

**Michigan State Housing
Development Authority
(A Component Unit of the
State of Michigan)**

**Financial Report
With Supplemental Information
June 30, 2004**

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Michigan State Housing Development Authority

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Independent Auditor's Report

To the Members of the Board of Directors of the
Michigan State Housing Development Authority, and
Mr. Thomas H. McTavish, Auditor General State of Michigan
Lansing, Michigan

We have audited the accompanying basic financial statements of the Michigan State Housing Development Authority, (the Authority) a component unit of the State of Michigan, as of and for the year ended June 30, 2004, as listed in the table of contents. These basic financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The basic financial statements of the Authority for the year ended June 30, 2003, before the restatement described in Note 14, were audited by other auditors, whose report dated October 10, 2003, expressed an unqualified opinion on those financial statements.

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

In our opinion, the 2004 basic financial statements referred to above present fairly, in all material respects, the financial position of the Michigan State Housing Development Authority as of June 30, 2004, and the changes in financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments described in Note 14 that were applied to restate the 2003 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

The Management's Discussion and Analysis (Unaudited) (identified in the table of contents) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

To the Members of the Board of Directors of the
Michigan State Housing Development Authority, and
Mr. Thomas H. McTavish, Auditor General State of Michigan

In accordance with *Government Auditing Standards*, we have also issued our report dated October 21, 2004, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Plante & Moran, PLLC

October 21, 2004

Michigan State Housing Development Authority

Management's Discussion and Analysis (Unaudited)

Michigan State Housing Development Authority (the Authority) provides financial and technical assistance through public and private partnerships to create and preserve decent, affordable housing for low and moderate-income Michigan residents. The Authority was created under the terms of Act 346, Public Acts of Michigan, 1966, as amended. The Authority is authorized to issue its bonds and notes to the investing public in order to create a flow of private capital through the Authority into mortgage loans to qualified housing sponsors and to certain qualified individuals.

The Authority offers a variety of programs to provide affordable housing opportunities, such as single-family lending, low-interest property improvement lending, multi-family lending, mortgage credit certificates, and pass-through obligations.

The enclosed financial statements present the Authority's financial position, revenue, expenses and changes in net Assets, and cash flows. The following is a condensed summary of financial information as of and for the years ended June 30, 2004 and 2003.

Michigan State Housing Development Authority

Management's Discussion and Analysis (Unaudited) (Continued)

Condensed Financial Information

(In Thousands of Dollars)

	2004	2003
Net Assets		
Investments	\$ 678,097	\$ 684,740
Loans Receivable, Net	1,807,085	1,802,545
Other Assets	222,671	204,267
Total Assets	<u>\$ 2,707,853</u>	<u>\$ 2,691,552</u>
Bonds Payable	\$ 1,682,510	\$ 1,713,065
Other Liabilities	472,609	477,753
Total Liabilities	<u>\$ 2,155,119</u>	<u>\$ 2,190,818</u>
Restricted Net Assets	\$ 261,272	\$ 242,277
Unrestricted Net Assets	291,462	258,457
Total Net Assets	<u>\$ 552,734</u>	<u>\$ 500,734</u>
Change in Net Assets		
Net Investment Income	\$ 55,743	\$ 76,545
Federal Assistance Programs Revenue	348,447	329,402
Section 8 Program Administrative Fees	10,438	9,928
Contract Administration Fees	7,030	7,219
Other Income	33,599	22,922
Total Revenue	455,257	446,016
Federal Assistance Programs Expenses	348,447	329,402
Salaries and Benefits	16,515	16,028
Other General Operating Expenses	18,922	17,667
Other Expenses	4,625	13,647
Total Expenses	388,509	376,744
Grants and Subsidies	14,748	15,095
Change in Net Assets	<u>\$ 52,000</u>	<u>\$ 54,177</u>

Michigan State Housing Development Authority

Management's Discussion and Analysis (Unaudited) (Continued)

Financial Analysis

Total assets increased from \$2.69 billion at June 30, 2003 to \$2.71 billion at June 30, 2004. This was an increase of \$16.3 million, or 0.6 percent.

Net loans receivable increased from \$1,802.5 million at June 30, 2003 to \$1,807.1 million at June 30, 2004. Loans receivable increased due to strong multi-family production, which led to a net increase in multi-family mortgage loans of \$86.3 million. The multi-family increase was offset by single-family mortgage loan prepayments, which led to a net decrease of \$81.8 million of single-family loans, caused by prepayments received due to the low interest rate environment.

Bonds payable decreased from \$1,713.1 million at June 30, 2003 to \$1,682.5 million at June 30, 2004, a net decrease of \$30.6 million. This decrease was primarily due to the Authority issuing \$161.4 million of Rental Housing Revenue Bonds and \$113.7 million of Single-Family Mortgage Revenue Bonds during the fiscal year, while bond calls and scheduled debt service totaled \$309 million.

Escrow funds decreased by \$12.5 million to \$368.1 million at June 30, 2004, from a year earlier due to the prepayment of multi-family developments with large escrow deposits.

The Authority's Net Assets totaled \$552.7 million at June 30, 2004, equal to 20.4 percent of total assets and 25.6 percent of total liabilities. A significant portion of Net Assets is restricted. At June 30, 2004, \$261.3 million of Net Assets was pledged for payment against the various bond indentures. In addition, \$87.0 million is designated by board resolution, for Community Development Activity.

Operating Results

Operations for the year ended June 30, 2004, resulted in excess of revenues over expenses of \$52.0 million, compared to prior year results of \$54.2 million. Under Governmental Accounting Standards Board (GASB) Statement No. 31, the Authority is required to present investments at fair market value and reflect this adjustment in the Statements of Revenue and Expenses and Changes in Net Assets. This presentation decreased revenue over expenses by \$8.5 million. Results for the year ended June 30, 2003, were negatively impacted by a decrease of \$2.6 million. Currently, GASB No. 31 has had a cumulative negative effect of \$0.6 million on the Authority's Net Assets, however, the Authority generally intends to hold these securities to maturity.

Michigan State Housing Development Authority

Management's Discussion and Analysis (Unaudited) (Continued)

Operating Results (Continued)

Net investment income decreased from \$76.5 million in 2003 to \$55.7 million in 2004, a decrease of \$20.8 million. On October 1, 2002, the 1992 Series A Rental Housing Revenue Bonds were called from the proceeds of the Rental Housing Revenue Bonds, 2002 Series B and C. On June 2, 2003, the 1993 Series A Rental Housing Revenue Bonds were called from the proceeds of the Rental Housing Revenue Bonds, 2003 Series A. As a result of the termination of the 1992 and 1993 Series, \$23.1 million of deferred interest income on the underlying mortgage loans, previously funded by such Bond Series, was recognized into mortgage loan interest income.

Total revenue increased from \$446.0 million for the year ended June 30, 2003 to \$455.3 million for the year ended June 30, 2004, a net increase of \$9.2 million. Total revenue increased due primarily to the increase of \$10.4 million in preservation fees, which are included in other income. Federal Assistance revenues increased by \$19.0 million from the prior year, which was partially offset by the prior year recognition of \$23.1 million in deferred mortgage interest income noted above.

Total expenses increased from \$376.7 million for the year ended June 30, 2003 to \$388.5 million for the year ended June 30, 2004, a net increase of \$11.8 million. Total expenses increased due primarily to an increase in the Federal assistance programs of \$19.0 million. The Authority increased the provision for possible losses on loans by \$0.9 million as compared to an increase of \$10.2 million in 2003.

