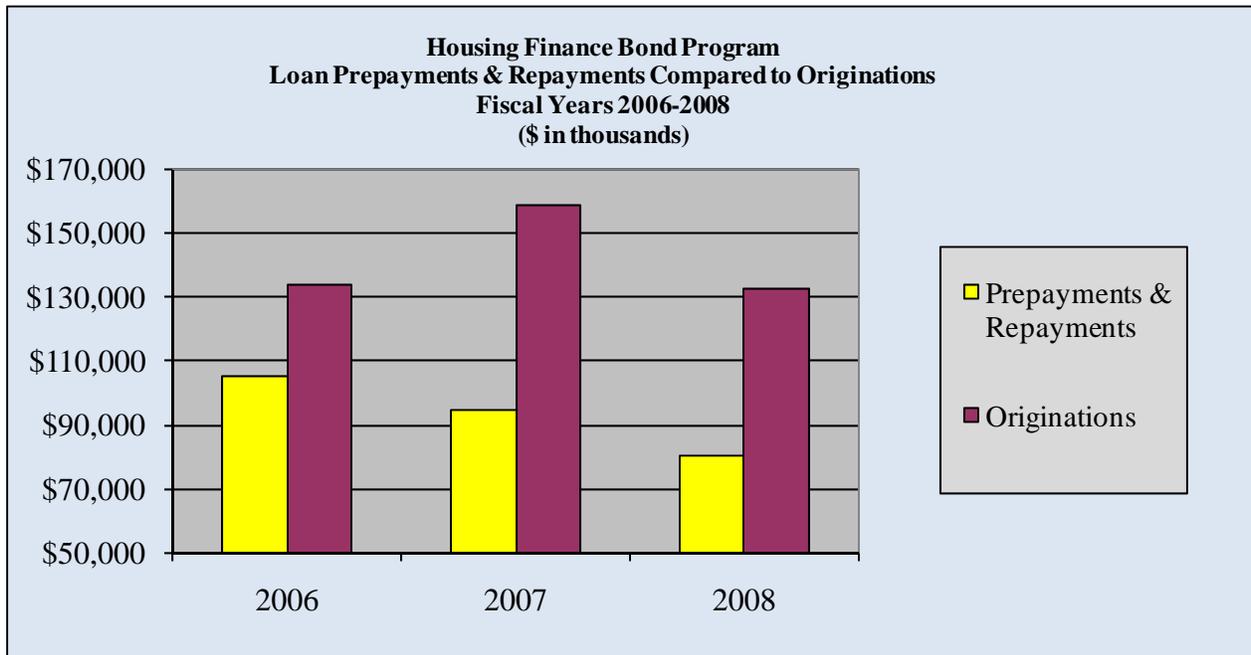
OVERVIEW OF THE FINANCIAL STATEMENTS

Mortgage Lending

The Fund's Housing Finance Bond Program is the core-housing program and the primary source of income for the Fund. Various economic and regulatory factors such as prevailing economic conditions, mortgage interest rates, investment rates, the demand for housing, the cost of housing and of operating housing programs, the volume of mortgage lending activity in the State and other factors affecting the supply of housing in the State can create significant challenges for the Fund in both the Housing Finance Bond Program and its overall operations.

As interest rates increased during fiscal year 2006, the Fund's mortgage loan rate became more competitive compared to the conventional loan market and the number of borrowers refinancing their mortgages decreased. As mortgage refinancing began to decrease from fiscal year 2006 to fiscal year 2007 and through fiscal year 2008, the Housing Finance mortgage loan balances increased \$64,091,000 in fiscal year 2007 and an additional \$52,003,000 in fiscal year 2008. Mortgage loan balances and continued loan originations are key elements to future earnings potential.

The following chart illustrates the volume of loan prepayments and repayments compared to originations from fiscal year 2006 through fiscal year 2008 for the Housing Finance Bond Program.



Interest rates on new single family mortgage loans originated in fiscal years 2006 through 2008 have averaged approximately 5.79%. Due to lower interest rates on new single family loan originations and the prepayment of higher interest single family and multifamily loans, the average interest rate on loans outstanding has declined as follows.

| | |
|---------------|-------|
| June 30, 2006 | 6.06% |
| June 30, 2007 | 5.96% |
| June 30, 2008 | 5.91% |

Even though the average mortgage interest rate decreased, total *Interest on loans* for the fiscal year ended June 30, 2008 increased \$3,751,000, or 7.2%, from the fiscal year ended June 30, 2007 due to an increase in mortgage loan balances.

Despite significant increases in the amount of foreclosures and delinquency rates nationwide, the Fund's foreclosures and delinquency rates have remained relatively stable. Nationwide increases began in late 2006 and have increased each quarter since. The increases are a result of sub-prime lending, lower home values and a weakened economy. The Fund attributes the steadiness of its rates to sound underwriting practices and with the exception of a few counties within the State, no significant decline in home values. Also, the Fund's core housing program, the Housing Finance Bond Program, consists of 30 year fixed rate loans and no sub-prime loans.

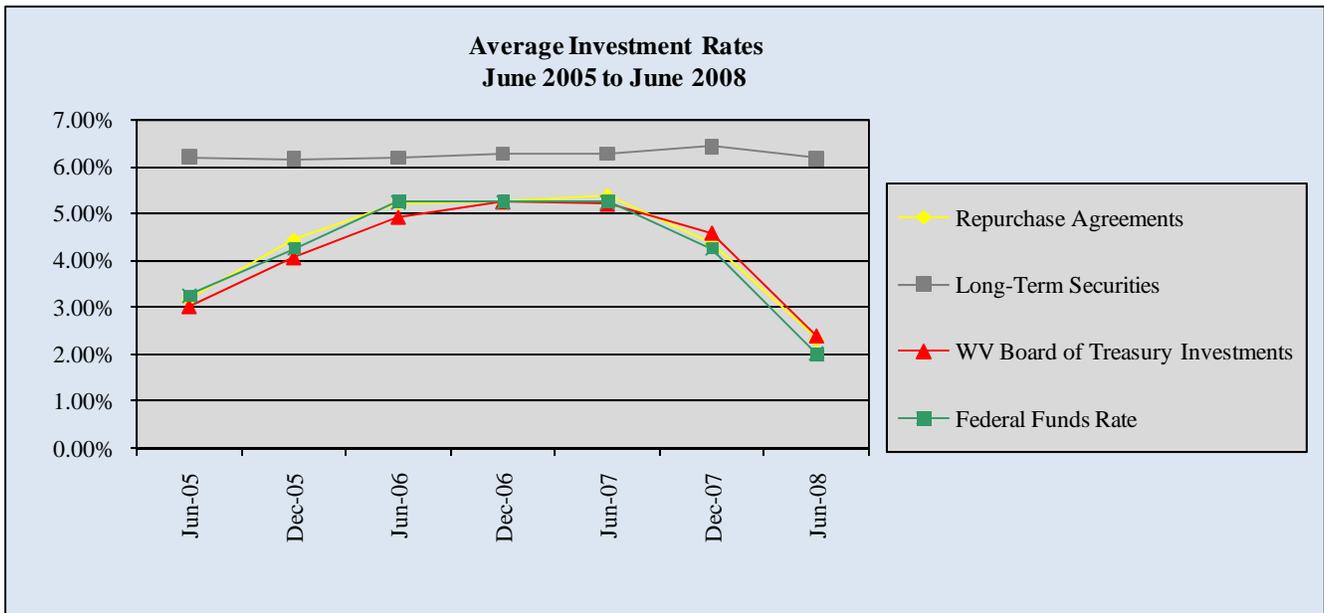
To help West Virginian's that have fallen prey to sub-prime lending or that are struggling to pay their mortgages due to the weakened economy and higher costs of living, the Fund is working to develop a homebuyer, credit and foreclosure counseling system across the state of West Virginia. This counseling network will be designed to help families avoid foreclosure and not only keep the Fund's foreclosure rates stable, but keep families in their homes.

Investments

The Fund invests cash not required for immediate disbursement as permitted by the Act, the bond resolutions, and the Board approved Investment Policy. Funds related to Housing Finance Bond Program capital reserves and the Bond Insurance Account are primarily invested in long-term United States government and agency securities, which are expected to be held to maturity. Certain funds in the Bond Insurance Account and general operating funds are invested in mortgage loans held solely for investment. The interest earnings on the above account types are less affected by the fluctuation in short-term interest rates.

Loan proceeds and revenues of the Housing Finance Bond Program, Other Loan Program, the Economic Development Financing Bonds and operating funds are primarily invested in collateralized repurchase agreements. The remaining funds are on deposit in a bank or with the West Virginia Board of Treasury Investments (WVBOTI). Such funds are extremely sensitive to short-term interest rate fluctuations.

