Arkansas Development Finance Authority, A Component Unit of the State of Arkansas

Accountants' Report and Financial Statements

June 30, 2005 and 2004

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
June 30, 2005 and 2004

Contents

Independent Accountants' Report on Financial Statements and Supplementary Information

The Board of Directors of
Arkansas Development Finance Authority ("ADFA")

We have audited the accompanying statements of net assets of the Arkansas Development Finance Authority, a component unit of the State of Arkansas (the "Authority") as of June 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2005 and 2004, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 31, 2005, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing 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.

/s/ **BKD, LLP**

August 31, 2005

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Management Discussion and Analysis

This discussion and analysis is designed to assist the reader in focusing on significant issues and activities and to identify any significant changes in the financial position of the Arkansas Development Finance Authority ("ADFA" or the "Authority"). Readers are encouraged to consider the information presented in conjunction with the financial statements and notes as a whole.

Understanding the Financial Statements

The basic financial statements include three required statements: the statement of net assets, the statement of revenues, expenses and changes in net assets and the statement of cash flows. These statements are presented for all of ADFA's programs in the Combined Statements. Comparative totals as of and for the years ended June 30, 2004 and 2003, respectively, are also presented. Although not required, these comparative totals are intended to facilitate an enhanced understanding of the Authority's financial position and results of operations for the current fiscal year in comparison to the prior fiscal years. ADFA has eight programs presented as supplementary information following the Notes to Financial Statements: Single Family Housing Programs; Federal Housing Programs; Multi-Family Programs; Economic Development Bond Guaranty Program; State and Health Facilities Programs; Other Economic Development Programs; Tobacco Bond Program and General Fund Programs. A description of each of these programs is included in *Note 1* of the Notes to Financial Statements.

Condensed Statements of Net Assets

In thousands	2005	2004	2003
Capital assets	$ 138	$ 198	$ 233
Other assets	1,728,852	1,578,794	1,686,705
Total assets	1,728,990	1,578,992	1,686,938
Current liabilities	81,139	255,453	184,878
Noncurrent liabilities	1,499,332	1,188,167	1,314,447
Total liabilities	1,580,471	1,443,620	1,499,325
Net assets			
Restricted by bond resolution	78,346	71,545	126,245
Invested in capital assets	138	198	233
Unrestricted	70,035	63,629	61,135
Total net assets	$ 148,519	$ 135,372	$ 187,613

At June 30, 2005, ADFA's total assets of $1.7 billion consisted primarily of investments of $1.1 billion, loans (net of allowance) of $313.3 million and cash of $196.4 million. Total assets increased $150.0 million or nine percent (9%), primarily attributed to the increase in investments of $87.0 million, an increase of direct financing leases of $36.1 million and an increase in loans (net of allowance) of $16.4 million. The increase in investments primarily relates to the net activity of the Single Family Note Program, which the Authority uses to preserve single family tax-exempt authority. Those investments increased $126.8 million, offset by a decrease of Single Family mortgage-backed securities of $50.3 million. The increase in direct financing leases and loans (net of allowance) relates to activity in the State and Health Facilities Programs, discussed below. ADFA's total liabilities, primarily bonds and notes payable, net, increased $136.8 million, or nine percent (9%), to $1.6 billion as of June 30, 2005. The Authority's new bond and note issuance of $622.6 million during the fiscal year exceeded total bond and note redemptions of $485.5 million. The increase is primarily attributed to the Single Family Note Program and the State and Health Facilities Programs. The Single Family Note Program had borrowings of $304.6 million and redemptions of $177.8 million, while new issuance for the Single Family mortgage-backed securities programs totaled $107.3 million and redemptions for the Single Family mortgage-backed securities and whole loan programs totaled $139.9 million.

The State and Health Facilities Programs had a significant amount of activity during the year, with new issuances of $153.2 million and redemptions of $72.8 million. ADFA serves as issuer for many state agencies requiring financing for various projects, whereby a loan receivable or a direct financing lease between ADFA and the state agency may result, as well as bonds payable from the issuance. During the year, the Arkansas Department of Human Services acquired the Donaghey office building through a $44.0 million bond issue, the Authority issued $19.6 million in bonds for the Arkansas Department of Environmental Quality to build a new office building and bonds were issued for the benefit of the Arkansas State Police for a wireless information network as well as to refund existing debt, for a total of $49.3 million. The Authority also issued refunding bonds for the benefit of the Arkansas Department of Corrections, related to projects in Newport and Malvern, in the amount of $33.4 million, and refunding bonds for Arkansas Building Authority's Justice building for $6.9 million.

At June 30, 2004, ADFA's total assets of $1.6 billion consisted primarily of investments of $1.0 billion, loans receivable, net of $296.9 million and cash of $185.4 million. Total assets decreased $107.9 million or six percent (6%), attributed to the decrease in investments of $59.4 million and the decrease of loans receivable, net, of $40.2 million. The decrease in investments was largely due to the net depreciation in the fair value of investments of $30.5 million and the decrease in investments, representing construction draws, for the Tobacco Bond Program of $23.3 million. The decrease in loans receivable, net was attributable to originations of new loans not exceeding loan remittances.

