

COMMUNITY DEVELOPMENT ADMINISTRATION
LOCAL GOVERNMENT INFRASTRUCTURE BONDS
(AMBAC INSURED)

Financial Statements

For the period ended June 30, 2002 with Report of Independent Auditors

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Financial Statements

June 30, 2002

Contents

| | |
|--|---|
| Report of Independent Auditors..... | 1 |
| Balance Sheet..... | 2 |
| Statement of Revenues, Expenses and Changes in Net Assets..... | 3 |
| Statement of Cash Flows..... | 4 |
| Notes to Financial Statements..... | 5 |

Report of Independent Auditors

Office of the Secretary
Department of Housing and Community Development:

We have audited the accompanying financial statements of the Community Development Administration Local Government Infrastructure Bonds (Ambac Insured) of the Department of Housing and Community Development of the State of Maryland, as of June 30, 2002 and for the period from March 1, 2002 (inception) to June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in 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.

As discussed in Note 1, the financial statements present only the Community Development Administration Local Government Infrastructure Bonds (Ambac Insured) and do not purport to, and do not, present fairly the financial position of the Department of Housing and Community Development of the State of Maryland, as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Community Development Administration Local Government Infrastructure Bonds (Ambac Insured) of the Department of Housing and Community Development of the State of Maryland, at June 30, 2002, and the changes in its financial position and cash flows for the period from March 1, 2002 (inception) to June 30, 2002 in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the financial statements, the Community Development Administration Local Government Infrastructure Bonds (Ambac Insured) adopted Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* and GASB Statement No. 38, *Certain Financial Statement Disclosures*.

Ernst & Young LLP

September 30, 2002

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Balance Sheet

June 30, 2002
(in thousands)

Restricted assets

Restricted current assets:

| | |
|--|-----------|
| Cash on deposit with trustee | \$ 10,607 |
| Community facilities loans | 320 |
| Accrued interest receivable | 50 |
| Total restricted current assets | 10,977 |

Restricted long-term assets:

| | |
|--|-----------|
| Community facilities loans, net of current portion | 11,470 |
| Total restricted long-term assets | 11,470 |
| Total restricted assets | \$ 22,447 |

Liabilities and net assets

Current liabilities:

| | |
|----------------------------------|--------|
| Accrued interest payable | \$ 42 |
| Bonds payable | 320 |
| Other liabilities | 10,571 |
| Total current liabilities | 10,933 |

Long-term liabilities:

| | |
|---|--------|
| Bonds payable, net of current portion | 11,470 |
| Other liabilities, net of current portion | 1 |
| Total long-term liabilities | 11,471 |
| Total liabilities | 22,404 |

Net assets:

| | |
|---|-----------|
| Restricted | 43 |
| Total net assets | 43 |
| Total liabilities and net assets | \$ 22,447 |

See accompanying notes.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Statement of Revenues, Expenses and Changes in Net Assets

For the period from March 1, 2002 (inception) to June 30, 2002
(in thousands)

Operating revenues

| | |
|--|------------|
| Interest on community facilities loans | \$ 194 |
| Operating income | <u>194</u> |

Nonoperating revenues (expenses)

| | |
|----------------------------------|--------------|
| Interest income on cash accounts | 1 |
| Interest expense on bonds | <u>(152)</u> |
| | <u>(151)</u> |

| | |
|----------------------|---------------------|
| Change in net assets | <u><u>\$ 43</u></u> |
|----------------------|---------------------|

Changes in net assets

| | |
|---|---------------------|
| Net assets at March 1, 2002 (inception) | \$ - |
| Change in net assets | <u>43</u> |
| Net assets at end of period | <u><u>\$ 43</u></u> |

See accompanying notes.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Statement of Cash Flows

For the period from March 1, 2002 (inception) to June 30, 2002
(in thousands)

Operating activities

| | |
|---|---------|
| Principal and interest received on community facilities loans | \$ 144 |
| Origination of community facilities loans | (1,219) |
| Advance trustee fees received | 1 |
| Net cash from operating activities | (1,074) |

Investing activities

| | |
|------------------------------------|---|
| Interest received on cash accounts | 1 |
| Net cash from investing activities | 1 |

Noncapital financing activities

| | |
|---|--------|
| Proceeds from sale of bonds | 11,790 |
| Interest on bonds | (110) |
| Net cash from noncapital financing activities | 11,680 |

| | |
|---|-----------|
| Net increase in cash on deposit with trustee | 10,607 |
| Cash on deposit with trustee at March 1, 2002 (inception) | — |
| Cash on deposit with trustee at end of period | \$ 10,607 |

Reconciliation of operating income to net cash from operating activities

| | |
|--|------------|
| Operating income | \$ 194 |
| Adjustments to reconcile operating income to net cash from operating activities: | |
| Increase in community facilities loans | (1,219) |
| Increase in accrued interest receivable | (50) |
| Increase in other liabilities | 1 |
| Net cash from operating activities | \$ (1,074) |

See accompanying notes.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Notes to Financial Statements

June 30, 2002
(in thousands)

1. Authorizing Legislation and Program Description

The Community Development Administration (CDA) is authorized to issue Local Government Infrastructure Bond Program Funds pursuant to Sections 2-201 through 2-208 of Article 83B of the Annotated Code of Maryland to provide a mechanism for financing the infrastructure needs of local governments. CDA is in the Division of Development Finance in the Department of Housing and Community Development (DHCD) of the State of Maryland.