As shown in the following chart, the average investment rate for repurchase agreements and the WVBOTI has been consistent with the Federal Funds rate. During fiscal year 2006 the Federal Reserve increased the federal funds rate eight times to a high of 5.25%, where it remained through fiscal year 2007. During fiscal year 2008, the Federal Reserve decreased the federal funds rate seven times to the current rate of 2.00%. The decrease in fiscal year 2008 directly impacted the Fund's investment earnings for the year as they decreased 20.4% from 2007, net of unrealized gains or losses. Average long-term investment rates remain relatively unchanged. However, as long-term investments mature or are redeemed, the Fund's long-term average rates are decreasing due to the current lower yield opportunities for the reinvestment of these funds.



Debt Management

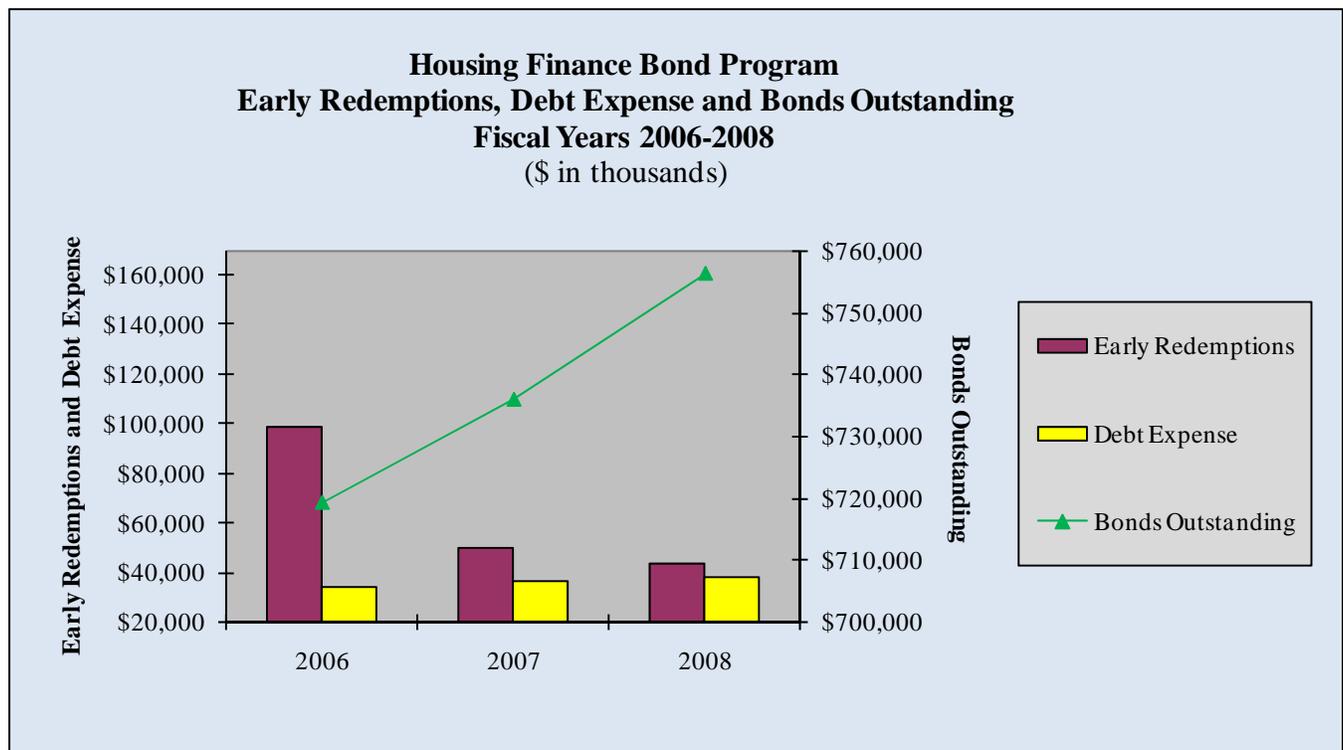
The Fund issues qualified mortgage revenue bonds to fund its single family Housing Finance Bond Program. When bonds are issued, the initial proceeds are invested in short-term investments until the funds are used for the purchase of mortgage loans. Because short-term investment rates may be lower than the long-term bond rates, this could create negative arbitrage. To reduce this negative arbitrage, the Fund delays the issuance of new bonds until absolutely necessary.

The Fund sometimes uses general operating funds as a warehouse line to purchase new loans in anticipation of bond sales. In addition to general operating funds, the Fund has a \$15,000,000 line of credit with the Federal Home Loan Bank (the FHLB) that is also available to use as a warehouse line for the purchase of single family, multifamily, secondary market and economic development loans. This line of credit is secured by investments of the Bond Insurance Account and is a general obligation of the Fund. At June 30, 2008, no advances had been drawn on this line of credit, and accordingly, no balance is outstanding.

When bonds are issued from the bond volume allocation, known as “new money” bonds, certain repayments and prepayments of mortgage loans made from these proceeds may be “recycled” into additional mortgage loans for ten years. Since 1992, the Fund has used recycling to supplement its bond issues by using prepayments for additional mortgage loans instead of issuing debt. If the market interest rates on mortgages are lower than the corresponding bond rates, the Fund may redeem bonds in lieu of recycling. However, if mortgage rates are higher than the corresponding bond rates the Fund may redirect prepayments into additional mortgage loans in lieu of redeeming bonds. Moving forward into fiscal year 2009 the Fund expects to continue to recycle mortgage loan repayments from its bond issues when it is economically prudent to do so.

During fiscal years 2006, 2007 and 2008, the Fund redeemed \$99,150,000, \$30,340,000, and \$43,970,000 in bonds, respectively. The decrease in early redemptions for 2007 and 2008 as compared to 2006 is a factor of a decrease in the amount of funds received from the early prepayment of mortgages and the Fund’s ability to recycle these prepayments in lieu of redeeming bonds. Due to the decrease in bonds redeemed, the Fund’s bond balance has increased and as a result of this, debt interest expense has increased. Debt expense was \$34,125,000, \$36,812,000 and \$38,406,000 in fiscal years 2006, 2007 and 2008, respectively.

The following chart illustrates early bond redemptions, debt expense and bonds outstanding in the Housing Finance Bond Program.



Economic Development Program

The Fund developed an Economic Development Program to generate and promote job creation in the State. In November 2005, \$15,000,000 Economic Development Financing Bonds were issued to fund a commitment of \$12,500,000 for one economic development project and the related capital reserve requirement. The Economic Development project funded by these bonds paid its loan in full and the bonds were redeemed in their entirety in February 2008. The Fund does not expect to issue any additional bonds for Economic Development at this time.

The Fund committed \$6,000,000 to the West Virginia University (“WVU”) Research Corporation to provide funds for the construction of biomedical research facilities, renovations to existing laboratories and the expansion of the WVU medical library. As of June 30, 2008, this commitment has been fully funded.

In 2003 the Fund provided a loan guarantee in the initial amount of \$10,465,000 for Wheeling-Pittsburgh Steel Corporation. The related loan was assigned to a new lender in fiscal year 2008. Consequently, the Fund was released from the loan guarantee commitment effective May 6, 2008.

Other

The Fund services all of its outstanding mortgage loans and services loans on behalf of Fannie Mae, Freddie Mac, the West Virginia Affordable Housing Trust and the West Virginia Jobs Investment Trust. The Fund is the largest loan servicer in the State with serviced loans of \$1.34 billion. Servicing fee income in the amount of \$3,445,000 represents 5.38% of the Fund’s operating revenues, net of pass through grant revenue, for the fiscal year ended June 30, 2008.

The Fund has entered into a Purchase Option agreement on a parcel of land with the intention of constructing a new office building for its operations. It is anticipated that bonds will be issued in the future to cover these costs.

CONTACTING THE FUND’S FINANCIAL MANAGEMENT

The above financial highlights are designed to provide a general overview of the Fund’s operations and insight into the following financial statements. Additional information may be requested by contacting the Deputy Director, West Virginia Housing Development Fund, at 814 Virginia St. East, Charleston, WV 25301, or may be found on our website at www.wvhdf.com.