ADFA's total liabilities, primarily bonds and notes payable, net, decreased $55.7 million, or four percent (4%), to $1.4 billion as of June 30, 2004. The decrease was primarily attributed to the Authority's new bond issuance of $350.1 million during the fiscal year not exceeding total bond redemptions of $406.7 million. Included in these amounts was activity related to the

Single Family Note Program, whereby the Authority borrowed $128.1 million and redeemed $55.0 million during the current year.

Condensed Statements of Revenues, Expenses and Changes in Net Assets

In thousands	2005	2004	2003
Total investment income	$ 89,782	$ 45,465	$ 121,119
Other income	188	23	183
Total operating revenues	89,970	45,488	121,302
Total interest on bonds and notes	69,876	70,145	79,118
Total amortization	2,000	2,297	2,105
Administrative expenses	19,505	23,034	15,704
Total operating expenses	91,381	95,476	96,927
Operating income (loss)	(1,411)	(49,988)	24,375
Federal grants	13,674	12,864	13,079
Transfers in (out)	884	(15,117)	(22,661)
Change in net assets	13,147	(52,241)	14,793
Net assets			
Beginning of year	135,372	187,613	172,820
End of year	$ 148,519	$ 135,372	$ 187,613

ADFA's net income, consisting of operating loss plus federal grants, totaled $12.3 million for the year ending June 30, 2005, compared with a net loss of $37.1 million for the year ending June 30, 2004 and net income of $37.5 million for year ending June 30, 2003. The difference is primarily attributed to a net increase in the fair value of investments of $10.6 million, compared with a net decrease in 2004 of $30.6 million and a net increase in 2003 of $33.5 million. In addition, interest and dividend income increased $2.3 million and the provision for loan losses decreased $1.5 million in 2005 from 2004. For year ending June 30, 2004, interest and dividend income decreased $9.0 million and the provision for loan losses increased $4.7 million from 2003. The financial position and operating results of the Authority have improved in 2005.

Other Financial Highlights

Loans and direct financing lease income increased $1.1 million, to $21.9 million for year ending June 30, 2005. The related average interest yield declined to 4.3% at June 30, 2005 compared with 4.6% and 4.9% at June 30, 2004 and 2003, respectively. Revenues from investment interest and dividends were $49.2 million, $46.9 million and $55.8 million for fiscal years ending June 30, 2005, June 30, 2004 and June 30, 2003, respectively. Although the average return on cash, cash equivalents and investments declined slightly to 4.1% at June 30, 2005 compared with 4.3% at June 30, 2004, revenues from investment interest and dividends increased due to higher cash, cash equivalents and investment balances during the year. The average return on cash, cash equivalents and investments at June 30, 2003 was 4.7%.

The Authority has certain bond issues whereby interest earnings on cash, cash equivalents and investments are deferred until the borrower uses the funds for debt service. These are primarily in the State and Health Facilities Programs, Economic Development Bond Guaranty Program and the Tobacco Bond Program. The total interest deferred for these programs was $2.6 million, $1.6 million and $2.8 million for June 30, 2005, June 30, 2004 and June 30, 2003, respectively. The yield above does not include these deferred amounts.

In September 2002, the Authority's general fund began warehousing mortgage-backed securities created by its Single Family Housing Programs. The securities are funded directly by the general fund or by borrowing from the Federal Home Loan Bank. The Authority will use bond proceeds to purchase the securities from the general fund. The average yield of the warehoused mortgage-backed securities at June 30, 2005, June 30, 2004 and June 30, 2003 was 4.8%, 4.7% and 5.1%, respectively.

The average interest expense on bonds and notes payable was 4.8% at June 30, 2005, compared with 5.0% and 5.6% at June 30, 2004 and 2003, respectively.

Total administrative expenses decreased $3.5 million during fiscal year ending June 30, 2005. This is primarily attributed to decreases of $1.5 million and $2.1 million for the provision for loan losses and for other expenses, respectively, during the year ended June 30, 2005. The provision for loan losses was higher for year ending June 30, 2004 (compared with 2005 and 2003) due to reserves for loans to two specific borrowers, in unrelated industries. Other expenses include market valuation adjustments and gain or loss on disposition of the Authority's real estate owned property. Other expense was higher for year ending June 30, 2004 due to the loss on sale of a large real estate owned property, which was collateral for a loan through the Bond Guaranty program.

During 2001, ADFA issued $60 million of revenue bonds associated with the State of Arkansas' Tobacco Settlement Revenue ("TSR") to be used by participating colleges to construct and equip three facilities outlined by the Arkansas Tobacco Settlement Funds Act of 2000. The bonds are to be repaid from the first $5 million of annual TSRs paid to the State. The bond proceeds for the construction of the three facilities was expended during year ending June 30, 2005. The financial statements for this program primarily reflect the debt service reserve account and bonds payable, but not the buildings as they reside on the financial statements of the respective colleges. Interest income is recorded as deposits against financing arrangements on the statement of net assets while interest expense is recorded as such on the statement of revenues, expenses and changes in net assets. For the fiscal years ending June 30, 2005, 2004 and 2003, interest expense was $2.9 million for this bond issue.