Michigan State Housing Development Authority

Statement of Net Assets June 30, 2004 and 2003 (In thousands of Dollars)

	2004	2003
Assets		
Cash and Cash Equivalents (Note 3)	\$ 162,199	\$ 144,206
Investments (Note 3)	678,097	684,740
Loans Receivables		
Multi-family mortgage loans	1,363,007	1,276,755
Single-family mortgage loans	468,791	550,611
Home improvement and moderate rehabilitation loans	11,737	13,502
Subtotal	1,843,535	1,840,868
Accrued loan interest receivable	17,551	16,001
Allowance on loans receivable (Note 4)	(42,900)	(43,000)
Loan origination fees	(11,101)	(11,324)
Loans receivable, net	1,807,085	1,802,545
Other Assets		
Unamortized bond financing costs	4,208	4,332
Real estate owned	11,886	10,819
Other	44,378	44,910
	<u>60,472</u>	<u>60,061</u>
Total assets	<u>\$ 2,707,853</u>	<u>\$ 2,691,552</u>
Liabilities and Net Assets		
Liabilities		
Bonds payable (Notes 5 and 6)	\$ 1,682,510	\$ 1,713,065
Accrued interest payable	8,588	9,264
Escrow funds	368,066	380,528
Deferred mortgage interest income (Note 7)	56,335	47,980
Other liabilities	39,620	39,981
Total liabilities	2,155,119	2,190,818
Net Assets		
Restricted (Note 11)	261,272	242,277
Unrestricted, as restated (Note 14)	291,462	258,457
Total net assets	<u>552,734</u>	<u>500,734</u>
Total liabilities and net assets	<u>\$ 2,707,853</u>	<u>\$ 2,691,552</u>

Michigan State Housing Development Authority

Statement of Revenue, Expenses, and Changes in Net Assets Year Ended June 30, 2004 and 2003 (In thousands of Dollars)

	<u>2004</u>	<u>2003</u>
Operating Revenue		
Investment income		
Loan interest income	\$ 118,875	\$ 150,368
Investment interest income	23,159	16,180
Increase (decrease) in fair value of investments, including change in unrealized losses of \$8,468 in 2004 and \$2,638 in 2003	<u>(7,592)</u>	<u>3,130</u>
Subtotal	134,442	169,678
Less interest expense and debt financing costs	<u>78,699</u>	<u>93,133</u>
Net investment income	55,743	76,545
Other Revenue		
Federal assistance programs	348,447	329,402
Section 8 Program administrative fees	10,438	9,928
Contract administration fees	7,030	7,219
Other income	<u>33,599</u>	<u>22,922</u>
Total other revenue	<u>399,514</u>	<u>369,471</u>
Total operating revenue	455,257	446,016
Operating Expenses		
Federal assistance programs	348,447	329,402
Salaries and benefits	16,515	16,028
Other general operating expenses	18,922	17,667
Loan servicing and insurance costs	3,749	3,495
Provision for possible losses on loans	<u>876</u>	<u>10,152</u>
Total operating expenses	<u>388,509</u>	<u>376,744</u>
Operating Income Before Nonoperating Expenses	66,748	69,272
Nonoperating Expenses - Grants and subsidies	<u>(14,748)</u>	<u>(15,095)</u>
Change in Net Assets	52,000	54,177
Net Assets - Beginning of year, as restated (Note 14)	<u>500,734</u>	<u>446,557</u>
Net Assets - End of year	<u>\$ 552,734</u>	<u>\$ 500,734</u>

Michigan State Housing Development Authority

Statement of Cash Flows Year Ended June 30, 2004 and 2003 (In thousands of Dollars)

	2004	2003
Cash Flows From Operating Activities		
Loan receipts	\$ 325,458	\$ 449,191
Other receipts	520,266	436,595
Loan disbursements	(222,282)	(190,181)
Payments to vendors	(50,132)	(49,707)
Payments to employees	(11,371)	(11,354)
Other disbursements	(470,456)	(406,188)
	<u>91,483</u>	<u>228,356</u>
Net cash provided by operating activities	91,483	228,356
Cash Flows From Investing Activities		
Purchase of investments	(1,005,472)	(1,147,149)
Proceeds from sale and maturities of investments	1,021,870	1,103,117
Interest received on investments	15,856	13,392
	<u>32,254</u>	<u>(30,640)</u>
Net cash provided by (used in) investing activities	32,254	(30,640)
Cash Flows From Noncapital Financing Activities		
Proceeds from issuance of bonds	274,182	414,736
Principal repayments on bonds	(309,370)	(527,230)
Interest paid	(70,556)	(92,602)
	<u>(105,744)</u>	<u>(205,096)</u>
Net cash used in noncapital financing activities	(105,744)	(205,096)
Net Increase (Decrease) in Cash and Cash Equivalents	17,993	(7,380)
Cash and Cash Equivalents - Beginning of year	<u>144,206</u>	<u>151,586</u>
Cash and Cash Equivalents - End of year	<u>\$ 162,199</u>	<u>\$ 144,206</u>

Michigan State Housing Development Authority

Statement of Cash Flows (Continued) Year Ended June 30, 2004 and 2003 (In thousands of Dollars)

	<u>2004</u>	<u>2003</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 66,748	\$ 69,272
Adjustments to reconcile operating income to net cash provided by operating activities:		
Amortization of deferred items - Net	(18,964)	(16,439)
Arbitrage rebate expense	4,954	(9,251)
Investment interest income	(15,567)	(22,783)
Decrease in realized and unrealized gain on market value of investments	8,468	2,638
Interest expense on bonds	77,166	93,546
Provision for possible losses on loans	876	10,152
Grants and Subsidies	(14,748)	(15,095)
Changes in assets and liabilities:		
Accrued loan interest receivable	(1,550)	(1,493)
Loans receivable	(2,667)	119,185
Other assets	(410)	(11,227)
Escrow funds	(12,462)	9,337
Other liabilities	(361)	514
	<u> </u>	<u> </u>
Net cash provided by operating activities	<u>\$ 91,483</u>	<u>\$ 228,356</u>

Non Cash Financing and Investing Activities - During the years ended June 30, 2004 and 2003, the Authority foreclosed on various properties with mortgage values of approximately \$12.9 million and \$8.3 million, respectively.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 1 - Authorizing Legislation

The Michigan State Housing Development Authority (the Authority) was created by the Michigan legislature under the provisions of the State Housing Development Authority Act of 1966, as amended (the Act). The Authority, as a special purpose entity, is a component unit of the State of Michigan and is reported as an enterprise fund in the State's Comprehensive Annual Financial Report. The Act empowers the Authority, among other things, to issue notes and bonds to finance housing for sale or rental to families with low and moderate income and to finance home improvements. The enabling legislation, along with the various bond and note resolutions adopted by the Authority, contain specific provisions pertaining to (a) the use of the proceeds from the sale of the notes and bonds, (b) the application of the revenues from mortgages, and (c) the creation of certain funds along with the accounting policies for such funds. As of June 30, 2004, the Authority is authorized by statute to have notes and bonds outstanding up to a total of \$3.0 billion.

Note 2 - Summary of Significant Accounting Policies

Basis of Presentation - The financial statements have been prepared in accordance with accounting principals generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Authority follows the "business-type activities" reporting requirements of GASB Statement 34 that provides a comprehensive one-line look at the Authority's financial activities.

Basis of Accounting - The Authority's financial statements have been prepared on the basis of the governmental proprietary fund concept which pertains to financial activities that operate in a manner similar to private business enterprises and are financed through fees and charges assessed primarily to the users of the services. The Authority applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. After November 30, 1989, the Authority only applies applicable GASB pronouncements.

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004 and 2003**

Note 2 - Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents - The Authority considers all highly liquid investments with an original maturity of three months or less when purchased and U.S. Government Money Market Funds, to be cash equivalents.

Investments - The Authority reports investments at fair value based on quoted market prices. The collateralized and uncollateralized investment agreements are not transferable and are considered nonparticipating contracts. As such, both types of investment agreements are carried at contract value. The net increase (decrease) in the fair value of investments includes both realized and unrealized gains and losses.

Multi-Family Mortgage Loans Receivable - Multi-family mortgage loans receivable consist of the remaining principal due from mortgagors of each completed development and construction advances for each development under construction under the multi-family program. Housing developments securing multi-family loans are subject to regulatory agreements under which the Authority has certain powers relating to rents, cash distributions, occupancy, management, and operations. Monies representing escrow funds for reserves for the payment of property taxes, insurance, property repairs and replacements, and income in excess of allowable cash distributions are required to be deposited with the Authority. Investment income earned on the deposited funds is credited to the respective mortgagors' escrow accounts.

Allowance on Loans Receivable - It is the Authority's policy to provide for future losses on mortgage loans based on an evaluation of the loan portfolio and of current economic conditions and such other factors which, in the Authority's judgment, require consideration in estimating future mortgage loan losses. The allowance is maintained at a level considered by management to be adequate to provide for probable mortgage loan losses inherent in the portfolio.

Loan Origination Fees - The Authority charges the mortgagor of each multi-family development a loan origination fee equal to 2 percent of the mortgage loan. These fees are amortized over the term of the loan receivable using the interest method.