WEST VIRGINIA HOUSING DEVELOPMENT FUND
STATEMENTS OF NET ASSETS
(Dollars in Thousands)

| | June 30, | |
|---|--------------------|--------------------|
| | <u>2008</u> | <u>2007</u> |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents-- (Notes A and C) | \$ 34,855 | \$ 36,432 |
| Accrued interest on loans | 503 | 314 |
| Accrued interest on investments | 37 | 12 |
| Mortgage loans held for sale-- (Note A) | 847 | 1,189 |
| Restricted cash and cash equivalents-- (Notes A and C) | 51,438 | 51,391 |
| Restricted accrued interest on loans | 3,703 | 3,620 |
| Restricted accrued interest on investments | 1,320 | 954 |
| Total current assets | <u>92,703</u> | <u>93,912</u> |
| Noncurrent assets: | | |
| Mortgage loans, net of allowance for losses-- (Note A) | 48,392 | 46,745 |
| Other assets, net of allowance for losses-- (Note A) | 1,563 | 817 |
| Restricted cash and cash equivalents-- (Notes A and C) | 13,830 | 51,287 |
| Restricted investments-- (Notes A and C) | 107,774 | 88,964 |
| Restricted mortgage loans, net of allowance for losses-- (Note A) | 950,615 | 910,177 |
| Restricted other assets, net of allowance for losses-- (Note A) | 5,065 | 3,548 |
| Total noncurrent assets | <u>1,127,239</u> | <u>1,101,538</u> |
| Total assets | <u>1,219,942</u> | <u>1,195,450</u> |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities: | | |
| Accounts payable and other liabilities-- (Note A) | 19,147 | 21,924 |
| Accrued interest payable | 6,275 | 6,580 |
| Bonds payable-- (Note D) | 24,835 | 24,925 |
| Total current liabilities | <u>50,257</u> | <u>53,429</u> |
| Noncurrent liabilities: | | |
| Federal program advances-- (Note A) | 60,844 | 63,486 |
| Bonds & notes payable-- (Note D) | 735,342 | 725,914 |
| Total noncurrent liabilities | <u>796,186</u> | <u>789,400</u> |
| Total liabilities | <u>846,443</u> | <u>842,829</u> |
| Net assets: | | |
| Restricted | 288,387 | 270,616 |
| Unrestricted | 85,112 | 82,005 |
| TOTAL NET ASSETS | <u>\$ 373,499</u> | <u>\$ 352,621</u> |

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

**WEST VIRGINIA HOUSING DEVELOPMENT FUND
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS
(Dollars in Thousands)**

| | Year Ended June 30, | |
|--|--------------------------------|--------------------|
| | <u>2008</u> | <u>2007</u> |
| OPERATING REVENUES | | |
| Interest on loans | \$ 55,826 | \$ 52,075 |
| Pass-through grant revenue-- (Note A) | 53,020 | 59,845 |
| Fee revenue-- (Note A) | 7,587 | 8,201 |
| Other-- (Note A) | 630 | 654 |
| | <u>117,063</u> | <u>120,775</u> |
| OPERATING EXPENSES | | |
| Pass-through grant expense-- (Note A) | 53,020 | 59,845 |
| Loan fees expense-- (Note A) | 6,053 | 5,984 |
| Program expenses, net-- (Note A) | 3,028 | 3,477 |
| Administrative expenses, net-- (Note A) | 8,361 | 8,273 |
| | <u>70,462</u> | <u>77,579</u> |
| OPERATING INCOME | 46,601 | 43,196 |
| NON-OPERATING - FINANCING AND INVESTING REVENUES (EXPENSES) | | |
| Net investment earnings | 12,683 | 13,259 |
| Interest and debt expense | (38,406) | (36,812) |
| | <u>(25,723)</u> | <u>(23,553)</u> |
| CHANGES IN NET ASSETS | 20,878 | 19,643 |
| NET ASSETS AT BEGINNING OF YEAR | <u>352,621</u> | <u>332,978</u> |
| NET ASSETS AT END OF YEAR | <u>\$ 373,499</u> | <u>\$ 352,621</u> |

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

WEST VIRGINIA HOUSING DEVELOPMENT FUND
STATEMENTS OF CASH FLOWS
(Dollars in Thousands)

| | Year Ended | |
|---|--------------------|--------------------|
| | June 30, | |
| | <u>2008</u> | <u>2007</u> |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Receipts from lending activities | \$ 161,613 | \$ 162,537 |
| Receipts from other operating activities | 8,154 | 8,774 |
| (Disbursements) receipts from escrows or advances | (238) | 1,924 |
| Receipts for federal lending activities | 3,320 | 12,122 |
| Receipts for federal activities | 48,065 | 45,951 |
| Disbursements for federal activities | (49,193) | (45,639) |
| Purchase of mortgage loans | (154,610) | (193,918) |
| Purchase of mortgage loans held for sale | (46,118) | (24,290) |
| Sales of mortgage loans | 46,460 | 23,766 |
| Payments to employees for salaries and benefits | (6,397) | (6,314) |
| Payments to vendors | (14,096) | (12,837) |
| Net cash used in operating activities | <u>(3,040)</u> | <u>(27,924)</u> |
| CASH FLOWS USED IN NONCAPITAL FINANCING ACTIVITIES | | |
| Net proceeds from bonds and notes | 76,853 | 97,289 |
| Retirement of bonds and notes | (67,491) | (80,520) |
| Interest paid | (39,135) | (36,402) |
| Net cash used in noncapital financing activities | <u>(29,773)</u> | <u>(19,633)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from maturities of investments | 23,852 | 34,261 |
| Purchase of investments | (40,197) | (2,408) |
| Net investment earnings | 10,171 | 13,354 |
| Net cash (used in) provided by investing activities | <u>(6,174)</u> | <u>45,207</u> |
| Net decrease in cash and cash equivalents | (38,987) | (2,350) |
| Cash and cash equivalents at beginning of year | 139,110 | 141,460 |
| Cash and cash equivalents at end of year | <u>\$ 100,123</u> | <u>\$ 139,110</u> |
| Cash and cash equivalents consist of: | | |
| Cash and cash equivalents | \$ 34,855 | \$ 36,432 |
| Restricted cash and cash equivalents - current | 51,438 | 51,391 |
| Restricted cash and cash equivalents - noncurrent | 13,830 | 51,287 |
| | <u>\$ 100,123</u> | <u>\$ 139,110</u> |

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

WEST VIRGINIA HOUSING DEVELOPMENT FUND
STATEMENTS OF CASH FLOWS (CONTINUED)
(Dollars in Thousands)

| | Year Ended | |
|---|--------------------|--------------------|
| | June 30, | |
| | <u>2008</u> | <u>2007</u> |
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 46,601 | \$ 43,196 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Provision for loan losses | 608 | 130 |
| Change in assets and liabilities: | | |
| Accrued interest on loans | (189) | (129) |
| Mortgage loans held for sale | 342 | (524) |
| Other assets | (1,030) | (249) |
| Restricted accrued interest on loans | (83) | (269) |
| Restricted other assets | (1,249) | 54 |
| Mortgage loans, net | (5,325) | (4,908) |
| Restricted mortgage loans, net | (37,352) | (73,449) |
| Accounts payable | (2,721) | 1,623 |
| Federal program advances | (2,642) | 6,601 |
| Net cash used in operating activities | <u>\$ (3,040)</u> | <u>\$ (27,924)</u> |
| Noncash investing and financing activities: | | |
| Increase in fair value of investments | \$ 2,371 | \$ 311 |
| Net amortization of premiums/discounts on investments | (57) | (60) |

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

WEST VIRGINIA HOUSING DEVELOPMENT FUND
NOTES TO FINANCIAL STATEMENTS, AN INTEGRAL PART OF THE FINANCIAL STATEMENTS
June 30, 2008

NOTE A – AGENCY DESCRIPTION AND SIGNIFICANT ACCOUNTING POLICIES

The West Virginia Housing Development Fund (the Fund), a component unit of the State of West Virginia (the State), is a governmental instrumentality of the State and a public body corporate, created under the provisions of Article 18, Chapter 31 of the Code of West Virginia, 1931, as amended, and known as the West Virginia Housing Development Fund Act (the Act). Under the Act, the Fund's corporate purposes primarily relate to providing various housing programs. The Fund can also finance non-residential projects as defined in the Act.

The Fund is governed by a Board of Directors consisting of the Governor, Attorney General, Commissioner of Agriculture, and Treasurer of the State, all of whom serve ex-officio as public directors, and seven members, chosen by the Governor with the advice and consent of the State Senate, as private directors from the general public residing in the State. The Act, as amended in January 2005, designates the Governor or his or her designee as the Chair of the Board of Directors. Furthermore, this amendment provides that the Governor shall appoint the executive director, with the advice and consent of the State Senate, and that the executive director will serve at the Governor's will and pleasure.

The Fund is included as a discretely presented component unit of the primary government in the State's Comprehensive Annual Financial Report. In defining the Fund for financial reporting purposes, management considered all potential component units. Based on the criteria of accounting principles generally accepted in the United States, the Fund has no component units.

The various programs of the Fund consist of the General Account, Housing Finance Bond Program, Other Loan Programs, Land Development Program, Bond Insurance Account, and Federal Programs.

The General Account includes the results of the Fund's loan servicing operations, administrative expenses of the Fund's operations, operations of the Fund's building and fee income related to the administration of the Section 8 Housing Assistance Payments Programs (HAPs Program). In April 2007, the Fund transferred operations of the Low-Income Assisted Mortgage Program and the Special Needs Program to Other Loan Programs. Fiscal year 2007 includes the activities of these programs for the period of time they were included in the General Account during fiscal year 2007.

The Housing Finance Bond Program includes the activities of the single family and multifamily bond program the purpose of which is to provide affordable housing throughout the State. Assets and revenues of the Housing Finance Bond Program are restricted subject to the provisions of the bond resolution and are available for other purposes only to the extent they are not required to meet specified reserve and funding provisions of the resolution.