Credit Ratings

ADFA has maintained an Issuer Credit Rating ("ICR") from Standard & Poor's of 'A' since it was received in 1999. During the year, Standard & Poor's affirmed the 'A' rating and "positive" outlook. Changes in state and federal legislation statutes can play a role in ADFA achieving its goals and objectives.

The Authority also administers the Bond Guaranty Fund created by Act 505. The fund currently has a rating of 'A' from Standard & Poor's. The obligations of the Authority as guarantor are limited to available monies in the ADFA Guaranty Reserve Account created and being maintained pursuant to the authority conferred in the ADFA Guaranty Act.

Contacting ADFA

This financial report is designed to provide bondholders, constituents and business partners with a general overview of the Authority's finances and to show the Authority's accountability for the funds it administers. Questions about this report and requests for additional financial information should be directed to the Vice President for Finance and Administration by telephoning (501) 682-5900.

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Statements of Net Assets
June 30, 2005 and 2004

In thousands	2005	2004
Current Assets		
Cash and cash equivalents	$ 196,356	$ 185,379
Accrued interest receivable		
Investments	4,521	4,101
Loans	1,665	1,898
Accounts receivable	1,141	1,064
Investments – current portion	1,485	—
Loans – current portion	4,646	13,993
Prepaid insurance	—	64
Total current assets	209,814	206,499
Noncurrent Assets		
Deferred charges	6,384	6,777
Investments – unrestricted	51,109	59,206
Investments – restricted	1,035,413	941,849
Loans, net of allowance for loan losses of $16,123 and $13,660 at June 30, 2005 and 2004, respectively	308,661	282,899
Direct financing leases – restricted	115,529	79,401
Real estate owned	1,942	2,163
Capitalized assets, net	138	198
Total noncurrent assets	1,519,176	1,372,493
Total assets	1,728,990	1,578,992
Current Liabilities		
Accounts payable	2,600	3,828
Accrued interest payable	21,343	23,572
Bonds and notes payable – current portion	57,196	228,053
Total current liabilities	81,139	255,453
Noncurrent Liabilities		
Deferred fees	6,924	7,646
Bonds and notes payable, net of unamortized premiums and discounts	1,441,260	1,131,846
Deposits against financing arrangements	51,148	48,675
Total noncurrent liabilities	1,499,332	1,188,167
Total liabilities	1,580,471	1,443,620
Net Assets		
Restricted by bond resolution	78,346	71,545
Invested in capital assets	138	198
Unrestricted	70,035	63,629
Total net assets	$ 148,519	$ 135,372

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2005 and 2004

In thousands	2005	2004
Operating Revenues		
Investment income		
Interest and dividends	$ 49,244	$ 46,887
Loans and direct financing leases	21,876	20,782
Amortization of discounts on loans	4,452	4,759
Financing fees	3,593	3,587
Net increase (decrease) in the fair value of investments	10,617	(30,550)
Total investment income	89,782	45,465
Other	188	23
Total operating revenues	89,970	45,488
Operating Expenses		
Interest on bonds and notes		
Current	69,576	69,765
Accreted	300	380
Total interest on bonds and notes	69,876	70,145
Amortization		
Amortization of discounts and premiums on bonds and notes	358	320
Amortization of bond and note issuance costs	1,642	1,977
Total amortization	2,000	2,297
Administrative expenses		
Provision for loan losses	3,712	5,173
Federal financial assistance programs	9,713	10,041
Salaries and benefits	3,836	3,708
Operations and maintenance	947	886
BMIR program participant expense	251	115
Other	1,046	3,111
Total administrative expenses	19,505	23,034
Total operating expenses	91,381	95,476
Operating Loss	(1,411)	(49,988)
Nonoperating Revenue		
Federal grants	13,674	12,864
Income (Loss) Before Transfers In (Out)	12,263	(37,124)
Transfers In (Out)	884	(15,117)
Change in Net Assets	13,147	(52,241)
Net Assets, Beginning of Year	135,372	187,613
Net Assets, End of Year	$ 148,519	$ 135,372

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Statements of Cash Flows
Years Ended June 30, 2005 and 2004