Unamortized Bond Financing Costs - The costs of issuing bonds, other than bond discount, have been deferred and are amortized using the interest method over the term of the related debt.

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004 and 2003**

Note 2 - Summary of Significant Accounting Policies (Continued)

Compensated Absences - Authority employees accrue vacation and sick leave in varying amounts for each biweekly period worked. Employees may accumulate, subject to certain limitations, vacation and sick leave, and upon retirement, termination, or death may be compensated for certain accumulated amounts at their then current rates of pay. The Authority records an expense for all accumulated vacation and sick leave that the Authority would be required to pay if all employees terminated their employment. The compensated absences included in other liabilities at June 30, 2004 and 2003, were \$2,256,000 and \$1,757,000, respectively.

Arbitrage Rebate - Federal income tax rules limit the investment and loan yields which the Authority may retain for its own use from investing the proceeds from certain of its tax-exempt bond issues. The excess yields are payable to the U.S. Treasury and are recorded in other liabilities.

Restricted Assets - Substantially all of the assets of the Authority are pledged for payment against the various bond indentures.

Section 8 Program - The Authority is the administrator of various Section 8 housing programs in Michigan for the U.S. Department of Housing and Urban Development. The Authority receives federal financial assistance to provide rental subsidies to the tenants of various housing developments and for program administration costs.

Operating Revenues and Expenses - The Authority was created with the authority to issue bonds to the investing public in order to create a flow of private capital through the Authority into mortgage loans to qualified housing sponsors and to certain qualified individuals. The Authority's primary operation is to borrow funds in the bond market and use those funds to make single-family and multi-family loans. Its primary operating revenue is derived from the investment income from proceeds of bond funds. The primary cost of the program is interest expense on bonds outstanding. Net investment income is an important measure of performance under the Authority's primary operation. Investment income, interest expense and net investment income are shown as operating revenues in the Statement of Revenue, Expenses, and Changes in Net Assets.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 2 - Summary of Significant Accounting Policies (Continued)

Reclassifications - The Federal assistance programs revenue and expenses have been increased in the amount of \$108,275,607 for 2003. These revenues and expenses have been recorded in order to be consistent with the 2004 presentation. There was no effect on the change in net assets for 2003.

Note 3 - Deposits and Investments

Cash, cash equivalents, and investments held by the Authority at June 30 were as follows (in thousands of dollars):

	2004		
	Cash and Cash Equivalents	Investments	Total
Deposits	\$ (1,938)	\$ 450	\$ (1,488)
Government money market funds	90,482	-	90,482
Investments	<u>73,655</u>	<u>677,647</u>	<u>751,302</u>
Total	<u>\$ 162,199</u>	<u>\$ 678,097</u>	<u>\$ 840,296</u>
	Cash and Cash		
	2003		
	Equivalents	Investments	Total
Deposits	\$ (2,182)	\$ 1,989	\$ (193)
Government money market funds	95,885	-	95,885
Investments	<u>50,503</u>	<u>682,751</u>	<u>733,254</u>
Total	<u>\$ 144,206</u>	<u>\$ 684,740</u>	<u>\$ 828,946</u>

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 3 - Deposits and Investments (Continued)

The types of cash, cash equivalents, and investments held by the Authority at June 30 were as follows (in thousands of dollars):

	2004		2003	
	Amortized Cost	Carrying Value	Amortized Cost	Carrying Value
Cash	\$ (3,506)	\$ (3,506)	\$ (2,182)	\$ (2,182)
Certificates of deposit	2,018	2,018	1,989	1,989
Government money market funds	90,482	90,482	95,885	95,885
Repurchase agreements	-	-	500	500
U.S. Government securities	249,614	265,557	171,497	199,356
Mortgage-backed securities	190,070	184,638	98,988	103,844
U.S. Government agency securities	204,425	197,940	229,753	240,767
Investment agreements	94,350	94,350	138,420	138,420
Michigan Broadband Authority	11,074	4,414	49,800	46,555
Subtotal	838,527	835,893	784,650	825,134
Accrued interest	4,403	4,403	3,812	3,812
Total	<u>\$ 842,930</u>	<u>\$ 840,296</u>	<u>\$ 788,462</u>	<u>\$ 828,946</u>

Deposits - At June 30, 2004 and 2003, the carrying amount of the Authority's bank deposits including Government Money Market Funds, was \$88,994,000 and \$95,692,000, and the bank balance was \$93,503,000 and \$99,314,000, respectively. Of the bank balance, \$480,000 and \$715,000 for 2004 and 2003 was covered by federal depository insurance, \$2,540,000 and \$2,063,000 was collateralized, and \$0 and \$651,000 was uninsured and uncollateralized.

Investments - Statutes authorize the Authority to invest, at the discretion of the Authority, funds held in reserve or sinking funds, or monies not required for immediate use or disbursement, in obligations of the State of Michigan or of the United States, in obligations of which the principal and interest are guaranteed by the State of Michigan or the United States, or in other obligations approved by the State Treasurer.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 3 - Deposits and Investments (Continued)

The Authority's investments are categorized below (in thousands of dollars) to give an indication of the level of risk assumed by the entity at June 30, 2004 and 2003. Category 1 includes investments that are insured or registered or for which the securities are held by the Authority's agent in the Authority's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered investments for which the securities are held by banks, brokers or dealers, or by its trust department or agent, but not in the Authority's name. Not categorized includes certain other investments, such as repurchase agreements and investment agreements, as they are not evidenced by securities that exist in physical or book entry form.

	2004				
	GASB Category			Not Categorized	Carrying Amount
	1	2	3		
U.S. Government securities	\$ 265,557	\$ -	\$ -	\$ -	\$ 265,557
Mortgage-backed securities	172,866	1,490	10,282	-	184,638
U.S. Government agency securities	-	-	197,940	-	197,940
Noncategorized investments	-	-	-	29,962	29,962
Total investments	<u>\$ 438,423</u>	<u>\$ 1,490</u>	<u>\$ 208,222</u>	<u>\$ 29,962</u>	<u>\$ 678,097</u>
	2003				
	GASB Category			Not Categorized	Carrying Amount
	1	2	3		
U.S. Government securities	\$ 199,356	\$ -	\$ -	\$ -	\$ 199,356
Mortgage-backed securities	91,405	902	11,537	-	103,844
U.S. Government agency securities	-	-	240,767	-	240,767
Noncategorized investments	-	-	-	140,773	140,773
Total investments	<u>\$ 290,761</u>	<u>\$ 902</u>	<u>\$ 252,304</u>	<u>\$ 140,773</u>	<u>\$ 684,740</u>

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 3 - Deposits and Investments (Continued)

The amortized cost and estimated market value of cash, cash equivalents, and investments at June 30, 2004, by contractual maturity, are shown below (in thousands of dollars). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Carrying Value
Due in one year or less	\$ 275,870	\$ 275,546
Due one through five years	60,072	60,821
Due after five years through ten years	29,062	36,437
Due after ten years	<u>283,453</u>	<u>278,451</u>
Subtotal	648,457	651,255
Mortgage-backed securities	<u>190,070</u>	<u>184,638</u>
Total	<u>\$ 838,527</u>	<u>\$ 835,893</u>

Proceeds from the sales of investments in debt securities in 2004 and 2003 were \$358,979,000 and \$593,812,000, respectively. Those sales had realized gains of \$875,000 and \$5,768,000 in 2004 and 2003, respectively. The calculation of realized gains is independent of the calculation of the net increase in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net change in the fair value of investments during 2004 and 2003 was a \$43,117,000 decrease and a \$13,086,000 increase, respectively. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year, however, some of these gains and losses are reflected as liabilities in escrow funds and not considered revenue for the authority.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 3 - Deposits and Investments (Continued)

Included in investments are funds held in trust for mortgagors with a carrying value of \$409,541,000 and \$358,026,000 at June 30, 2004 and 2003, respectively, and amortized cost of \$415,418,000 and \$331,725,000 at June 30, 2004 and 2003, respectively.

Michigan Broadband Authority - The Authority has committed to invest up to \$50.0 million to assist the Broadband Authority with operations. As of June 30, 2004, approximately \$11.0 million has been distributed.

Note 4 - Loans Receivable

All loans receivable are collateralized by first liens on the real property developed or purchased with the proceeds of the loans, except for certain home improvement and moderate rehabilitation loans. Substantially all single-family loans are insured by the Federal Housing Administration (FHA) or private mortgage insurance companies, or are guaranteed by the Veterans Administration (VA) or the United States Department of Agriculture. Substantially all multi-family loans are uninsured.