Other Loan Programs include the Homeownership Assistance Program, Secondary Market Program, Leveraged Loan Program, Economic Development Program, Mini-Mod Renovation Program, Constructing Affordable Sensible Homes Program, Flood Program, Demolition Program, Home Emergency Loan Program, Low-Income Assisted Mortgage Program and the Special Needs Program, all of which have been financed from the general reserves of the Fund. Other Loan Programs also include activities of the Economic Development Financing Bond Program. These bonds were paid in full on February 25, 2008 as a result of the prepayment of the corresponding economic development project.

The Land Development Program was established by the Act in 1973 with a \$2,000,000 appropriation from the State Legislature from which the Fund can make below-market interest rate loans to developers to acquire and improve land for residential housing and non-residential construction. The Land Development Program is restricted by State statute.

The Bond Insurance Account was created by the Act as a special trust fund within the State Treasury designated as the "Mortgage Finance Bond Insurance Fund", and was established to provide for the payment of principal and interest in the event of default by the Fund on "Mortgage Finance Bonds," as defined in the Act. The Bond Insurance Account is restricted by State statute and is under the supervision of the West Virginia Municipal Bond Commission (the "Bond Commission"). The Bond Insurance Account is included in the Fund's financial statements but is kept separate and

apart from all other accounts of the Fund, the Bond Commission, and the State. The only Mortgage Finance Bonds currently outstanding are the Housing Finance Bonds.

Federal Programs include the United States Department of Housing and Urban Development's (HUD) HOME Investment Program (HOME), and HAPs Program for which the Fund acts as program administrator. These programs are funded solely through federal monies and are restricted by Federal regulations.

Accounting methods: The accounting policies of the Fund conform to generally accepted accounting principles for state housing finance agency enterprise funds. The various programs were established in accordance with the Act, the bond resolutions, or at management's discretion. The financial statements are prepared following the flow of economic resources measurement focus on the accrual basis of accounting, which requires recognition of revenue when earned and expenses when incurred.

The Fund follows Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, and accordingly, does not adopt Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, unless the GASB specifically adopts such FASB statements or interpretations.

Cash and cash equivalents: The Fund considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. This includes cash, certificates of deposit, collateralized repurchase agreements, and deposits with the West Virginia Board of Treasury Investments (WVBOTI). Under arrangements relating to collateralized repurchase agreements, third parties hold the underlying securities and monitor the market values of such securities so that the market value of the collateral pledged is maintained at a minimum of 102% of the amount of the repurchase agreements.

Mortgage loans held for sale: In its Secondary Market Program, the Fund purchases and sells fixed-rate and adjustable-rate mortgage loans, primarily to government agencies, on a servicing retained basis. Mortgage loans held for sale, including commitments to purchase and sell loans, are carried at the lower of aggregate cost or market. The sale price is determined at the date of commitment and the commitment period generally ranges from 30 to 90 days. At June 30, 2008, the Fund had commitments to originate loans of \$1,477,000, net of estimated fallout, and commitments to sell loans of \$482,000.

Restricted cash and cash equivalents represents monies the Fund holds on behalf of others, restricted by the Act or by the bond resolutions. Included in this line item are tax and insurance escrows held on behalf of the Fund's various mortgagors, owner's equity held on behalf of multifamily developers for construction costs and payments collected on mortgages for which the Fund acts as servicer only. The Fund is obligated to expend these monies on escrowed items or remit them to the appropriate investors in the case of mortgage loans serviced for the benefit of others. Also included in Restricted cash and cash equivalents are federal housing program funds for which the Fund acts as grantee or agent. The total funds held on behalf of others were \$15,376,000 at June 30, 2008 and \$16,707,000 at June 30, 2007. Restricted cash and cash equivalents to be used for the acquisition of noncurrent assets, such as mortgage loans or investments, are classified as Noncurrent assets.

Mortgage loans, net of allowances for losses: These loans consist primarily of unrestricted mortgage loans made under the General Account and Other Loan Programs. The Fund provides for possible losses on loans based on management's review of potential problem loans. The allowance for loan losses is shown below.

| | June 30, 2008 | | | June 30, 2007 | | |
|------------------------------|------------------------|--------------------|------------------|------------------------|--------------------|------------------|
| | <u>Loan Balance</u> | <u>Allowance</u> | <u>Net</u> | <u>Loan Balance</u> | <u>Allowance</u> | <u>Net</u> |
| | (Dollars in thousands) | | | (Dollars in thousands) | | |
| Unrestricted Mortgage Loans: | | | | | | |
| General Account | \$ 4,228 | \$ (1,106) | \$ 3,122 | \$ 6,081 | \$ (1,257) | \$ 4,824 |
| Other Loan Programs | 56,206 | (10,936) | 45,270 | 52,125 | (10,204) | 41,921 |
| Total | <u>\$ 60,434</u> | <u>\$ (12,042)</u> | <u>\$ 48,392</u> | <u>\$ 58,206</u> | <u>\$ (11,461)</u> | <u>\$ 46,745</u> |

Other assets include accounts receivables, foreclosed properties and properties owned, net of an allowance for estimated probable declines in net realizable value. Also included in Other assets is land and an office building owned by the Fund stated at its original cost of \$1,100,000, net of accumulated depreciation on the building of \$880,000. The building is fully depreciated. Capital assets are not separately presented in the financial statements due to immateriality.

| | June 30, 2008 | | | June 30, 2007 | | |
|--------------------------|------------------------|-----------|----------|------------------------|-----------|--------|
| | Balance | Allowance | Net | Balance | Allowance | Net |
| | (Dollars in thousands) | | | (Dollars in thousands) | | |
| Other Assets: | | | | | | |
| Accounts receivable | \$ 593 | \$ (5) | \$ 588 | \$ 398 | \$ (13) | \$ 385 |
| Land and office building | 438 | (85) | 353 | 300 | (8) | 292 |
| Foreclosed property | 1,093 | (471) | 622 | 366 | (226) | 140 |
| Total | \$ 2,124 | \$ (561) | \$ 1,563 | \$ 1,064 | \$ (247) | \$ 817 |

Office furniture, equipment, and improvements are charged to operations when purchased; accordingly, no depreciation or amortization for these items is included in the financial statements. If such assets were capitalized and depreciated over their estimated useful lives, there would be no material effect on the accompanying financial statements.

Restricted investments: The Fund established guidelines for the investment of its funds to meet the requirements of the bond resolutions and the Act. Investments consist primarily of collateralized repurchase/investment agreements, United States government and agency obligations and certificates of deposit with maturities greater than 90 days.

Investment securities are recorded at fair value, based on quoted market prices, and a portion of the unrealized gains or losses is reported in the Statements of Revenues, Expenses, and Changes in Net Assets as part of Net investment earnings as more fully explained in *Note C – Cash and Investments*.

Restricted mortgage loans, net of allowance for losses includes loans originated under the General Account, the Housing Finance Bond Program, Other Loan Programs, Land Development Program, and Federal Programs as well as loans held in the Bond Insurance Account. The allowance for loan losses in these programs is shown below.

| | June 30, 2008 | | | June 30, 2007 | | |
|------------------------------|------------------------|-------------|------------|------------------------|-------------|------------|
| | Balance | Allowance | Net | Balance | Allowance | Net |
| | (Dollars in thousands) | | | (Dollars in thousands) | | |
| Restricted Mortgage Loans: | | | | | | |
| General Account | \$ 1,680 | \$ (1,641) | \$ 39 | \$ 1,725 | \$ (1,679) | \$ 46 |
| Other Loan Programs | - | - | - | 12,343 | (3,086) | 9,257 |
| Land Development | 4,881 | (465) | 4,416 | 5,336 | (509) | 4,827 |
| Bond Insurance Account | 15,768 | (489) | 15,279 | 15,851 | (390) | 15,461 |
| Housing Finance Bond Program | 880,063 | (9,122) | 870,941 | 825,063 | (6,125) | 818,938 |
| Federal Programs | 82,680 | (22,740) | 59,940 | 83,356 | (21,708) | 61,648 |
| Total | \$ 985,072 | \$ (34,457) | \$ 950,615 | \$ 943,674 | \$ (33,497) | \$ 910,177 |

Federal Programs include HOME, which is designed to assist very low-income borrowers and to provide capacity building funds for nonprofit housing organizations. The funds provided to these nonprofits will only be repaid if the nonprofit fails to provide the services required as a condition of receiving HOME funds. Therefore, these HOME loans are recorded as restricted mortgage loans with a corresponding 100% loss allowance in the Statements of Net Assets.

Most loans in the Housing Finance Bond Program are protected against loss by collateralization and various federal and private insurance programs. Repayment of certain multifamily rental project loans is dependent, in part, upon rental and interest subsidy programs of HUD.