In thousands	2005	2004
Operating Activities		
Interest received on investments	$ 48,824	$ 47,258
Interest received on loans	22,109	21,053
Financing fee income received	4,315	5,047
Loan disbursements	(96,965)	(36,133)
Principal repayments on loans	78,749	73,960
Direct financing lease disbursements	(79,746)	(4,161)
Principal repayments on capital leases	43,618	10,351
Other cash received	2,601	1,078
Cash paid for interest	(71,805)	(71,845)
Cash paid for program administration	(16,966)	(17,234)
Net cash (used in) provided by operating activities	(65,266)	29,374
Noncapital Financing Activities		
Proceeds from issuance of bonds and notes payable	622,625	350,114
Repayments of bonds and notes payable	(485,505)	(406,658)
Nonoperating grants received	13,674	12,864
Transfers out	884	(15,117)
Payments of debt issuance costs	(1,394)	(1,155)
Collection of financing fees	949	814
Net cash provided by (used in) noncapital financing activities	151,233	(59,138)
Investing Activities		
Purchase of investments	(1,008,459)	(872,679)
Maturities of investments	932,124	901,562
Proceeds from sale of real estate owned	1,358	2,191
Purchase of capitalized assets	(13)	(40)
Net cash (used in) provided by investing activities	(74,990)	31,034
Increase in Cash and Cash Equivalents	10,977	1,270
Cash and Cash Equivalents, Beginning of Year	185,379	184,109
Cash and Cash Equivalents, End of Year	$ 196,356	$ 185,379

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Statements of Cash Flows (Continued)
Years Ended June 30, 2005 and 2004

In thousands	2005	2004
Reconciliation of Operating Loss to Net Cash Provided By Operating Activities		
Operating loss	$ (1,411)	$ (49,988)
Items not requiring (providing) operating activities cash flows		
Amortization of discounts on loans	(4,452)	(4,759)
Amortization of deferred financing fees	(1,671)	(2,274)
Accreted interest	300	380
Amortization of bond and note discounts	1,137	(384)
Amortization of bond and note issuance costs	1,642	2,363
Depreciation of capitalized assets	55	75
Loss on sale of capital assets	18	—
Provision for loan losses	3,712	5,173
Loss on sale of real estate owned	177	25
Provision for loss on real estate owned	31	1,477
Net depreciation (appreciation) of investments	(10,617)	30,550
Changes in		
Accounts receivable	(77)	(18)
Accrued interest receivable	(187)	642
Loans receivable	(17,020)	37,827
Direct financing leases	(36,128)	6,190
Other assets	209	12
Accounts payable	(1,228)	552
Accrued interest payable	(2,229)	(2,080)
Other liabilities	2,473	3,611
Net cash (used in) provided by operating activities	$ (65,266)	$ 29,374
Supplemental Cash Flows Information		
Real estate acquired in settlement of loans	$ 1,625	$ 2,041
Sale and financing of real estate owned	$ 280	$ 1,056

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Notes to Financial Statements
June 30, 2005 and 2004

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

The Arkansas Development Finance Authority, a Component Unit of the State of Arkansas (the "Authority") was created May 1, 1985, by Act 1062 of 1985 (Arkansas Development Finance Authority Act) as a successor to the former Arkansas Housing Development Agency (created in 1977) whereby all records, funds, property, obligations, debts, functions, powers and duties were transferred to the Authority. The Authority is a public body politic and corporate, with corporate succession, to be an independent instrumentality exercising essential public functions. Pursuant to Act 1062, the Authority is authorized and empowered to issue bonds and various other debt instruments for the purpose of financing qualified agricultural business enterprises, capital improvement facilities, educational facilities, health care facilities, housing developments and industrial enterprises.

Bonds and other debt instruments issued by the Authority and included on the Authority's financial statements are special obligations of the Authority, payable solely from and collateralized by a first lien on the proceeds, monies, revenues, rights, interests and collections pledged therefore under the resolutions authorizing the particular issues. The State of Arkansas is not obligated to pay the bonds and other debt instruments, and neither the faith and credit nor the taxing power of the State of Arkansas is pledged to the payment of the principal or redemption price of, or interest on, the bonds and other debt instruments. The Authority has no taxing power.

Accounting Method

The Authority utilizes the proprietary fund method of accounting whereby operating revenues and expenses are distinguished from nonoperating items. Operating revenues and expenses generally result from providing services in connection with the principal ongoing operations. All revenues and expenses not meeting this definition are reported as nonoperating items. All revenues and expenses are recognized on the accrual basis. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989, unless the GASB specifically adopts such FASB Statements or Interpretations. The Authority first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

Fund Accounting

The Authority utilizes internal accounts, each of which includes accounts for the assets, liabilities, net assets, revenues and expenses of the Authority's programs and activities.

The following describes the nature of the operations and significant programs currently maintained by the Authority:

(i) Single Family Housing Programs

(a) *Single Family Mortgage Purchase Program* – Accounts for proceeds from single family mortgage revenue bonds, the debt service requirements of the bonds, and the related mortgage-backed securities or mortgage loans for single family owner-occupied housing in Arkansas.

(b) *Single Family Note Program* – Accounts for investments and notes payable related to a drawdown bond program utilized by ADFA to warehouse tax-exempt authority obtained through replacement refundings. The program utilizes privately placed, tax-exempt bonds, with the bond interest rate determined by collateral earnings.

(ii) Federal Housing Programs

(a) *Section* 8 *Housing Assistance Payment Program* – Accounts for Section 8 housing assistance funds received in advance, housing assistance payment disbursements, and Authority fees and expenses related to the Section 8 Housing Assistance Payment Program. In July 2005, the Authority relinquished all administrative responsibilities associated with this program. Federal grant revenue attributed to this program totaled \$5.4 million and \$5.1 million for the year ended June 30, 2005 and 2004, respectively.