A summary of loans receivable are as follows (in thousands of dollars):

	<u>2004</u>	<u>2003</u>
Loans receivable:		
FHA insured, VA, or Department of Agriculture guaranteed	\$ 391,964	\$ 465,524
Insured by private mortgage insurance companies	70,445	84,262
Uninsured	<u>1,381,126</u>	<u>1,291,082</u>
Total loans receivable	<u>\$ 1,843,535</u>	<u>\$ 1,840,868</u>

A summary of the allowance for possible losses is as follows:

	<u>2004</u>	<u>2003</u>
Beginning balance	\$ 43,000	\$ 33,000
Provision for possible losses on loans	876	10,152
Write-offs of uncollectible losses, net of recoveries	<u>(976)</u>	<u>(152)</u>
Ending balance	<u>\$ 42,900</u>	<u>\$ 43,000</u>

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004 and 2003**

Note 5 - Bonds Payable

The Authority issues revenue bonds to provide loans to finance multi-family housing projects, single-family housing units, and home improvements for persons of low and moderate income within the State of Michigan. Such bonds constitute a direct obligation of the Authority and are not a debt of the State of Michigan. Each bond issue is secured by the pledge of all repayments to the Authority of loans issued with the proceeds of the bond issue, and all income earned by the Authority relating to those bonds. Interest on all bonds, except capital appreciation bonds, is payable semi-annually. Capital appreciation bonds are bonds that are issued at a deep discount and for which all interest is accrued and paid at retirement. The Authority amortizes the discount using the interest method over the terms of the bonds. Capital appreciation bonds in the following table are shown net of unamortized discount. All bonds are subject to a variety of redemption provisions as set forth in the official statements for each of the issues. One such redemption provision is that each of the Bond Resolutions contains cross-default provisions which permit the acceleration of the maturity of all such bonds, as well as certain other remedies, in the event of a default by the Authority in the payment of principal or interest on any bond of the Authority.

Changes in bonds are as follows:

	Beginning Balance	Additions	Payments	Ending Balance
Revenue Bonds:				
Single-Family Insured Mortgage	\$ 7,420	\$ -	\$ -	\$ 7,420
Section 8 Assisted Mortgage	10,084	1,127	-	11,211
Single-Family Mortgage	655,625	113,780	202,365	567,040
Multi-Family Housing	47,800	-	1,500	46,300
Rental housing	939,535	161,440	104,065	996,910
Insured Rental Housing	36,650	-	650	36,000
Multi-Family	32,550	-	405	32,145
Total Revenue Bonds	1,729,664	<u>\$ 276,347</u>	<u>\$ 308,985</u>	1,697,026
Less deferred amounts	<u>(16,599)</u>			<u>(14,516)</u>
Total Bonds, net	<u>\$ 1,713,065</u>			<u>\$ 1,682,510</u>
Due within one year				<u>\$ 148,780</u>

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 5 - Bonds Payable (Continued)

Bonds payable at June 30 are as follows (in thousands of dollars):

	2004	2003
Single-Family Insured Mortgage Bonds -		
1978 Series A, 2005 to 2010, 5%	\$ 7,420	\$ 7,420
Section 8 Assisted Mortgage Bonds -		
1983 Series I, 2009 to 2014, 10.875% *	11,211	10,084
Single-Family Mortgage Bonds:		
1994 Series A	-	12,015
1994 Series C and D	-	5,590
1995 Series A	-	7,155
1995 Series C and D, 2004 to 2016, 5.15% to 5.875%	16,215	26,850
1996 Series A, B, and C, 2011 to 2027, 5.90% to 6.05%	73,190	95,010
1996 Series D and E, 2004 to 2027, 5.20% to 5.95%	14,065	33,930
1997 Series A, 2004 to 2027, 5.10% to 5.95%	18,315	26,570
1997 Series C, D, and E, 2004 to 2028, 5.65% to 6.87% including \$8,350 at a variable rate	39,970	57,080
1998 Series B and C, 2004 to 2030, 4.20% to 5.20%	49,350	64,535
1999 Series A, 2004 to 2010, 5.35% to 5.75%	2,365	14,555
1999 Series B-1, 2004 to 2027, 5.35% to 6.00%	2,530	13,860
1999 Series B-2, 2024 variable rate (Note 6)	12,850	12,850
2000 Series A, 2016, variable rate (Note 6)	27,710	27,710
2000 Series B	-	1,785
2000 Series C, 2020, variable rate (Note 6)	23,040	40,000
2001 Series A, 2004 to 2032, 3.70% to 5.55%	89,670	101,110
2002 Series A, 2002, variable rate (Note 6)	15,000	15,000
2002 Series B, 2005 to 2030, 3.25% to 5.50%	7,615	7,615
2002 Series C, 2030, variable rate (Note 6)	20,000	20,000
2002 Series D, 2004, variable rate	41,375	41,375
2003 Series A	-	31,030
2003 Series B, 2004 to 2014, 1.22% to 4.30%	16,295	-
2003 Series C, 2029, variable rate (Note 6)	26,820	-
2003 Series D, 2034, variable rate (Note 6)	20,000	-
2004 Collateralized Note	50,665	-
	<hr/>	<hr/>
Total Single-Family Mortgage Bonds	567,040	655,625

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 5 - Bonds Payable (Continued)

	2004	2003
Multi-Family Housing Bonds -		
1988 Series A, 2004 to 2019, variable rate (Note 6)	\$ 46,300	\$ 47,800
Rental Housing Bonds:		
1994 Series B, 2004 to 2019, 5.60% to 5.80%	71,685	76,085
1995 Series A and B, 2004 to 2015, 5.30% to 6.15%	60,930	71,710
1997 Series A, 2004 to 2033, 5.75% to 6.10%	79,140	80,590
1997 Series B, 2004 to 2009, variable rate (Note 6)	25,895	30,190
1999 Series A, B, and C, 2004 to 2037, 3.85% to 5.30%	86,530	91,530
1999 Series D, 2014, variable rate	25	46,150
2000 Series A and B, 2024 and 2035, variable rate (Note 6)	78,125	80,795
2001 Series A, B, and C, 2023 to 2035, variable rate	134,710	147,075
2002 Series A, B, and C, 2019 to 2037, variable rate (Note 6)	175,590	182,665
2003 Series A, 2023, variable rate	122,840	132,745
2003 Series B, C and D, 2018 to 2037, variable rate (Note 6)	161,440	-
Total Rental Housing Bonds	996,910	939,535
Insured Rental Housing Bonds -		
1998 Series A, 2008 to 2026, 6.325% to 6.89%	36,000	36,650
Multi-Family Bonds -		
1995 Series A, 2005 to 2030, 7.90% to 8.55%	32,145	32,550
Total Revenue Bonds	1,697,026	1,729,664
Less deferred amounts	14,516	16,599
Total	\$ 1,682,510	\$ 1,713,065

A portion of the bonds indicated with an asterisk (*) above is capital appreciation bonds (CAB). A CAB is a debt instrument that is satisfied with a single payment when retired, representing both the initial principal amount and the total investment return.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 5 - Bonds Payable (Continued)

The annual requirements to service debt outstanding, including both principal and interest (in thousands of dollars), are as follows:

Fiscal Year	Principal	Interest	Total
2005	\$ 148,780	\$ 79,444	\$ 228,224
2006	58,700	75,871	134,571
2007	63,750	73,091	136,841
2008	64,240	70,071	134,311
2009	67,726	67,174	134,900
2010-2014	350,150	286,990	637,140
2015-2019	323,575	204,620	528,195
2020-2024	231,635	129,210	360,845
2025-2029	196,490	73,513	270,003
2030-2034	140,225	26,776	167,001
2035-2039	51,755	4,235	55,990
Total	<u>\$ 1,697,026</u>	<u>\$ 1,090,995</u>	<u>\$ 2,788,021</u>

Early Retirement of Debt - Under provisions of the Authority's bond issues, the Authority is able to retire bonds, without the payment of call premiums, prior to their maturity dates from the proceeds of loan prepayments and foreclosures and, for certain bonds, from excess program revenues. Bonds retired pursuant to such provisions total \$194,130,000 and \$213,805,000 during the years ended June 30, 2004 and 2003, respectively. Such bond retirements, in the aggregate, resulted in a net (loss) gain of \$(1,533,000) and \$412,000 for the years ended June 30, 2004 and 2003, respectively. These losses and gains represent the net write-off of related bond issuance costs, and are recorded in interest expense and debt financing costs in the Statement of Revenue, Expenses, and Changes in Net Assets.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 6 - Demand Bonds