Restricted other assets include certain foreclosed properties, properties developed for flood activities, other land for restricted housing purposes, and miscellaneous receivables, net of an allowance for estimated probable declines in the net realizable value. These assets are restricted subject to the provisions of the bond resolutions, the Act, or federal regulations.

| | June 30, 2008 | | | June 30, 2007 | | |
|--------------------------|------------------------|-------------------|-----------------|------------------------|-------------------|-----------------|
| | Balance | Allowance | Net | Balance | Allowance | Net |
| | (Dollars in thousands) | | | (Dollars in thousands) | | |
| Restricted other assets: | | | | | | |
| Accounts receivable | \$ 277 | \$ (166) | \$ 111 | \$ 228 | \$ (166) | \$ 62 |
| Land | 3,406 | (2,574) | 832 | 3,576 | (2,593) | 983 |
| Foreclosed property | 5,616 | (1,494) | 4,122 | 3,849 | (1,346) | 2,503 |
| Total | <u>\$ 9,299</u> | <u>\$ (4,234)</u> | <u>\$ 5,065</u> | <u>\$ 7,653</u> | <u>\$ (4,105)</u> | <u>\$ 3,548</u> |

Accounts payable and other liabilities includes amounts held on behalf of others as explained in Note A - Restricted cash and cash equivalents, amounts due to vendors, and rebateable investment earnings.

Federal program advances are federal housing program funds for which the Fund acts as grantee or agent to originate mortgages under the HOME program.

Restricted net assets: Net assets of the Housing Finance Bond Program and a portion of the net assets of Other Loan Programs relating to the Economic Development Financing Bonds are restricted to meet specified reserve and funding provisions in accordance with the Housing Finance Bond Resolution and the Economic Development Bond Resolution, respectively. The Economic Development Bonds were paid in full on February 25, 2008. Net assets of the Land Development Program and Bond Insurance Account are restricted in accordance with the Act. Federal Programs are restricted due to requirements of HUD as the grantor agency. When both restricted and unrestricted resources are available for use, it is generally the Fund's policy to use restricted resources first, and then unrestricted resources as they are needed.

Operating revenues and expenses: The Fund classifies operating revenues and expenses based on the services provided by the Fund and its ongoing operations. This includes such activities as mortgage lending, administration of federal financial awards programs, property management and development, and other related program activities. Net investment earnings and interest on debt are reported as non-operating revenues and expenses.

Pass-through grant revenue and pass-through grant expense: The Fund receives grants and other financial assistance from HOME and the HAPs Programs to transfer or spend on behalf of various secondary recipients. These amounts are considered pass-through grants and are reported in the financial statements as revenue and expense when funds are disbursed to the subrecipient.

Fee revenue consists primarily of loan servicing fees on mortgage loans serviced by the Fund, administration fees earned from the HAPs Program, financing fees, bond insurance fees, secondary market fees, prepayment penalties on multifamily loans and deferred document penalty fees.

The Fund services all loans in its portfolio as well as loans on behalf of others totaling approximately \$1,346,237,000 and \$1,297,928,000 at June 30, 2008 and 2007, respectively. Of this total, the portfolio serviced by the Fund on behalf of others approximated \$291,983,000 and \$285,777,000 at June 30, 2008 and 2007, respectively.

Other revenues consist primarily of rental income, gains on sales of foreclosed properties acquired through the Fund's mortgage lending activities, and other miscellaneous revenue items.

Loan fees expense includes fees paid to lenders for the origination of mortgage loans. In addition, loan fees expense includes the cost of acquiring the servicing rights to mortgage loans owned by the Fund and loans owned by others, primarily Fannie Mae. Since such costs are expensed as incurred, no purchased mortgage servicing right is capitalized. The impact of not capitalizing the present value of net future servicing revenues, less amortization, over the estimated lives of the underlying mortgage loans, is not material to the accompanying financial statements.

Program expenses primarily consist of disbursements made under the Fund's various programs, provisions for mortgage loan losses and costs of bond issuance. The Fund expenses bond issuance costs in the period the related bonds are issued and it does not amortize the costs. Expensing debt issuance costs in the period of borrowing does not materially affect the accompanying financial statements. Program expenses also include daily operating expenses of the office building owned by the Fund and certain foreclosed multifamily properties the Fund owns and manages.

Administrative expenses, net include salary, benefits, and other operating expenses related to the daily operations of the Fund. When an expense is incurred, the expense is charged to the program or account for which it is directly applicable, whether restricted or unrestricted. Indirect expenses are allocated to programs and accounts based on a percentage of the program's or account's direct salary cost.

NOTE B – ASSETS FOR RESERVED AND OTHER PURPOSES

Assets and revenues of the Housing Finance Bond Program and Economic Development Financing Bond Program are subject to the provisions of the bond resolution and are available for other purposes only to the extent they are not required to meet specified reserve and funding provisions of the resolution. The Fund, to the extent such monies become available under the terms of the resolution, has pledged to maintain the net assets of its Housing Finance Bond Program at a level to preserve the Fund's bond ratings. In the event that the Fund fails to comply with the terms of the Housing Finance Resolution or the General Economic Development Bond Resolution, the holders of such obligations would have recourse to the unrestricted assets of the Fund.

Assets of the General Account and Other Loan Programs are principally unrestricted and may be transferred to other programs subject to the approval of the Fund's management or Board of Directors. The Fund has committed \$494,000 from the General Account and \$10,737,000 from Other Loan Programs for various loans and economic development projects at June 30, 2008. These amounts are included in Unrestricted net assets. The Fund is actively accepting applications from prospective recipients to originate loans from amounts allocated by the Board of Directors from the General Account and Other Loan Programs.

The Board of Directors has also allocated \$1,000,000 of the Unrestricted net assets for the "Directors' and Officers' Insurance Account" for the purpose of providing indemnification for the directors and officers of the Fund. The fiscal year 2009 administrative budget of \$9,997,800 will be provided from the Unrestricted net assets and from future revenues of the Fund.

NOTE C – CASH AND INVESTMENTS

The Fund actively invests cash in conformity with the Act, the Housing Finance Bond Program and Economic Development Financing Bond Program resolutions, and the Board approved Investment Policy. Permitted investments include a wide variety of securities and obligations such as certain corporate deposits, investment agreements or repurchase agreements with primary government dealers, direct obligations or obligations guaranteed by the State, United States government securities, or federal agency securities. Currently, the Fund's investments consist primarily of United States government or agency securities or repurchase agreements collateralized with United States government or agency securities. The Investment Policy also permits the Fund to invest a maximum of \$25,000,000 with the WVBOTI of which a maximum of \$10,000,000 can be Housing Finance Bond Program funds. The reported value of the deposits with the WVBOTI is the same as the fair value of the pool shares. The WVBOTI operates in accordance with applicable State laws and regulations. The following is a detail of the Fund's investments by type:

| | Weighted Avg Maturity at June 30, 2008 | June 30, 2008 | | June 30, 2007 | |
|---|---|------------------------|-----------------------|------------------------|-----------------------|
| | | Amortized | Estimated | Amortized | Estimated |
| | | Cost | Fair Value | Cost | Fair Value |
| | | (Dollars in thousands) | | (Dollars in thousands) | |
| Repurchase agreements | 52 days | \$ 48,049 | \$ 48,049 | \$ 111,305 | \$ 111,305 |
| Fannie Mae MBS pools | 22.51 years | 7,913 | 7,838 | 8,845 | 8,601 |
| Federal agency securities | 11.72 years | 69,206 | 76,121 | 63,310 | 68,375 |
| U.S. government | 13.04 years | 7,099 | 8,814 | 10,661 | 11,987 |
| Mortgages held for investment | 22.16 years | 21,111 | 21,111 | 23,189 | 23,189 |
| Demand deposits | 1 day | 23,732 | 23,732 | 15,230 | 15,230 |
| Certificates of deposit | 60 days | 21,500 | 21,500 | - | - |
| WVBOTI deposits | 1 day | 21,843 | 21,843 | 12,576 | 12,576 |
| Total investments, including cash equivalents | | <u>\$ 220,453</u> | <u>\$ 229,008</u> | <u>\$ 245,116</u> | <u>\$ 251,263</u> |

Interest Rate Risk –The Investment Policy limits the weighted average maturity of various fund types as shown in the following chart. The Act does not provide for investment maturity limits. Reserve funds are the capital reserve investments required for the Housing Finance Bonds and the Economic Development Financing Bonds which are invested in long-term U.S. Government and government agency obligations and repurchase agreements. The Bond Insurance Account, which provides additional reserves for the payment of the Housing Finance Bonds, is invested in U.S. Government and government agency obligations as well as mortgage loans for investment purposes and certificates of deposit. Other funds consist of bond revenues to be used for debt service on the outstanding bonds, bond proceeds for the purchase of mortgage revenue bond loans or economic development projects, Other Loan Program funds and general operating funds. Other funds are primarily invested in short-term repurchase agreements to meet program-funding needs and to provide for daily operational costs of the Fund. Funds held for others consist of single family and multifamily escrow funds as well as amounts to be remitted to others. The Fund has both the intent and the ability to hold long-term securities until final maturity and is therefore limited in its exposure to interest rate risk on these long-term obligations.