(b) *HOME Partnership Program* – Accounts for federal financial assistance received from the Department of Housing and Urban Development for the purpose of developing and supporting affordable housing through tenant based rental assistance, rental rehabilitation, new construction, or assistance to homebuyers and homeowners.

(iii) Multi-Family Programs

(a) *Multi-Family Mortgage Purchase Program* – Accounts for the proceeds of the multi-family mortgage revenue bonds, the debt service requirements of the bonds, and the related mortgage loans for multi-family housing in Arkansas, most of which are HUD approved and insured.

(b) *GNMA/BMIR Bond Program* – Accounts for proceeds from the sale of GNMA Guaranteed Bonds, debt service requirements on the bonds, related Below Market Interest Rate mortgages purchased with bond proceeds, disbursements to program participants of excess loan prepayments, and the Authority's fees and expenses in connection with the program.

(c) *FAF/New BMIR Loan Programs* – Accounts for loans receivable funded by distributions the Authority received from the GNMA/BMIR Bond Program as well as from Financing Adjustment Factor distributions from the federally funded Section 8 Housing Assistance Payment Program.

(iv) Economic Development Bond Guaranty Program

(a) *Bond Guaranty Program* – Accounts for guaranty fees collected, interest earned on investments, and disbursements made in connection with bond guaranties provided by the Authority, as well as the proceeds from the sale of development revenue bonds issued by ADFA and guaranteed by the fund; the debt service requirements of the bonds and related loans and leases to private companies and one state commission. The fund was created by Act 505 of 1985 which authorized a grant of $6 million from the State Treasurer (which was subsequently repaid by the Authority) for the purpose of enhancing and supporting the creditworthiness of bonds and other debt instruments guaranteed by the Authority. At June 30, 2005 and 2004, the fund has cash and cash equivalents and investments totaling $19.8 million and $21.2 million, respectively, in the reserve account to collateralize Authority-guaranteed bonds and future issues under the bond guaranty program.

(v) State and Health Facilities Programs

(a) *State and Health Facilities Programs* – Accounts for the proceeds from the sale of development revenue bonds; the debt service requirements of the bonds and related loans and leases to public and private institutions and government bodies within the State of Arkansas; and includes certain assets not owned and related obligations not owed by the Authority.

(vi) Other Economic Development Programs

(a) *Other Economic Development Programs* – Accounts for the proceeds from the sale of the Higher Education Capital Asset Program bonds and a note payable for the Intermediary Relending Program; the related debt service requirements of the bonds and note and related loans to private businesses and public higher education institutions. Also, accounts for loan reserve programs, such as Capital Access, Business Life and Disadvantaged Business Enterprise.

(vii) Tobacco Bond Program

(a) *Tobacco Settlement Revenue Bonds, Series* 2001 – Accounts for the proceeds from the sale of tobacco settlement revenue bonds; the debt service requirements of the bonds and related disbursements of bond proceeds to participating colleges to be used to fund the construction and equipping of three projects outlined by the Arkansas Tobacco Settlement Funds Act of 2000.

(viii) Other Programs and General Fund

(a) *ADFA General Fund* – Accounts for revenue charged by the Authority for issuing and administering various programs; operating expenses of the Authority; special initiatives of the Authority, such as direct loan programs and funding downpayment assistance; and money or residual assets, such as mortgages, transferred from other funds to the extent such transfers are permitted by the resolutions.

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 affect 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.

Cash and Cash Equivalents

The Authority considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2005 and 2004, cash equivalents of $196.0 million and $185.4 million, respectively, consisted primarily of money market mutual funds with variable interest rates.

Investments and Investment Income

Investments are carried at fair value. Fair value is determined using quoted market prices, if available.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

The fair value of the investments at June 30, 2005 and 2004, was in excess of the cost basis by $28.6 million and $21.3 million, respectively.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses. Interest income is reported using the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, loans are placed on non-accrual status at 180 days past due and interest is considered a loss, unless the loan is well-secured and in the process of collection.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Impaired loans are evaluated as part of the review of the allowance for loan losses. A loan is considered impaired when, based on current information and events, it is probable that the Authority will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Income Taxes

As an essential government function of the State of Arkansas, the Authority is exempt from income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

Direct Financing Leases

The Authority issues revenue bonds to provide financing of correction facilities, office space for the State of Arkansas and certain transactions for private companies. In all cases, the Authority does not maintain or operate the facilities. Arrangements of this type are accounted for in the various funds as financing arrangements in accordance with the provisions of Financial Accounting Standards Board Statement No. 13, *Accounting for Leases.*

Deferred Charges

Costs related to issuing bonds and underwriters' compensation on sale of bonds are capitalized and are amortized over the term of the bonds based on the balance of bonds outstanding. Early retirement of bonds results in proportionate amounts of amortization of bond issuance costs.

Capitalized Assets

Furniture, fixtures and equipment are carried at cost, less accumulated depreciation. Depreciation for financial statement purposes is computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 10 years.