The accompanying financial statements only include CDA's Local Government Infrastructure Bonds (Ambac Insured) (the Fund). CDA's other funds are not included.

The Fund was established to issue bonds to provide funds for construction and permanent financing to local governments for public facilities. The first bonds were issued by the Fund on March 1, 2002.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Fund is set up primarily in accordance with CDA's enabling legislation and the Resolution providing for the issuance of Local Government Infrastructure Bonds (Ambac Insured) (the Resolution). The Fund is an enterprise fund of the State of Maryland and uses the accrual basis of accounting.

Generally Accepted Accounting Principles

CDA reports its financial activities by applying Standards of Governmental Accounting and Financial Reporting as promulgated by the Governmental Accounting Standards Board (GASB). CDA has adopted GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. Consequently, CDA applies all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) Statements and Interpretations, APB Opinions, and ARBS of the Committee on Accounting Procedure issued on or prior to November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements

Both GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments* and GASB Statement No. 37, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments: Omnibus* were adopted for the period ended June 30, 2002.

Adoption of these statements required the following financial statement presentation:

- Balance Sheet uses a classified presentation;
- Net Assets are classified as Restricted or Unrestricted;
- Statement of Revenues, Expenses and Changes in Net Assets is formatted to identify operating revenues and expenses;
- Statement of Cash Flows presentation is based on the direct method; and
- the Annual Financial Report normally includes a Management’s Discussion and Analysis. Since CDA is an enterprise fund included in the State of Maryland’s Comprehensive Annual Financial Report, a separate Management’s Discussion and Analysis is not required in these financial statements.

CDA has also adopted GASB Statement No. 38, *Certain Financial Note Disclosures*, which requires additional disclosures on debt. See Notes 6 and 7 for bonds payable and debt service requirements, respectively. GASB Statement No. 38 also requires additional disclosures on receivables and payables (Note 5).

The adoption of these GASB statements for the period ended June 30, 2002 had no effect on the financial results of the Fund.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Cash on Deposit with Trustee

Cash on deposit is primarily cash equivalents. Cash equivalents may include commercial paper, money market funds, repurchase agreements, investment agreements and any other investments, primarily U.S. Treasuries and agencies, which have maturities of 90 or less days at the time of purchase. As of June 30, 2002 all of CDA's cash equivalents are invested in a money market mutual fund that is more fully described in Note 3.

Community Facilities Loans

Community facilities loans are carried at their unpaid principal balances. See Note 4 for additional information on community facilities loans.

Allowance for Loan Losses

Community facilities loans are secured by the full faith and credit of the applicable local governments. Therefore, CDA has determined that no allowance for loan losses was necessary as of June 30, 2002.

Accrued Interest and Receivable

Accrued interest includes both income on cash deposits and interest on loans. As of June 30, 2002, no loans were delinquent. Therefore, all accrued interest on loans was recorded during the period. See Note 5 for additional information.

Bonds Payable

Bonds payable are carried at their unpaid principal balances. There are no premiums or discounts to amortize. See Notes 6 and 7 for additional information.

Other Liabilities

This account consists primarily of undisbursed loan proceeds.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Restricted Net Assets

Under GASB Statement No. 34, net assets should be reported as restricted when constraints placed on net asset use are either: externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or are imposed by law through constitutional provisions or enabling legislation. Accordingly, all net assets of the Fund are restricted as to their use.

Administrative Support

In addition to expenses incurred directly by the Fund, CDA receives certain support services from other divisions of DHCD. The cost of these services are allocated to CDA's General Bond Reserve Fund and reported in the financial statements of CDA's Revenue Obligation Funds. The General Bond Reserve Fund records these expenses as invoiced by DHCD for the fiscal year.

For the year ended June 30, 2002, the allocation to CDA's General Bond Reserve Fund was:

| | |
|-------------------------------------|-------------|
| Salaries and related costs | \$ 5,646 |
| General and administrative expenses | 1,977 |
| | <hr/> |
| | \$ 7,623 |
| | <hr/> <hr/> |

The employees of CDA are covered by the Maryland State Retirement and Pension System (the System) and the costs of employees' retirement benefits are included in the salaries and related costs discussed above. See Note 9 for additional information.

Revenues and Expenses

The Fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from the community facilities loans originated by the Fund in connection with the Fund's principal ongoing operations. Operating revenues arise from the collection of interest on community facilities loans. Operating expenses are those costs incurred in the collection of this income. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Notes to Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains and losses during the reporting periods. Actual results could differ from these estimates.