| | Permitted Maturity Limit | Average Maturity as of June 30, 2008 |
|-----------------------|-------------------------------------|---|
| Reserve Funds | 30 Years | 14.82 years |
| Bond Insurance Funds | 10 Years | 9.90 years |
| Other Funds | 4 years | 1.25 years |
| Funds Held for Others | 1 year | 1.00 day |

Credit Risk - The Act limits investments in direct and general obligations of any other state to those rated in either of the two highest rating categories by a nationally recognized bond rating organization. The Act also limits the investment in corporate debt instruments to U.S. corporations with a minimum net worth and other requirements as well as a minimum credit rating of “AA”. The Fund’s Investment Policy additionally requires repurchase agreements to be invested with banks or primary dealers which are rated or provide the necessary collateral to maintain the Fund’s bond, note and issuer ratings. Furthermore the Investment Policy limits collateral for repurchase agreements to direct federal and federally guaranteed obligations, and federal agency obligations. The Fund’s investments in the WVBOTI are rated AAA. Mortgages held for investment are not rated. Repurchase agreements are collateralized by Fannie Mae, Ginnie Mae and Freddie Mac securities all of which are rated AAA. Federal agency securities consist of Fannie Mae, Federal Farm Credit Bank, Federal Home Loan Bank and Freddie Mac all of which are rated AAA. Fannie Mae MBS pools are also rated AAA. Certificates of deposit are either FDIC insured through the Certificate of Deposit Account Registry Service (CDARS) or collateralized with an irrevocable stand by letter of credit issued by the Federal Home Loan Bank of Pittsburgh, which is rated AAA.

Concentration of Credit Risk – The Investment Policy limits the percentage of the investment portfolio that may be invested in various types of issuers as indicated in the chart below. Underlying collateral for repurchase agreements is used in determining the percentage of the permitted investments. The Act does not limit the percentage of investments in any permitted investment type.

| | Maximum of Portfolio | June 30, 2008 | |
|--|-------------------------|-------------------|--------------------------|
| | | Invested Funds | % of Total Investment |
| (Dollars in thousands) | | | |
| Direct Federal Obligations | 100% | \$ 7,099 | 3% |
| Federal Agency Obligations | 90% | 125,168 | 56% |
| Federally Guaranteed Obligations | 100% | - | 0% |
| Housing Bonds | 5% | - | 0% |
| Demand Deposits, Certificates of Deposit | 30% | 45,232 | 21% |
| West Virginia Obligations | 15% | - | 0% |
| Other State/Local Obligations | 15% | - | 0% |
| Corporate Obligations | 15% | - | 0% |
| Mortgages Held for Investment Purposes | 30% | 21,111 | 10% |
| Mutual Funds | 10% | - | 0% |
| Options | 5% | - | 0% |
| WVBOTI | \$25,000 | 21,843 | 10% |
| Total Invested Funds | | \$ 220,453 | 100% |

Custodial Credit Risk – Deposits - The Fund's cash, including escrow funds, had a carrying value of \$23,732,000 and \$15,230,000 as of June 30, 2008 and 2007, respectively. Bank balances approximated \$26,177,000 and \$14,101,000 as of June 30, 2008 and 2007, respectively, of which approximately \$9,759,000 and \$7,156,000 was covered by federal depository insurance as of June 30, 2008 and 2007, respectively, and \$16,418,000 and \$6,945,000 was either collateralized with securities pledged to the Fund and held by the trust department of the pledging financial institution or held and pledged to the Fund by the pledging financial institution's agent as of June 30, 2008 and 2007, respectively. Trust balances were \$10,615,000 and \$2,163,000 as of June 30, 2008 and 2007, respectively, and are not subject to custodial credit risk. The Act requires all deposits to be FDIC insured or fully collateralized by permitted investments. The Investment Policy further limits the securities permitted as collateral for amounts in excess of FDIC insurance to direct federal or federally guaranteed obligations, federal agency, State or other state and local obligations.

Custodial Credit Risk – Investments – The Investment Policy requires purchased securities be physically delivered to the Fund's custodian or trustee or, in the case of book-entry securities, registration books shall designate the custodian or trustee. The Investment Policy also requires collateral for repurchase agreements be delivered to a third party custodian or in the case of book-entry securities, be registered to the Fund. All U.S. government and agency obligations owned by the Fund are registered in the Fund's name or the Fund's designated trustee. All repurchase agreements and investment contracts are tri-party agreements where third parties hold the underlying securities on behalf of the Fund. The Act does not address custodial credit risk for investments.

Mortgages held for investment are included in Mortgage loans, net of allowances and Restricted mortgage loans, net of allowances on the Statement of Net Assets. Investments are included at estimated fair value in the accompanying financial statements as follows:

| | June 30, | |
|---|------------|------------|
| | 2008 | 2007 |
| (Dollars in thousands) | | |
| Cash and cash equivalents | \$ 34,855 | \$ 36,432 |
| Current restricted cash and cash equivalents | 51,438 | 51,391 |
| Noncurrent restricted cash and cash equivalents | 13,830 | 51,287 |
| Restricted investments | 107,774 | 88,964 |
| Plus mortgages held for investment purposes | 21,111 | 23,189 |
| Total Investments and cash equivalents | \$ 229,008 | \$ 251,263 |
| Less unrealized gains | 8,555 | 6,147 |
| Total Invested Funds | \$ 220,453 | \$ 245,116 |

In accordance with GASB 31 at June 30, 2008, the Fund has an unrealized gain on investments of \$8,555,000. This represents a \$2,408,000 increase from the June 30, 2007 unrealized gain on investments. A portion of this unrealized gain, \$654,000 is recorded as a liability. This portion is recorded as a liability because, if this gain were realized, it would increase excess rebateable investment earnings pursuant to Section 103A of the Internal Revenue Code, as amended (the Code). To adjust the fair value of investments to reflect this unrealized gain at June 30, 2008 and to properly reflect the rebate liability, a \$2,371,000 increase was recorded in Net investment earnings in the Statements of Revenues, Expenses, and Changes in Net Assets for year ended June 30, 2008.

NOTE D – BONDS PAYABLE

The Act authorizes the Fund to issue bonds and notes for its various programs in an aggregate principal amount not to exceed \$1,250,000,000 outstanding at any one time, exclusive of refunded obligations. Bonds and notes issued by the Fund are considered obligations of the Fund and are not deemed to constitute a debt or liability of the State.

The proceeds from the Fund’s Housing Finance Bond Program are used to finance mortgage loans to eligible State borrowers and to establish certain reserves as required by the resolution. The mortgage loans are secured by deeds of trust and substantially all loans are subject to coverage under federal or private mortgage insurance or guarantee programs. All bonds are secured by a pledge of all mortgage loan repayments, all proceeds of federal or private mortgage insurance, interest received on any monies or securities held pursuant to the resolution, and the rights and interest of the Fund in and to the mortgage loans.

To reduce its debt expense, the Fund redeems Housing Finance Program Bonds from prepayments of the mortgages in its portfolio. The Code permits the Fund to issue new bonds or notes to replace some of those bonds redeemed early from prepayments. This enables the Fund to issue debt in excess of the bond volume cap allocated to it by the State if required.

On November 1, 2005, the Fund issued \$15,000,000 in bonds under the General Economic Development Bond Resolution. These bonds were fully redeemed February 25, 2008 as a result of the prepayment of the corresponding economic development project.

The On-Site Systems Loan Program (the OSLP) was created in September 2007 in partnership with the West Virginia Department of Environmental Protection (the DEP). Under this program the Fund may borrow up to \$1,000,000 from the DEP Clean Water Revolving Loan Fund. These funds will then be loaned to State residents to upgrade, replace or repair inadequate septic systems. The Fund is obligated to repay the amount borrowed from the DEP only to the extent the Fund receives payments from loan recipients. At June 30, 2008, Bonds & notes payable - noncurrent include a \$249,000 note payable due to DEP related to this program under Other Loan Programs.