Deposits Against Financing Arrangements

Deposits against financing arrangements represent debt service funds and interest earned on funds created by trust indentures associated with bond issuances that are held by the Authority to be used by the borrower to pay debt service to the Authority. If not used to pay debt service, these funds are returned to the borrower at the end of the financing arrangement.

Deferred Fees

The Authority receives commitment fees for earmarking funds and financing fees from borrowers. Deferred commitment fees, which are nonrefundable, are amortized into income ratably over the term of the respective programs based on the balance of bonds outstanding, which approximates the mortgage loans outstanding.

Conduit Debt Obligations

Conduit debt issued by the Authority is recorded on the Authority's balance sheet if either (a) the Authority has a vested interest in the residual value of the bond issue after its retirement or (b) the Authority guarantees the debt through the Bond Guaranty fund. Additionally, the Authority reports conduit debt obligations of entities that are included in the State of Arkansas reporting entity on its statement of net assets.

Net Assets

Restricted by Bond Resolution and Programs – Represents those funds restricted within the respective bond resolution or by specific provisions of the Programs.

Invested in Capital Assets – Represents the balance of capital assets, net of depreciation. No related debt exists.

Unrestricted Net Assets – Represents those funds used at the discretion of ADFA’s Board of Directors to compliment bond and loan programs and to provide for the Authority’s operations.

Note 2: Deposits and Investments

Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority's deposit policy for custodial credit risk requires compliance with the provisions of state law, the Authority's various bond indentures and the Authority's general fund investment policy. Deposits are collateralized for those amounts exceeding federal depository insurance, typically with obligations of the U.S. Treasury, U.S. agencies or instrumentalities, municipal bonds, or bank purchase agreements having an aggregate value at least equal to the amount of the deposits.

At June 30, 2005 and 2004, respectively, $14.4 million and $31.2 million of the Authority's deposits of $15.1 million and $31.7 million were exposed to custodial credit risk as follows:

In thousands	2005	2004
Uninsured and uncollateralized	$ 29	$ 41
Uninsured and collateral held by pledging financial institution	14,330	31,182
	$ 14,359	$ 31,223

The uninsured and uncollateralized balance represents deposits with the Federal Home Loan Bank of Dallas.

Investments

The Authority may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities, in mortgage-backed securities, in money market mutual funds, in guaranteed investment contracts, in municipal bonds and in bank repurchase agreements.

At June 30, 2005 and 2004, the Authority had the following investments and maturities:

In thousands

		June 30, 2005			
		Maturities in Years			
Type	Fair Value	Less than 1	1-5	6-10	More than 10
Repurchase agreements	$ 1,381	$ —	$ 1,381	$ —	$ —
U.S. Treasury obligations	76,214	27,902	47,500	812	—
U.S. agencies obligations	39,684	3,736	27,032	8,876	40
Mortgage-backed securities	561,236	—	97	—	561,139
Money market mutual funds	196,938	196,938	—	—	—
Guaranteed investment contracts	393,309	—	336,338	12,999	43,972
Municipal bonds	485	—	—	485	—
	$ 1,269,247	$ 228,576	$ 412,348	$ 23,172	$ 605,151

		June 30, 2004			
		Maturities in Years			
Type	Fair Value	Less than 1	1-5	6-10	More than 10
Repurchase agreements	$ 1,129	$ —	$ 1,129	$ —	$ —
U.S. Treasury obligations	63,544	12,584	44,656	6,304	—
U.S. agencies obligations	32,708	2,041	22,679	7,948	40
Mortgage-backed securities	621,246	—	162	—	621,084
Money market mutual funds	185,738	185,738	—	—	—
Guaranteed investment contracts	249,695	132,588	57,509	7,292	52,306
Municipal bonds	469	—	—	469	—
Commercial paper	253	—	—	—	253
	$ 1,154,782	$ 332,951	$ 126,135	$ 22,013	$ 673,683

Interest Rate Risk - As a means of limiting its exposure to fair value losses arising from rising interest rates, the Authority's investments typically match the term of the corresponding bonds or, in the case of general funds, limits the maturity to no greater than fifteen years for municipal bonds and seven years for Treasuries, agencies and mortgage-backed securities. The money market mutual funds are presented as an investment with a maturity of less than one year because they are redeemable in full immediately.

The Authority invests in various asset and mortgage-backed securities. These securities are reported at fair value in the statement of net assets. The Authority invests in these securities to enhance yields on investments. Changes in market interest rates could affect the cash flows of these securities and may result in changes in fair value. The overall return or yield on these securities depends on the changes in the interest and principal payment pattern and the market value of the underlying assets.

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. The Authority's investments in U. S. agencies obligations and mortgage-backed securities not directly guaranteed by the U. S. government were rated "AAA" by Standard & Poor's and its investments in money market mutual funds were rated "AAAm" by Standard & Poor's and "Aaa" by Moody's Investors Service.

Custodial Credit Risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for the Authority's investments in repurchase agreements at June 30, 2005 and 2004 are held by the counterparties in other than the Authority's name. The Authority's investment policy does not address how securities underlying repurchase agreements are to be held.

