

**Rhode Island Housing
Board of Commissioners
Audit Committee**

Minutes of Meeting

February 21, 2008

Board Attendees: Kevin Flynn (Chair), Frank Caprio, Perry Clough and Anthony Marouchoc

Also Attending: Richard Godfrey, Richard Hartley, Thomas Hogg, Xay Khamsyvoravong, Kara Lachapelle, Joseph Voccio

The Audit Committee of the Board of Commissioners convened at 8:30 a.m. to review current financial markets and a new investment policy governing interest rate-related derivatives.

Financial markets relating to housing and mortgage securities are currently very illiquid and extremely focused on credit quality. Concerns stem primarily from the continuing repercussions from the sub-prime mortgage market collapse, but are exacerbated by fears of emerging recession, rising mortgage delinquency, declining real estate values, suspect rating agency valuations, weakened bond insurance credit strength, and general bond market disintermediation. Our investment and legal advisors have characterized the current market situation as the worst they have experienced.

On the asset side of its balance sheet, Rhode Island Housing uses investment contracts issued by insurance companies and large banks as security for its bond resolutions. This is standard housing agency investment practice but is of some concern presently as several of the largest insurance companies and banks are experiencing credit rating downgrades. Historically we have been very conservative in our use of these investment contracts, but it is a concern which staff will monitor.

On the liability side of its balance sheet, Rhode Island Housing is experiencing the same difficulties as other housing agencies as it prepares to issue bonds that match the funding of its mortgage loans. Rhode Island Housing has historically issued fixed rate, long term bonds for the extended duration portion of its loan portfolio. Presently, the long term portion of the bond market has become extremely shallow and very expensive, if available at all.

Over the last five years, some housing finance agencies have issued long term, variable rate bonds (usually hedged with a interest rate exchange agreement) to help with their bond issuance activities. Staff would now recommend the utilization of this technique for our own portfolio in order to expand issuance flexibility. To this end, staff presented a recommendation to incorporate derivative securities as part of its asset/liability management methodology.

Use of derivative securities to match interest rates on related loans, investments, bonds and notes has constituted established and prudent practice in the financial industry for many years. Over the last five years, housing finance agencies have utilized these securities to a growing extent. As a result, industry “best practices” have emerged and risk mitigation strategies have been developed. Using derivatives in its asset/liability management function will assist Rhode Island Housing generally with its matching and margin operations especially in these difficult markets. A Policy Statement governing the acceptable use of derivatives, the major risks inherent in their use and the general parameters for their employment was presented to the Committee.

The General Treasurer offered several suggestions for the Policy Statement which improved its focus and methodologies. The Treasurer also asked for a refinement to the procedures for choosing qualified counterparties and this has also been included in the revised Policy.

After discussion, a motion to recommend to the Board of Commissioners the Investment Policy Relating to Interest Rate-Related Derivatives, as revised, was made, seconded and affirmatively voted.

There being no further business, the meeting was adjourned at 10:00.

Respectfully submitted:

Kevin Flynn
Chairperson