The following charts summarize bond and note activity from 2007 to 2008 and 2006 to 2007, respectively.

| | Outstanding June 30, 2007 | Debt Issued | Debt Paid | Early Redemptions | Amortization of Premium | Reclassification from noncurrent to current | Outstanding June 30, 2008 |
|------------------------------------|---------------------------------|----------------|--------------|----------------------|-------------------------------|--|---------------------------------|
| | (Dollars in thousands) | | | | | | |
| Bonds payable - current | \$ 24,925 | \$ - | \$ (23,520) | \$ (1,405) | \$ - | \$ 24,835 | \$ 24,835 |
| Bonds & notes payable - noncurrent | 725,914 | 77,253 | (1) | (42,565) | (424) | (24,835) | 735,342 |
| Total | \$ 750,839 | \$ 77,253 | \$ (23,521) | \$ (43,970) | \$ (424) | \$ - | \$ 760,177 |

| | Outstanding June 30, 2006 | Debt Issued | Debt Paid | Early Redemptions | Amortization of Premium | Reclassification from noncurrent to current | Outstanding June 30, 2007 |
|----------------------------|---------------------------------|----------------|--------------|----------------------|-------------------------------|--|---------------------------------|
| | (Dollars in thousands) | | | | | | |
| Bonds payable - current | \$ 58,795 | \$ - | \$ (50,180) | \$ (8,615) | \$ - | \$ 24,925 | \$ 24,925 |
| Bonds payable - noncurrent | 675,395 | 97,289 | - | (21,725) | (120) | (24,925) | 725,914 |
| Total | \$ 734,190 | \$ 97,289 | \$ (50,180) | \$ (30,340) | \$ (120) | \$ - | \$ 750,839 |

The following is a summary of the note outstanding in Other Loan Programs and bonds outstanding in the Economic Development Financing Bond Program and the Housing Finance Bond Program:

| | <u>Original Amount Authorized</u> | <u>Outstanding at June 30,</u> | |
|--|---|------------------------------------|-------------------|
| | | <u>2008</u> | <u>2007</u> |
| (Dollars in thousands) | | | |
| <u>OTHER LOAN PROGRAMS</u> | | | |
| Note Payable, dated February 12, 2008 (0.00%) ⁽¹⁾ | \$ 250 | \$ 249 | \$ - |
| <u>ECONOMIC DEVELOPMENT FINANCING BOND PROGRAM</u> | | | |
| 2005 Series A | \$ 15,000 | \$ - | \$ 15,000 |
| <u>HOUSING FINANCE BOND PROGRAM</u> | | | |
| 1997 Series C (5.75%), due 2017-2026 | 46,040 | 36,770 | 36,770 |
| 1998 Series A & B (4.85% to 5.30%), due 2008-2023 | 86,855 | 48,695 | 55,460 |
| 1998 Series E (6.10%), due 2008 | 76,150 | 4,990 | 14,525 |
| 1998 Series F (5.70%), due 2008-2013 | 2,235 | 1,055 | 1,215 |
| 1999 Series A & B (4.45% to 5.00%), due 2008-2020 | 50,000 | 20,925 | 24,600 |
| 2000 Series C (6.00%), due 2010-2034 | 35,000 | 34,760 | 34,760 |
| 2000 Series D (6.55%), due 2008-2010 | 7,500 | 2,515 | 3,330 |
| 2001 Series A & B (4.35% to 5.25%), due 2008-2018 | 65,000 | 20,400 | 24,620 |
| 2001 Series C (5.20%), due 2012-2032 | 50,000 | 50,000 | 50,000 |
| 2001 Series D (5.20% to 5.35%), due 2017-2030 | 79,665 | 47,230 | 58,025 |
| 2002 Series B & C (5.30% to 5.35%), due 2019-2024 | 40,035 | 19,010 | 21,965 |
| 2003 Series A (4.75%), due 2013-2039 | 25,000 | 25,000 | 25,000 |
| 2003 Series B (4.90%), due 2014-2039 | 17,500 | 17,500 | 17,500 |
| 2003 Series C (4.00%), due 2008-2013 | 16,800 | 7,975 | 9,360 |
| 2004 Series A (4.40%), due 2008-2034 | 30,000 | 26,000 | 27,325 |
| 2004 Series B (4.90%), due 2008-2034 | 20,000 | 17,635 | 18,510 |
| 2004 Series C (4.35%), due 2008-2034 | 35,000 | 31,760 | 33,285 |
| 2005 Series A (4.375%), due 2008-2035 | 30,000 | 27,455 | 28,760 |
| 2005 Series B (4.40%), due 2008-2033 | 60,110 | 51,160 | 54,680 |
| 2005 Series C (4.50%), due 2008-2035 | 30,000 | 28,975 | 29,495 |
| 2006 Series A (4.70%), due 2008-2040 | 60,000 | 29,425 | 29,810 |
| 2006 Series C (5.00%), due 2008-2040 | 40,000 | 39,065 | 39,700 |
| 2006 Series D (3.75% to 5.75%), due 2008-2036 | 35,000 | 33,800 | 34,975 |
| 2007 Series A (3.70% to 5.50%), due 2008-2037 | 60,000 | 59,115 | 60,000 |
| 2007 Series B (4.15% to 6.00%), due 2008-2038 | 40,000 | 39,965 | - |
| 2007 Series C (3.625% to 5.75%), due 2008-2038 | 35,000 | 35,000 | - |
| Total bonds payable, excluding unamortized premium | | 756,180 | 748,670 |
| Unamortized bond premium | | 3,748 | 2,169 |
| Total notes payable | | 249 | - |
| Total bonds & notes payable, net of unamortized premium | | <u>\$ 760,177</u> | <u>\$ 750,839</u> |

⁽¹⁾ Payments are due to the DEP as the Fund receives payments from OSLP loan recipients.

Total bonds payable does not include \$11,655,000 in special obligation bonds issued by the Fund as a conduit issuer. These special obligation bonds are secured by loan payments and deeds of trust on three projects. None of the Fund's assets or revenues are pledged to the payment of these special obligations. Furthermore, these special obligations are not secured by the Fund's general obligation debt pledge or its moral obligation and are not included in the Fund's financial statements. The Fund anticipates issuing two additional series of special obligation bonds in the approximate amount of \$14,545,000 in August 2008.

In June 2008, the Fund committed to sell the Housing Finance 2008 Series A and B Bonds in the principal amount of \$30,000,000. These bonds were issued on July 10, 2008.

Interest paid on bonds was \$39,135,000 and \$36,402,000 for the fiscal years ended June 30, 2008, and 2007, respectively.

The following is a summary of scheduled annual principal and interest for bonds in the Housing Finance Bond Program for the five years commencing July 1, 2008 and thereafter to maturity.

| Bonds Maturing During Year Ending June 30: | Principal | Interest | Total |
|---|-------------------|-------------------|---------------------|
| (Dollars in thousands) | | | |
| 2009 | \$ 24,835 | \$ 37,321 | \$ 62,156 |
| 2010 | 19,615 | 36,304 | 55,919 |
| 2011 | 20,335 | 35,387 | 55,722 |
| 2012 | 23,475 | 34,426 | 57,901 |
| 2013 | 24,555 | 33,300 | 57,855 |
| 2014-2018 | 131,210 | 148,421 | 279,631 |
| 2019-2023 | 162,005 | 111,661 | 273,666 |
| 2024-2028 | 145,170 | 70,643 | 215,813 |
| 2029-2033 | 127,260 | 36,454 | 163,714 |
| 2034-2038 | 70,865 | 9,988 | 80,853 |
| 2039-2040 | 6,855 | 464 | 7,319 |
| | <u>\$ 756,180</u> | <u>\$ 554,369</u> | <u>\$ 1,310,549</u> |

Most Housing Finance Bonds issued by the Fund are subject to redemption at the option of the Fund prior to maturity at dates and premiums as set forth in the Housing Finance Bond resolution. The Fund redeems bonds prior to their stated maturity dates primarily due to excess program revenues, the prepayments of mortgage loans pledged for the repayment of the bonds, excess amounts in the capital reserve funds, and/or from proceeds of refunding bonds. During the fiscal years ended June 30, 2008 and 2007, the Fund redeemed \$43,970,000 and \$30,340,000 of Housing Finance Bonds, respectively, at redemption prices that approximated their carrying value. The impact of these early redemptions on the financial statements was not material.

In accordance with Section 103A of the Code, the Fund has established allowances for excess rebateable investment earnings. The excess rebateable investment earnings arise due to actual investment yields earned by the Fund being greater than yields permitted to be retained by the Fund under the Code. The Code requires such excess investment earnings to be remitted to the Internal Revenue Service. The Housing Finance Bond Program established liabilities for excess rebateable investment earnings in the amount of \$507,000 and \$203,000 at June 30, 2008 and 2007, respectively. These amounts are included in *Accounts payable and other liabilities* and represent actual earnings in excess of those permitted by the Code. These amounts are in addition to the \$654,000 and \$616,000 established as a liability at June 30, 2008 and 2007, respectively, for the excess of the fair value of investments over amortized costs as explained in *Note C – Cash and Investments*. Future excess investment earnings may require the establishment of additional liabilities for these and other bond issues.

The Fund has a \$15,000,000 line of credit with the Federal Home Loan Bank that is available to use as a warehouse line for the purchase of single family, multifamily, secondary market loans and economic development projects. This line of credit is secured by investments of the Bond Insurance Account and is a general obligation of the Fund. At June 30, 2008, no advances had been drawn on this line of credit, and accordingly, no balance is outstanding.