3. Cash on Deposit with Trustee

Proceeds from bonds are invested in authorized investments as defined in the respective indentures until required for financing projects, redeeming outstanding bonds and notes, and funding program expenses. Authorized investments include obligations of the U.S. Treasury, U.S. Government agencies, political subdivisions in the United States, bankers acceptances, repurchase agreements, corporate debt securities and certificates of deposit with foreign or domestic banks. All CDA accounts held in trust by the trustee are kept separate from the assets of the bank and from other trust accounts.

As of June 30, 2002, the Fund had \$10,607 invested in a money market mutual fund (ARK U.S. Government Cash Management Corporate II Class Fund) which is classified as cash. This fund invests exclusively in obligations of the U.S. Government and its agencies and instrumentalities and in repurchase agreements. It is rated AAA by Standard & Poor's and Aaa by Moody's Investors Services.

As of June 30, 2002, the cost of this money market mutual fund approximates fair value.

The money market mutual fund is not categorized by credit risk because it is not evidenced by securities that exist in physical or book entry form.

4. Community Facilities Loans

Community facilities loans are secured by the full faith and credit of the applicable local government. As such, no allowance for loan losses was necessary as of June 30, 2002. Interest rates on such loans range from 3.78% to 4.87% with remaining loan terms ranging from 10 years to 30 years.

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Notes to Financial Statements (continued)

5. Accrued Interest and Other Current Liabilities

Accrued interest as of June 30, 2002 was as follows:

| | |
|--|-------|
| Accrued interest on community facilities loans | \$ 50 |
|--|-------|

Other current liabilities as of June 30, 2002 were as follows:

| | |
|--------------------------|-----------|
| Due to local governments | \$ 10,571 |
|--------------------------|-----------|

6. Bonds Payable

The bonds issued by CDA are special obligations of CDA and are payable from the revenues and special funds of the applicable programs. These bonds do not constitute debt of and are not guaranteed by the State of Maryland or any other program of the State of Maryland or any political subdivision. The provisions of the Resolution require or allow for the redemption of bonds through the use of unexpended bond proceeds and excess funds accumulated primarily through prepayment of community facilities loans. All outstanding bonds are subject to redemption at the option of CDA, in whole or in part at any time after certain dates, as specified in the respective series resolutions. The prescribed redemption prices range from 100% to 102% of the principal amount. All bonds have fixed interest rates.

The following is a summary of the bond activity for the year ended June 30, 2002 and the bonds payable as of June 30, 2002:

| Bond | Issue Dated | Range of Interest Rates | Range of Maturities | Bonds Payable at June 30, 2001 | Bond Activity | | | Bonds Payable at June 30, 2002 |
|---|-------------|-------------------------|---------------------|--------------------------------|------------------|-----------------------------|-------------|--------------------------------|
| | | | | | New Bonds Issued | Scheduled Maturity Payments | Redemptions | |
| Local Government Infrastructure Bonds (Ambac Insured) | | | | | | | | |
| 2002 Series A | 03/01/02 | 3.00%-5.00% | 2003-2032 | \$ — | \$ 11,790 | \$ — | \$ — | \$ 11,790 |
| Totals | | | | \$ — | \$ 11,790 | \$ — | \$ — | \$ 11,790 |

Community Development Administration
Local Government Infrastructure Bonds (Ambac Insured)

Notes to Financial Statements (continued)

7. Debt Service Requirements

As of June 30, 2002, the required principal payments for bonds (including mandatory sinking fund payments) and interest payments for each of the next five years and in five-year increments thereafter, are as follows:

**For the Year Ended
June 30,**

| | <u>Interest</u> | <u>Principal</u> |
|-----------|-----------------|------------------|
| 2003 | \$ 510 | \$ 320 |
| 2004 | 500 | 330 |
| 2005 | 490 | 340 |
| 2006 | 480 | 355 |
| 2007 | 469 | 365 |
| 2008–2012 | 2,138 | 2,040 |
| 2013–2017 | 1,693 | 2,465 |
| 2018–2022 | 1,097 | 2,905 |
| 2023–2027 | 556 | 1,175 |
| 2028–2032 | 232 | 1,495 |
| Total | <u>\$ 8,165</u> | <u>\$ 11,790</u> |

8. Bond Insurance

All bonds of the Fund are insured by Ambac Assurance Corporation. The provisions of the policy require the insurer to pay that portion of the principal of and interest on the bonds which become due for payment but are not paid by CDA. The insurance generally extends for the term of the bonds and cannot be cancelled by the insurer.

9. Pension and Other Postretirement Benefits

Eligible employees of CDA and employees of the State of Maryland are covered under the retirement plans of the State Retirement and Pension System of Maryland (System) and are also entitled to certain healthcare benefits upon retirement. CDA's only liability for retirement and postemployment benefits is its required annual contribution, which was paid in full by CDA to the State of Maryland prior to year end. The System prepares a separate audited Comprehensive Annual Financial Report which can be obtained from the State Retirement and Pension System of Maryland, 120 East Baltimore Street, Baltimore, Maryland 21202.