Concentration of Credit Risk - The Authority places no limit on the amount that may be invested in any one issuer. Investments of the Authority (not guaranteed by the U.S. government or considered a mutual fund) representing five percent or more of total investments are as follows (in thousands):

Issuer	Fair Value	Percentage
Bayerische Landesbank Girozentrale	$ 197,834	16%
AIG Matched Funding Corp.	$ 138,005	11%

Summary of Carrying Values

The carrying values of deposits and investments are included in the balance sheets as follows:

In thousands	2005	2004
Carrying value		
Deposits	$ 15,116	$ 31,652
Investments	1,269,247	1,154,782
	$ 1,284,363	$ 1,186,434
Included in the following balance sheet captions:		
Current assets		
Cash and cash equivalents	$ 196,356	$ 185,379
Investments – current portion	1,485	—
Noncurrent assets		
Investments – unrestricted	51,109	59,206
Investments – restricted	1,035,413	941,849
	$ 1,284,363	$ 1,186,434

Note 3: Loans

Single Family Mortgage Purchase Program and Multi-Family Mortgage Purchase Program – All mortgage loans purchased under the single family and multi-family mortgage purchase programs are collateralized by first liens on real property. All mortgage loans purchased by the Authority under the FHA/VA Single Family Mortgage Purchase Program are FHA insured or VA guaranteed mortgage loans. Loans purchased under the Conventional Single Family Mortgage Purchase Program are insured up to an aggregate limit for each issue by supplemental mortgage insurance. Private mortgage insurance is required to the extent that individual loans purchased under the Conventional Single Family Mortgage Purchase Program exceed 80% of the lessor of the appraised value of the property or sales price.

Each loan purchased under the GNMA/BMIR Bond Program was made pursuant to the FHA program for below market interest rate mortgage loans and is insured by the FHA pursuant to Section 212(d)(3) of Title II of the National Housing Act.

Bond Guaranty Program – Loans and leases to private companies for financing the acquisition or expansion of facilities are collateralized by liens on and security interests in collateral granted by the companies and by guaranty agreements between the Authority and one or more guarantors. To a limited extent and only when specified by a specific trust indenture, the payment of principal and interest on the bonds is guaranteed by the Authority under the ADFA Bond Guaranty Act (Act 505 of 1985). At June 30, 2005 and 2004, respectively, the Authority reported in its statement of net assets $51.9 million and $53.4 million in loans and leases to private companies and with an agency of the State of Arkansas as well as $61.4 million and $65.4 million in related bond issues which are guaranteed by the Bond Guaranty fund. Differences between the loan balance and the related bond balance are attributed primarily to the allowance for loan loss of $6.7 million and $6.8 million, timing differences between loan collection and bond payment of $6.7 million and $8.0 million offset by loans with no associated bonds of $3.9 million and $3.1 million at June 30, 2005 and 2004, respectively, and construction draw payable accounts of $0.3 million at June 30, 2004. Additionally, the Bond Guaranty fund guarantees principal and interest on revenue bonds issued by municipalities within the State of Arkansas for economic development purposes. At June 30, 2005 and 2004, bonds outstanding of $15.5 million and $12.2 million, respectively, were guaranteed by the Bond Guaranty fund. Furthermore, the Bond Guaranty fund guarantees principal and interest on bond anticipation notes. At June 30, 2005, principal guaranteed on these notes totaled $9.3 million.

Construction draw payables will be advanced to a customer as long as there is no violation of any condition established in the contract. Construction draw payables generally have fixed expiration dates or other termination clauses. Since a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer’s creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained is based on management’s credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment and commercial real estate.

State and Health Facilities Programs – Includes financing activities with various state agencies and health facilities. At June 30, 2005 and 2004, respectively, the Authority reported loans of $106.7 million and $67.1 million, direct financing leases of $108.4 million and $71.7 million, and bonds outstanding of $277.5 million and $197.1 million related to the financing arrangements with these institutions and agencies. Differences between the loan and lease balances and the related bond balance are attributed primarily to construction draw payable accounts of $63.5 million and $60.6 million at June 30, 2005 and 2004, respectively.

Other Economic Development Programs – Includes financing activities with educational institutions and financing activities to private companies through various means. At June 30, 2005 and 2004, respectively, the Authority reported loans of $9.5 million and $10.6 million, and bonds and note payable of $16.7 million and $18.0 million. Differences between the loan balances and the related bonds and notes payable balances are attributed primarily to a debt service reserve balance of $6.5 million for June 30, 2005 and 2004.

The stated interest rates on the loans are as follows:

	Stated Interest Rate
Single Family Housing Programs Fund	4.00 to 10.78%
Multi-Family Programs Fund	0.00 to 7.334%
Bond Guaranty Program	Rate on bonds
State and Health Facilities Programs	Rate on bonds
Other Economic Development Programs	
U.S. Department of Agriculture/Farmers Home Administration	3.00%
Higher Education Capital Access Program	Rate on bonds
General Fund Programs	0.00 to 8.50%

Impaired loans totaled $35.7 million and $37.6 million at June 30, 2005 and 2004, respectively, with related allowances for loan losses of $12.5 million and $10.0 million. Impaired loans includes loans made under the federally-funded HOME Partnership Program with repayment terms allowing deferment or repayment based on net income of the multifamily developments. These loans totaled $18.3 million and $17.0 million at June 30, 2005 and 2004, respectively, with related allowances for loan losses of $6.2 million and $3.5 million.