NOTE E - CONTINGENT LIABILITIES AND RISK MANAGEMENT

Under the terms of certain federal programs, periodic audits are required and certain costs and expenditures may be questioned as not being appropriate under the terms of the program. Such audits could lead to reimbursements to the grantor agencies. Historically, questioned costs have been insignificant. Management of the Fund believes future disallowances, if any, will continue to be insignificant.

The Fund is a defendant in various legal proceedings arising in the normal course of business. In the opinion of management and its legal counsel the ultimate resolution of these proceedings will not have a material adverse effect on the Fund's financial position.

Through its business operations, the Fund is exposed to various risks of loss related to potential loan losses on program mortgages, fire, liability, and employee wrongdoing. To reduce risk of loss on program mortgages, the Fund has various types of mortgage insurance. At June 30, 2008, 44.95% of the Fund's single family Housing Finance Bond Program loans were either VA, USDA Rural Development, or FHA guaranteed. Another 35.44% of these loans carry private mortgage insurance. Substantially all multifamily mortgages are federally insured or guaranteed and/or are subject to HUD Section 8 rental assistance subsidies.

The Fund is insured against fire for owned assets and liability, and employee negligence through private insurance. Furthermore, key staff members of the Fund are bonded against theft in the aggregate amount of \$4,000,000. The Board of Directors has allocated \$1,000,000 of the Fund's unrestricted net assets to provide indemnification for the directors and officers of the Fund. Additionally, the Fund has general liability insurance with the State Board of Risk and Insurance Management in the amount of \$1,000,000 per occurrence and another \$5,000,000 per occurrence with General Star Insurance Company for officers' and directors' indemnity. The Fund pays an annual premium in exchange for such coverage. There have been no significant settlements in excess of insurance coverage during the past three calendar years.

In 2003, the Fund provided a loan guarantee in the initial amount of \$10,465,000 for Wheeling-Pittsburgh Steel Corporation. The related loan was assigned to a new lender in fiscal year 2008. Consequently, the Fund was released from the loan guarantee commitment effective May 6, 2008.

NOTE F - RETIREMENT PLAN

All full-time Fund employees are eligible to participate in the State's Public Employees' Retirement System (PERS), a cost-sharing multiple-employer public employee retirement system. Employees who retire at or after age 60 with five or more years of credited service, or at least age 55 with age and service equal to 80, are entitled to a retirement benefit established by State statute, payable monthly for life, in the form of a straight-life annuity equal to two percent of the employee's final average salary, multiplied by the number of years of the employee's credited service at the time of retirement.

Final average salary is the average of the highest annual compensation received by an employee during any period of three consecutive years of credited service included within ten years of credited service immediately preceding the termination date of employment with a participating public employer or, if the employee has less than three years of credited service, the average of the annual rate of compensation received by the employee during the total years of credited service. The PERS also provides deferred retirement, early retirement, death, and disability benefits. The required contributor's percentage of 10.5% is determined by actuarial advisement within ranges set by statute. As permitted by legislation, the Fund has elected to pay 100% of all costs relating to the Plan, including the employee's 4.5% contribution. Such costs approximated \$756,000, \$747,000, and \$731,000 for the fiscal years ended June 30, 2008, 2007, and 2006, respectively. The PERS issues an annual report, which can be obtained by contacting the PERS.

NOTE G – COMPENSATED ABSENCES AND OTHER POSTEMPLOYMENT BENEFITS (OPEB)

Employees accumulate annual leave balances to maximum amounts ranging from 210 to 420 hours. Most employees receive a 100% termination payment upon separation based upon their final rate of pay. The liability for annual leave is valued at 100% of the balance plus the Fund's share of Social Security and Medicare contributions. The Fund has recorded a liability for accrued vacation for all employees in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. The liability for annual leave at June 30, 2008 and June 30, 2007 is \$508,000 and \$529,000, respectively. In lieu of cash payment at retirement, an employee can elect to use accumulated annual leave toward their postemployment health care insurance premium as further explained below.

NOTE H - POSTEMPLOYMENT HEALTHCARE PLAN

Plan Description. The Fund provides certain health care insurance benefits for retired employees. The Fund established the Welfare Benefit Plan (the Plan), an irrevocable trust, for the future costs of these benefits. The assets of the Plan are with an external trustee and, accordingly, no assets or liabilities are reflected in the Fund's financial statements. The Plan is a single-employer defined benefit healthcare plan administered by the Fund. Substantially all employees may become eligible for these benefits if they reach normal retirement age while working for the Fund. Management of the Fund has the authority to establish and amend benefit provisions to the Plan. The financial statements and required supplementary information for the Plan are included in this note as supplementary information to the Fund's financial statements.

| WEST VIRGINIA HOUSING DEVELOPMENT FUND POSTEMPLOYMENT HEALTHCARE PLAN | |
|--|---------------------------------|
| STATEMENT OF PLAN NET ASSETS | |
| (Dollars in Thousands) | |
| | June 30, <u>2008</u> |
| ASSETS | |
| Restricted cash and cash equivalents | \$ 337 |
| Restricted accrued interest on investments | 19 |
| Total assets | <u>356</u> |
| Restricted investments: | |
| U.S. Government Securities | 597 |
| Federal Agency Securities | <u>2,050</u> |
| Total Investments | <u>2,647</u> |
| Total assets | <u>3,003</u> |
| LIABILITIES AND NET ASSETS | |
| Current liabilities: | |
| Accounts payable and other liabilities | - |
| Total current liabilities | <u>-</u> |
| TOTAL NET ASSETS HELD IN TRUST | <u>\$ 3,003</u> |
| STATEMENT OF CHANGES IN PLAN NET ASSETS | |
| ADDITIONS | |
| Contributions - Employer | \$ 3,000 |
| Investment Income | 26 |
| | <u>3,026</u> |
| DEDUCTIONS | |
| Benefits | 23 |
| | <u>23</u> |
| CHANGES IN NET PLAN ASSETS | 3,003 |
| NET ASSETS HELD IN TRUST: | |
| BEGINNING OF YEAR | <u>-</u> |
| END OF YEAR | <u>\$ 3,003</u> |

Funding Policy. The contribution requirements of plan members and the Fund are established and may be amended by the Fund’s management. In lieu of cash payment at retirement, an employee can elect to use accumulated annual and accumulated sick leave toward their postemployment health care insurance premium. A retiree may convert two unused leave days into one month’s insurance premium for single coverage or three unused leave days into one month’s premium for family coverage. Accordingly, the maximum period for which a retiree may be entitled to such benefits would be twelve years. The Fund will pay monthly health insurance premiums of these retirees based on unused sick leave and/or annual leave at the time of retirement until the unused leave is fully utilized or until the retiree reaches the eligible age for Medicare. The Fund’s policy is to fund the cost of medical benefits in amounts determined at the discretion of management.

Annual OPEB Cost and Net OPEB Obligation. The Fund’s annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45, “Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions” (OPEB). The ARC represents a level of funding that, if paid on an ongoing basis it is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years.

The following table shows the components of the Fund’s annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the Fund’s net OPEB obligation to the Plan.

| As of June 30, 2008: | | |
|------------------------------------|--------------------|--------------------------------------|
| (Dollars in thousands) | | % Contributed by The Fund |
| Annual Required Contribution | \$ 101 | |
| Interest on Net OPEB Obligation | - | |
| Annual OPEB cost (expense) | <u>\$ 101</u> | |
| Contributions Made | <u>\$ 101</u> | 100% |
| Increase in Net OPEB Obligation | - | |
| Net Obligation - Beginning of Year | - | |
| Net OPEB Obligation - End of Year | <u><u>\$ -</u></u> | |

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the ARC are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future.

Funded Status and Funding Progress. The funded status of the Plan as of the most recent valuation date, January 1, 2007, was as follows:

| As of January 1, 2007: | |
|---|-----------------|
| (Dollars in thousands) | |
| Actuarial accrued liability (AAL) | \$ 2,244 |
| Actuarial value of plan assets | 2,678 |
| Plan assets in excess of actuarial accrued liability (UAAL) | <u>\$ (434)</u> |
| Funded ratio (actuarial value of plan assets/AAL) | 119.3% |
| Covered payroll (active plan members) | \$ 5,259 |
| Excess of plan assets over AAL as a percentage of covered payroll | (8.3%) |

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes include the types of benefits provided at the time of the valuation and the historical pattern of sharing of benefit costs between the Fund and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2007 actuarial valuation, the Entry Age Normal actuarial cost method was used. The actuarial assumptions included a 4.5% investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the Fund's investments calculated on the funded level of the plan at the valuation date, and an annual healthcare cost trend rate of 11% initially, reduced by decrements to an ultimate rate of 5% after ten years. Both rates included a 3% inflation assumption. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five-year period. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 2008 was 30 years.

NOTE H – SUBSEQUENT EVENTS

On July 1, 2008 the Fund redeemed various Housing Finance Bonds in advance of the scheduled maturities at a par amount of \$1,130,000.

On August 1, 2008 the Fund redeemed various Housing Finance Bonds in advance of the scheduled maturities at a par amount of \$1,515,000.