The following table summarizes the demand bonds outstanding at June 30, 2004, which are included in the bonds payable disclosed in Note 5:

Debt Associated	Bonds		Liquidity or Irrevocable Letter of Credit Provider	Remarketing Fee (1)	Liquidity/ LOC Fee	Expiration Date of Agreement
	Outstanding	Remarketing Agent				
<u>Multi-Family Housing Revenue Bonds:</u>						
1988 Series A	\$46,300	Merrill Lynch & Co.	Helaba	0.08%	0.280% (10)	03/31/08
<u>Single-Family Mortgage Revenue Bonds:</u>						
1999 Series B-2	\$12,850	Lehman Brothers	Bank One	0.10%	0.115% (7)	06/01/05
2000 Series A	\$27,710	Lehman Brothers	Bank One	0.10%	0.115% (7)	06/01/05
2000 Series C	\$23,040	Lehman Brothers	Bank One	0.10%	0.115% (7)	06/01/05
2002 Series A	\$15,000	Lehman Brothers	Dexia Credit Local	0.10%	0.170% (5)	05/25/07
2002 Series C	\$20,000	Lehman Brothers	Helaba	0.10%	0.170% (6)	09/28/04
2003 Series C	\$11,775	Merrill Lynch & Co.	Dexia Credit Local	0.08%	0.175% (8)	11/25/06
2003 Series D	\$20,000	Merrill Lynch & Co.	Dexia Credit Local	0.08%	0.175% (8)	11/25/06
<u>Rental Housing Revenue Bonds:</u>						
1997 Series B	\$25,895	Goldman Sachs & Co.	Helaba	0.10%	0.250% (4)	03/12/05
2000 Series A	\$44,900	Goldman Sachs & Co.	Morgan Guaranty Trust	0.10%	0.200% (3)	09/28/05
2000 Series B	\$33,225	Goldman Sachs & Co.	Morgan Guaranty Trust	0.10%	0.200% (3)	09/28/05
2002 Series A	\$59,605	Goldman Sachs & Co.	Helaba	0.10%	0.170% (2)	12/31/15
2002 Series B	\$45,500	Goldman Sachs & Co.	Helaba	0.10%	0.170% (2)	12/31/15 (9)
2002 Series C	\$70,485	Goldman Sachs & Co.	Helaba	0.10%	0.170% (2)	12/31/15 (9)

- (1) Fee is per annum based on the outstanding principal amount of the bonds.
- (2) While Helaba is holding the bonds, they will bear interest at the higher of Helaba's prime rate or the Federal Funds Rate plus 0.50 percent per annum. Once Helaba becomes the owner of the bonds, the bonds will be subject to a mandatory redemption that begins 90 days after Helaba becomes the holder of the bonds and is amortized in 20 equal quarterly installments. The Authority is required to pay Helaba an annual commitment fee of 0.17 percent per annum on the amount of bonds outstanding plus interest for 34 days at a rate of 14 percent.
- (3) While the Bank is holding the bonds, they will bear interest at the higher of the Bank's prime rate or the Federal Funds Rate plus 0.50 percent per annum. Once the Bank becomes the owner of the bonds, the bonds will be subject to a mandatory redemption commencing between six and twelve months after the Bank becomes the holder of the bonds and is amortized in 10 equal semi-annual installments. The Authority is required to pay the Bank an annual commitment fee of 0.20 percent per annum on the amount of bonds outstanding plus interest for 34 days at a rate of 14 percent.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 6 - Demand Bonds (Continued)

- (4) The Trustee is entitled to draw on the irrevocable letter of credit, issued by Helaba, in an amount sufficient to pay the purchase price of bonds delivered to it. The Authority must repay the bank for each draw on the letter of credit by its expiration date. Interest is also payable on any of these draws outstanding at a variable rate not to exceed 12 percent. The Authority is required to pay Helaba an annual commitment fee for the letter of credit of 0.25 percent per annum of the amount of the outstanding bonds plus interest for 211 days at 12 percent per annum.
- (5) While Dexia is holding the bonds, they will bear interest at the higher of Dexia's prime rate or the Federal Funds Rate plus 0.50 percent per annum. Once Dexia becomes the owner of the bonds, the bonds will be subject to a mandatory redemption that begins the first business day of January, April, July, or October and is amortized in 20 equal quarterly installments. The Authority is required to pay Dexia an annual commitment fee of 0.17 percent per annum on the amount of bonds outstanding plus interest for 185 days at a rate of 14 percent.
- (6) While Helaba is holding the bonds, they will bear interest at the higher of Helaba's prime rate or the Federal Funds Rate plus 0.50 percent per annum. Once Helaba becomes the owner of the bonds, the bonds will be subject to a mandatory redemption that begins six months after Helaba becomes the holder of the bonds and is amortized within five years in equal installments. The Authority is required to pay Helaba an annual commitment fee of 0.17 percent per annum on the amount of bonds outstanding plus interest for 183 days at a rate of 14 percent.
- (7) While the bonds are held by Bank One they shall bear interest at a rate determined in reference to the British Bankers' Association Interest Settlement Rate, as adjusted for Bank One's Reserve Requirement, plus 0.70 percent and will be subject to mandatory redemption by the Authority on a quarterly basis beginning six months and ending five years after the purchase by Bank One. The Authority is required to pay an annual commitment fee of 0.115 percent per annum on the amount of bonds outstanding plus interest for 205 days at a rate of 14 percent per annum.
- (8) While Dexia is holding the bonds, they will bear interest at the higher of Dexia's prime rate or the Federal Funds Rate plus 0.50 percent per annum. Once Dexia becomes the owner of the bonds, the bonds will be subject to a mandatory redemption that begins on the earlier of the 181st day after the purchase date or the first business day of the sixth month after the end of the purchase period and are amortized over 14 equal semi-annual installments. The Authority is required to pay Dexia an annual commitment fee of 0.175 percent per annum on the amount of bonds outstanding plus interest for 185 days at a rate of 12 percent per annum for the Series C Bonds and at a rate of 18 percent per annum for the Series D Bonds.
- (9) The Authority and Helaba both have the option to terminate the Standby Bond Purchase Agreement on June 29, 2007, June 29, 2010, and June 29, 2013.
- (10) The Trustee is entitled to draw on the irrevocable letter of credit, issued by Helaba, in an amount sufficient to pay the purchase price of bonds delivered to it. The Authority must repay the bank for each draw on the letter of credit by its expiration date. Interest is also payable on any of these draws outstanding at a variable rate not to exceed 25 percent. The Authority is required to pay Helaba an annual commitment fee for the letter of credit of 0.28 percent per annum of the amount of the outstanding bonds plus interest for 41 days at 25 percent per annum.

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004 and 2003**

Note 7 - Deferred Mortgage Interest Income

Since 1990, the Authority has refunded a substantial amount of high yielding multi-family bond issues with lower yielding bonds. In conjunction with the sale of certain refunding bonds, the Authority has sold additional bonds to provide funds for new multi-family mortgage loans, generally with interest rates below the interest rates on the bonds. The Authority is deferring the interest income on mortgage loans funded by the new bonds to the extent that the total exceeds the total interest income that would have been earned if the average interest rate on such loans was equal to the average interest rate paid on the new bonds plus approximately 1.5 percent. This deferred interest income is and will continue to be amortized to income in the future as the average rate on the outstanding mortgage loans drops to a rate that is less than 1.5 percent above the average rate on the new bonds. The average rate will decline primarily because the higher yielding mortgage loans have average remaining lives substantially shorter than the lower yielding mortgage loans. The mortgage interest income that was deferred, net of amortization was \$8,355,000 and (\$14,120,000) for the years ended June 30, 2004 and 2003, respectively.

Note 8 - Limited Obligation Bonds

The Act, as amended, authorizes the Authority to issue limited obligation bonds to finance multi-family housing. Such bonds are not general obligations of the Authority and the Authority has no liability for this debt. Such bonds are secured solely by revenues and property derived from or obtained in connection with the housing projects. Thus, with the exception of limited obligation bond financing fees, transactions related to these bonds are not reflected in the Authority's financial statements. At June 30, 2004, limited obligation bonds had been issued totaling approximately \$615,193,000 of which 14 issues totaling \$131,033,000 have been retired.

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004 and 2003**

Note 9 - Other Employee Benefits

Plan Description - The Authority participates in the State of Michigan's defined benefit and defined contribution plans that covers most State employees, as well as related component units such as the Michigan State Housing Development Authority. The defined benefit plan provides retirement, disability, death benefits, and annual cost of living adjustments to plan members. The System issues a publicly available financial report that includes financial statements and required supplementary information for the System. The report may be obtained by writing to the System at 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-6262.

Funding Policy - Plan members are not required to make contributions: The Authority is required to contribute an actuarially determined rate for the defined benefit plan of 4.02 percent of payroll for the year. The defined benefit contributions to the plan were equal to the required contributions for each year. The Authority is required to contribute to the defined contribution plan 4.0 percent of payroll with an additional match of up to 3.0 percent. The contribution requirements of plan members and the Authority are established and may be amended by the state legislature. The state legislature establishes the extent to which employer and employees are required to make contributions and establishes the benefit provisions for the plan. The Authority's contributions to the plans, including post-employment benefits as described below, were \$2,199,000 and \$1,962,000 for the years ended June 30, 2004 and 2003, respectively, and are recorded in salaries and benefits expense.

Post-Employment Benefits - In addition, the Authority participates in the State of Michigan's post-employment benefits. The cost of retiree healthcare benefits is an allocation calculated by the State of Michigan and funded on a pay-as-you-go basis. The contributions paid to this plan for the year ended June 30, 2004, were 12.50 percent of payroll. Employees hired on or before March 30, 1997, who participate in either the defined benefit plan or the defined contribution plan and meet certain vesting and other requirements, will receive the full amount of healthcare benefits from the State of Michigan. For employees who were hired after March 30, 1997, the State will pay up to 90 percent of healthcare benefits for employees who meet certain vesting and other requirements.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 10 - Capital Lease

The Authority has an agreement to lease its building through the year 2021. The Authority has purchase options at the end of five or ten years respectively, equal to the present value of the future lease payments. Accordingly, the land and building has been recorded as a capital asset of the Authority, totaling \$13,041,632 with accumulated depreciation of \$2,055,888 and \$1,351,012 at June 30, 2004 and 2003, respectively, and is included in other assets. Depreciation expense for the years ended June 30, 2004 and 2003, totaled approximately \$705,000.

Future minimum lease payments under the scheduled capital lease that have initial or remaining non-cancelable terms in excess of one year are as follows:

Fiscal Year	Principal	Interest	Total
2005	\$ 425,170	\$ 1,054,330	\$ 1,479,500
2006	458,997	1,020,503	1,479,500
2007	495,516	983,984	1,479,500
2008	534,940	944,560	1,479,500
2009	577,501	901,999	1,479,500
2010-2014	3,654,327	3,743,173	7,397,500
2015-2019	5,358,522	2,038,978	7,397,500
2020-2022	2,415,462	173,663	2,589,125
Total	<u>\$ 13,920,435</u>	<u>\$ 10,861,190</u>	<u>\$ 24,781,625</u>

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004 and 2003

Note 11 - Restricted Net Assets

The components of restricted net assets are as follows (in thousands of dollars):

	<u>2004</u>	<u>2003</u>
Pledged for payment of:		
All bond issues (Capital Reserve Capital Account)	\$ 42,188	\$ 41,480
Single-Family Insured Mortgage Revenue Bonds	3,927	3,970
Section 8 Assisted Mortgage Revenue Bonds	11,164	12,920
Single-Family Mortgage Revenue Bonds	64,941	60,748
Home Improvement Program Bonds	6,336	6,324
Multi-Family 1988 Housing Revenue Bonds	1,197	415
Rental Housing Revenue Bonds	123,530	106,887
Insured Rental Housing Revenue Bonds	6,468	7,340
Multi-Family Revenue Bonds	<u>1,521</u>	<u>2,193</u>
Total	<u>\$ 261,272</u>	<u>\$ 242,277</u>

Note 12 - Contingencies

The Authority is involved in various legal proceedings, claims, and disputes arising in the ordinary course of its financing activities with real estate developers and others. Management does not expect the amount of the ultimate liability with respect to the disposition of these matters will have any material adverse impact on the financial condition or results of operations of the Authority.

Note 13 - Commitments

As of June 30, 2004 and 2003, the Authority has commitments to issue multi-family mortgage loans in the amounts of \$77,418,000 and \$104,786,000, respectively, and single-family mortgage loans in the amounts of \$7,728,000 and \$9,828,000, respectively.

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004 and 2003**

Note 13 - Commitments (Continued)

The Authority has committed up to approximately \$1,055,000 per year for up to 30 years from the date of completion of the respective developments (subject to three years advance notice of termination) from its accumulated reserves and future income to subsidize operations or rents for certain tenants occupying units in certain developments funded under the Authority's multi-family program. Such developments receive funds either for the purpose of subsidizing rents so that some units can be afforded by families with incomes at 50 percent or less of median income or to subsidize operations in general. Subsidy disbursements began in 1985 and totaled approximately \$751,000 and \$611,000 for the years ended June 30, 2004 and 2003, respectively.

In addition, the Authority makes available up to approximately \$1,000,000 per year for up to 30 years to subsidize rents in a similar fashion for 20 percent of the units in certain other developments financed or to be financed under its multi-family mortgage lending program. Under this program, the Authority is entitled to receive a portion of any excess cash flow generated by the developments as well as a share of the profits from the sale of the developments and is able to reduce the rent subsidies if the interest rates being charged by the Authority on the related mortgage loans are below certain preset levels. Subsidy repayments exceeded subsidy disbursements by \$20,000 and \$34,000 for the years ended June 30, 2004 and 2003, respectively.

In conjunction with a multi-family taxable bond lending program, the Authority is making available annually to certain developments financed under the program an amount equal to 400 times the number of units in such developments (subject to a one year advance notice of termination) for the purpose of subsidizing rents so that some of the units in such developments can be made available to very low income tenants. Under certain circumstances, after 15 years or more, the owners of the developments will be required to repay without interest up to 100 percent of the subsidies provided by the Authority. The Authority has not established a maximum amount that it will make available under this program. Subsidy disbursements under this program totaled \$901,000 and \$933,000 for the years ended June 30, 2004 and 2003, respectively.

Finally, the Authority also makes available interest free loans of up to \$25,000 annually to developments that incur increased operating costs because of their small size (less than 100 rental units) and up to \$25,000 annually for developments that incur increased security costs due to their location. The loans are repayable from excess development revenues and are also repayable upon repayment of the first mortgage loan. Disbursements under this program totaled \$457,000 and \$501,000 for the years ended June 30, 2004 and 2003, respectively.

Michigan State Housing Development Authority

Notes to Financial Statements
June 30, 2004 and 2003

Note 13 - Commitments (Continued)

Grants and Subsidies

Disbursements under these programs are included in grants and subsidies along with grants made to non-profit organizations pursuant to various programs that have as their purpose increasing the supply of affordable housing for low and medium income families in Michigan and the provision of temporary shelter for homeless individuals and families.

Note 14 - Prior Period Adjustment

Net assets as of July 1, 2002, have been restated to reflect a change in accounting for grants from previously issued financial statements. Previously, grant commitments were recorded based on the commitment date and not when the grants were earned by the grantee. Accounting principles generally accepted in the United States of America require commitments to be recognized as expenses when earned. The financial statements for 2003 have been restated for the change, which resulted in an increase in revenue for 2003 of \$2,291,932 and an increase in unrestricted net assets at the beginning of 2003 of \$11,230,691.

Net assets have been restated as follows:

	Net Assets (In Thousands of Dollars)
Balance July 1, 2002, as previously reported	\$ 435,326
Prior period adjustment	<u>11,231</u>
Balance July 1, 2002, as restated	<u>\$ 446,557</u>

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004 and 2003**

Note 15 - Off Balance Sheet Financial Instruments

In connection with the issuance of various debt, the Authority has entered into interest rate swap contracts. To date, the interest rate swap contracts have all been the type where the Authority pays a fixed rate and receives a variable rate. No amount of compensation was paid or received at the time the contracts were executed. Interest rate swap agreements are important tools that the Authority utilizes to accomplish its goals. These contracts have reduced the Authority's cost of borrowing and reduced exposure to variable interest rate risk. This has allowed the Authority to finance developments, reduce single-family mortgage rates, and fund programs that otherwise would not have been feasible.

Michigan State Housing Development Authority

Notes to Financial Statements June 30, 2004

Note 15 - Off Balance Sheet Financial Instruments (Continued)

The following summarizes the interest rate swap contracts at June 30, 2004:

Associated Debt/Swap Agreement	National Amount as of June 30, 2004	Termination Date	Rate	Fixed Rate	Optional Termination	Market (Payment)/ to Terminate Swap	Type of Risk Associated With Swap Contract (4)(8)
					Date/ Without Payment (9)		
Rental Housing:							
Revenue Bonds (1):							
2000 Series A	\$ 44,900,000	10/01/20	70% of 1 M LIBOR	4.960%	Current	\$ (5,425,146)	(5)(6)(7)
2001 Series B	41,525,000	04/01/23	Actual Bond Rate	5.530%	Current	(4,500,222)	
2001 Series C	42,815,000	04/01/23	Actual Bond Rate	4.770%	Current	(2,903,616)	
2002 Series A	60,000,000	04/01/27	70% of 1 M LIBOR	4.560%	Current	(5,489,331)	(5)(6)
2002 Series B	45,500,000	04/01/19	70% of 1 M LIBOR	3.535%	Current	(884,165)	(5)(6)
2003 Series B	79,615,000	10/01/37	70% of 1 M LIBOR	4.197%	Current/ 10/01/17	(3,014,932)	(5)(6)
2003 Series C	<u>23,700,000</u>	10/01/37	Floating Rate (10)	3.808%	Current/ 10/01/23	<u>251,621</u>	(5)(6)
Subtotal	338,055,000					(21,965,791)	
Single-Family Mortgage:							
Revenue Bonds:							
1999 Series B-2 (2)	12,850,000	12/01/18	Actual Bond Rate	5.489%	Current	(1,736,676)	(6)(7)
2000 Series A (2)	13,750,000	12/01/16	Actual Bond Rate	5.439%	Current	(2,313,947)	(6)
2000 Series C (2)	22,095,000	12/01/08	Actual Bond Rate	7.696%	Current	(2,123,217)	(7)
2002 Series A (2)	15,000,000	06/01/20	Actual Bond Rate	3.860%	Current	(414,032)	(6)
2003 Series C (3)	11,775,000	12/01/20	Floating Rate (11)	3.512%	Current/ 12/01/13	638	(5)(6)(7)
2003 Series C (3)	<u>15,045,000</u>	06/01/30	Floating Rate (11)	4.347%	Current/ 12/01/06	<u>(145,720)</u>	(5)(6)(7)
Subtotal	<u>90,515,000</u>					<u>(6,732,954)</u>	
Total	<u>\$ 428,570,000</u>					<u>\$ (28,698,745)</u>	

- (1) Counterparty risk is the risk that the swap counterparty will not fulfill its obligations set forth under the terms and conditions of the swap contract. The counterparty associated with these bonds is Goldman Sachs Mitsui Marine Derivative Products, L.P. (GSMMDP). GSMMDP is currently AAA by Moody's and AA+ by S&P as of June 30, 2004.
- (2) Counterparty risk is the risk that the swap counterparty will not fulfill its obligations set forth under the terms and conditions of the swap contract. The counterparty associated with these bonds is Lehman Brothers Derivative Product Inc. (LBDP). LBDP is currently rated AAA by Moody's and AAA by S&P as of June 30, 2004.
- (3) Counterparty risk is the risk that the swap counterparty will not fulfill its obligations set forth under the terms and conditions of the swap contract. The counterparty associated with these bonds is Merrill Lynch Capital Services, Inc. (MLCS). MLCS is rated AAA by Moody's and AAA by S&P as of June 30, 2004.
- (4) Termination risk is the risk that the swap could be terminated by the counterparty due to any of several events, which may include an Authority or counterparty ratings downgrade, covenant violation by either party, bankruptcy of either party, swap payment default by either party, and default events as defined in the Authority's bond indentures. All contracts have this risk.
- (5) Basis risk refers to a mismatch between the interest rate received from the swap contract and the interest actually paid on the Authority's debt.

Michigan State Housing Development Authority

**Notes to Financial Statements
June 30, 2004**

Note 15 - Off Balance Sheet Financial Instruments (Continued)

- (6) Tax event risk is the risk that a change in the marginal income tax rates or a change in the tax code impacts the trading value of tax-exempt bonds.
- (7) Rollover risk is the risk that the swap contract is not coterminous with the related debt.
- (8) Amortization risk is the risk that there is a mismatch or potential mismatch between the Authority's bonds and the notional amount of the swap outstanding. This mismatch could expose the Authority to variable interest rates if the swap amortizes quicker than the bonds or subject the Authority to a payment to the counterparty to terminate a portion of the swap contract early if the bonds are redeemed quicker than anticipated. All contracts have this risk.
- (9) The Authority has the option to terminate the contract in whole or in part without payment after the stated date.
- (10) The floating Rate Option is the lesser of a) 1-month USD-LIBOR-BBA, and b) the greater of i) 1-month USD-LIBOR-BBA times 68 percent, and ii) 1-month USD-LIBOR-BBA times 58 percent plus .42 percent.
- (11) The Floating Rate is the sum of 65 percent of the USD-LIBOR-BBA and .23 percent.

Michigan State Housing Development Authority
Lansing, Michigan
and
Mr. Thomas H. McTavish, CPA
Auditor General
State of Michigan
Lansing, Michigan

We have audited the basic financial statements of the Michigan State Housing Development Authority, a component unit of the State of Michigan, as of and for the year ended June 30, 2004. Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The other supplemental information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Michigan State Housing Development Authority. The information has been subjected to the procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Plante & Moran, PLLC

October 21, 2004

Supplemental Data

Michigan State Housing Development Authority

Statement of Net Assets (in Thousands of Dollars) June 30, 2004

	Activities					
	Section 8 Assisted Mortgage Revenue Bonds	Single-Family Insured Mortgage Revenue Bonds	Home Improvement Program Bonds	Single-Family Mortgage Revenue Bonds	Multi-Family Housing Revenue Bonds	Rental Housing Revenue Bonds
Assets						
Cash and cash equivalents	\$ 202	\$ 1	\$ 157	\$ 78,751	\$ 4,663	\$ 62,046
Investments, including related interest receivable	13,450	2,999	-	96,669	3	88,951
Total cash and investments	13,652	3,000	157	175,420	4,666	150,997
Loans Receivable						
Multi-family mortgage loans:						
Construction-in-progress	-	-	-	-	-	147,972
Completed construction	9,243	-	-	-	42,878	895,612
Single-family mortgage loans	-	8,927	434	449,409	-	-
Home improvement and moderate rehabilitation loans	-	-	4,025	-	-	-
Subtotal	9,243	8,927	4,459	449,409	42,878	1,043,584
Add interest receivable	70	64	17	3,892	160	9,254
Less allowance for possible losses	-	-	(200)	(500)	(400)	(24,700)
Less mortgage discount	(144)	-	-	(560)	-	(1,019)
Loans receivable, net	9,169	8,991	4,276	452,241	42,638	1,027,119
Other Assets						
Unamortized bond financing costs	12	3	-	1,525	101	2,335
Real estate owned	-	-	25	5,436	-	2,214
Other assets	-	18	434	794	-	-
Interfund accounts	99	(833)	1,444	(4,352)	(2)	(2,031)
Total other assets	111	(812)	1,903	3,403	99	2,518
Total assets	\$ 22,932	\$ 11,179	\$ 6,336	\$ 631,064	\$ 47,403	\$ 1,180,634
Liabilities and Net Assets						
Liabilities						
Bonds payable	\$ 11,768	\$ 7,159	\$ -	\$ 563,406	\$ 46,155	\$ 986,780
Accrued interest payable	-	93	-	1,908	39	5,891
Escrow funds	-	-	-	-	-	1,307
Deferred mortgage interest income	-	-	-	-	-	56,335
Other liabilities	-	-	-	809	12	6,791
Total liabilities	11,768	7,252	-	566,123	46,206	1,057,104
Net Assets	11,164	3,927	6,336	64,941	1,197	123,530
Total liabilities and net assets	\$ 22,932	\$ 11,179	\$ 6,336	\$ 631,064	\$ 47,403	\$ 1,180,634

Michigan State Housing Development Authority

Statement of Net Assets (in Thousands of Dollars) (Continued) June 30, 2004

	Activities						Combined
	Insured Rental Housing Revenue Bonds	Multi-Family Revenue Bonds	General Operating	Capital Reserve	Mortgage Escrow and Reserve	Other	
Assets							
Cash and cash equivalents	\$ 555	\$ 428	\$ 8,379	\$ 1,608	\$ 5,409	\$ -	\$ 162,199
Investments, including related interest receivable	2,943	4,915	21,118	40,580	406,469	-	678,097
Total cash and investments	3,498	5,343	29,497	42,188	411,878	-	840,296
Loans Receivable							
Multi-family mortgage loans:							
Construction-in-progress	-	-	11,653	-	-	-	159,625
Completed construction	40,272	32,854	126,574	-	-	55,949	1,203,382
Single-family mortgage loans	-	-	10,021	-	-	-	468,791
Home improvement and moderate rehabilitation loans	-	-	7,712	-	-	-	11,737
Subtotal	40,272	32,854	155,960	-	-	55,949	1,843,535
Add interest receivable	332	233	2,109	-	-	1,420	17,551
Less allowance for possible losses	(2,400)	(1,300)	(13,400)	-	-	-	(42,900)
Less mortgage discount	-	-	(9,378)	-	-	-	(11,101)
Loans receivable, net	38,204	31,787	135,291	-	-	57,369	1,807,085
Other Assets							
Unamortized bond financing costs	146	86	-	-	-	-	4,208
Real estate owned	-	-	4,211	-	-	-	11,886
Other assets	-	-	41,415	-	-	1,717	44,378
Interfund accounts	(51)	(3,125)	11,666	-	3,965	(6,780)	-
Total other assets	95	(3,039)	57,292	-	3,965	(5,063)	60,472
Total assets	\$ 41,797	\$ 34,091	\$ 222,080	\$ 42,188	\$ 415,843	\$ 52,306	\$ 2,707,853
Liabilities and Net Assets							
Liabilities							
Bonds payable	\$ 35,125	\$ 32,117	\$ -	\$ -	\$ -	\$ -	\$ 1,682,510
Accrued interest payable	204	453	-	-	-	-	8,588
Escrow funds	-	-	3,098	-	415,843	(52,182)	368,066
Deferred mortgage interest income	-	-	-	-	-	-	56,335
Other	-	-	31,789	-	-	219	39,620
Total liabilities	35,329	32,570	34,887	-	415,843	(51,963)	2,155,119
Net Assets	6,468	1,521	187,193	42,188	-	104,269	552,734
Total liabilities and net assets	\$ 41,797	\$ 34,091	\$ 222,080	\$ 42,188	\$ 415,843	\$ 52,306	\$ 2,707,853

Michigan State Housing Development Authority

Statement of Revenue and Expenses and Changes in Net Assets Information (in Thousands of Dollars) June 30, 2004

	Activities					
	Section 8 Assisted Mortgage Revenue Bonds	Single-Family Insured Mortgage Revenue Bonds	Home Improvement Program Bonds	Single-Family Mortgage Revenue Bonds	Multi-Family Housing Revenue Bonds	Rental Housing Revenue Bonds
Investment Income						
Loan interest income	\$ 867	\$ 500	\$ 272	\$ 31,985	\$ 1,971	\$ 63,184
Investment interest income	511	204	1	3,480	3	4,020
(Decrease) increase in fair value of investments	(152)	(300)	-	(13)	-	(50)
Subtotal	1,226	404	273	35,452	1,974	67,154
Less interest expense and debt financing costs	1,102	448	-	30,430	701	40,485
Net investment income	124	(44)	273	5,022	1,273	26,669
Other Revenue						
Federal assistance programs	-	-	-	-	-	-
Section 8 program administrative fees	-	-	-	-	-	-
Contract administration fees	-	-	-	-	-	-
Other income	-	-	-	70	-	122
Total operating revenue	124	(44)	273	5,092	1,273	26,791
Operating Expenses						
Federal assistance programs	-	-	-	-	-	-
Salaries and benefits	-	-	-	-	-	-
Other general operating expenses	-	-	8	-	-	-
Loan servicing and insurance costs	-	(1)	248	141	-	-
Provision for possible losses on loans	-	-	5	820	(600)	(4,000)
Total operating expenses	-	(1)	261	961	(600)	(4,000)
Operating Income (Loss) Before Grants and Subsidies	124	(43)	12	4,131	1,873	30,791
Grants and Subsidies	-	-	-	-	-	-
Change in Net Assets	124	(43)	12	4,131	1,873	30,791
Net Assets - Beginning of year	12,920	3,970	6,324	60,747	415	106,887
Transfers (To) From Other Funds For						
Payment of operating fund expenses	(1,880)	-	-	-	(1,091)	(15,229)
Funding to provide additional cash flow and payment of bond issuance costs	-	-	-	63	-	1,081
Net Assets - End of year	\$ 11,164	\$ 3,927	\$ 6,336	\$ 64,941	\$ 1,197	\$ 123,530

Michigan State Housing Development Authority

Statement of Revenue and Expenses and Changes in Net Assets Information (in Thousands of Dollars) (Continued) June 30, 2004

	Activities						Combined
	Insured Rental Housing Revenue Bonds	Multi-Family Revenue Bonds	General Operating	Capital Reserve	Mortgage Escrow and Reserve	Other	
Investment Income							
Loan interest income	\$ 3,376	\$ 2,926	\$ 11,217	\$ -	\$ -	\$ 2,577	\$ 118,875
Investment interest income	283	258	9,108	2,918	-	2,373	23,159
(Decrease) increase in fair value of investments	(362)	(222)	(7,040)	(2,209)	-	2,756	(7,592)
Subtotal	3,297	2,962	13,285	709	-	7,706	134,442
Less interest expense and debt financing costs	2,577	2,834	1,208	-	-	-	79,785
Net investment income	720	128	12,077	709	-	7,706	54,657
Other Revenue							
Federal assistance programs	-	-	235,483	-	-	-	235,483
Section 8 program administrative fees	-	-	10,438	-	-	-	10,438
Contract administration fees	-	-	7,030	-	-	-	7,030
Other income	1	-	6,935	-	-	26,471	33,599
Total operating revenue	721	128	271,963	709	-	34,177	341,207
Operating Expenses							
Federal assistance programs	-	-	235,483	-	-	-	235,483
Salaries and benefits	-	-	16,515	-	-	-	16,515
Other general operating expenses	-	-	17,828	-	-	-	17,836
Loan servicing and insurance costs	-	-	3,361	-	-	-	3,749
Provision for possible losses on loans	900	800	2,951	-	-	-	876
Total operating expenses	900	800	276,138	-	-	-	274,459
Operating Income (Loss) Before Grants and Subsidies	(179)	(672)	(4,175)	709	-	34,177	66,748
Grants and Subsidies	-	-	(2,089)	-	-	(12,659)	(14,748)
Change in Net Assets	(179)	(672)	(6,264)	709	-	21,518	52,000
Net Assets - Beginning of year	7,340	2,193	187,708	41,479	-	70,751	500,734
Transfers (To) From Other Funds For							
Payment of operating fund expenses	(693)	-	18,893	-	-	-	-
Funding to provide additional cash flow and payment of bond issuance costs	-	-	(13,144)	-	-	12,000	-
Net Assets - End of year	\$ 6,468	\$ 1,521	\$ 187,193	\$ 42,188	\$ -	\$ 104,269	\$ 552,734

**Report Letter on Compliance With
Laws and Regulations and Internal Controls**

Report Letter on Compliance With Laws and Regulations and Internal Controls

Michigan State Housing Development Authority
Lansing, Michigan

We have audited the basic financial statements of the Michigan State Housing Development Authority (the Authority), a component unit of the State of Michigan, as of and for the year ended June 30, 2004, and have issued our report thereon dated October 21, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

Michigan State Housing Development Authority
Lansing, Michigan

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

We noted other matters involving the internal control over financial reporting that we have reported to the management of the Authority in a separate letter dated October 21, 2004.

This report is intended for the information of the Michigan State Housing Development Authority and the Auditor General of the State of Michigan and is not intended to be, and should not be, used by anyone other than these specified parties.

Plante & Moran, PLLC

October 21, 2004