At June 30, 2005 and 2004, respectively, accruing loans delinquent 180 days or more totaled $0.1 million and $0.6 million. Non-accruing loans at June 30, 2005 and 2004, respectively, were $32.9 million and $34.0 million.

Note 4: Net Investment in Direct Financing Leases

The Authority is the lessor under various direct financing capital leases whereby the Authority issued bonds for the acquisition or construction of certain facilities and then leased the facilities to other state agencies or private companies. At the end of the lease terms, these leases either transfer ownership to the other agencies or contain bargain purchase options. Future minimum lease payments receivable under these leases which begin expiring in 2007 are as follows:

In thousands	Lease Payments
Year ending June 30,	
2006	$ 14,738
2007	14,868
2008	15,075
2009	11,681
2010	11,675
2010 – 2015	44,651
2015 – 2020	34,476
2020 – 2025	19,744
2025 – 2030	19,809
2030 – 2035	17,036
2035 – 2040	5,718
2040 – 2045	1,143
Total minimum lease payments receivable	210,614
Less amount representing interest	(76,518)
Less unfunded lease amount	(18,567)
Present value of minimum lease payments receivable	$ 115,529

Note 5: Capitalized Assets

Premises and equipment at June 30 are summarized as follows:

In thousands	2005	2004
Cost		
Furniture, fixtures and equipment	$ 515	$ 673
Less accumulated depreciation	(377)	(475)
Net	$ 138	$ 198

Depreciation expense for the years ending June 30, 2005 and 2004, respectively, was approximately $55,000 and $75,000.

Note 6: Bonds and Notes Payable

Bonds and notes payable at June 30 were as follows:

In thousands	2005	2004
Total Single Family Bonds and Note Payable, with interest rates ranging from 1.15 – 10.00% and final maturity at varying dates through 2035	$ 951,216	$ 856,830
Less unamortized discount/plus unamortized premium	66	(859)
Total Single Family Bonds Payable, net	951,282	855,971
Total Multi-Family Bonds Payable, with interest rates ranging from 2.75 – 9.75% and final maturity at varying dates through 2035	126,041	141,102
Less unamortized discount/plus unamortized premium	(832)	(958)
Total Multi-Family Bonds Payable, net	125,209	140,144
Total Economic Development Bonds Payable, Guaranteed by the Bond Guaranty Fund, with interest rates ranging from 1.58 – 8.125% and final maturity at varying dates through 2024	61,388	65,408
Total State and Health Facilities Bonds Payable, with interest rates ranging from 1.89 – 7.0% and final maturity at varying dates through 2040	277,630	197,240
Less unamortized discount/plus unamortized premium	(96)	(163)
Total State and Health Facilities Bonds Payable, net	277,534	197,077
Total Other Economic Development Bonds and Note Payable, with interest rates ranging from 1.00 – 12.5% and final maturity at varying dates through 2017	16,812	18,090
Less unamortized discount/plus unamortized premium	(99)	(118)
Total Other Economic Development Bonds Payable, net	16,713	17,972
Tobacco Bond Payable, with interest rates ranging from 2.80 – 5.50% and final maturity at varying dates through 2042	57,765	58,900
Total General Fund Note Payable, with interest rates ranging from 1.21 – 3.61% and final maturity at varying dates through 2005	8,565	24,427
Total all programs bonds and notes payable, net	$ 1,498,456	$ 1,359,899

Activity in bonds and notes payable for 2005 was as follows:

In thousands	Beginning Balance	Additions Including Accretion	Reductions	Ending Balance	Amount Due within One Year
Bonds payable	$ 1,145,682	$ 267,690	$ (240,010)	$ 1,173,362	$ 48,556
Notes payable	216,315	355,235	(245,495)	326,055	8,640
	1,361,997	622,925	(485,505)	1,499,417	57,196
Unamortized premiums (discounts)	(2,098)	778	359	(961)	—
Total	$ 1,359,899	$ 623,703	$ (485,146)	$ 1,498,456	$ 57,196

Activity in bonds and notes payable for 2004 was as follows:

In thousands	Beginning Balance	Additions Including Accretion	Reductions	Ending Balance	Amount Due within One Year
Bonds payable	$ 1,269,113	$ 159,404	$ (282,835)	$ 1,145,682	$ 44,887
Notes payable	149,049	191,089	(123,823)	216,315	183,166
	1,418,162	350,493	(406,658)	1,361,997	228,053
Unamortized premiums (discounts)	(1,715)	(724)	341	(2,098)	—
Total	$ 1,416,447	$ 349,769	$ (406,317)	$ 1,359,899	$ 228,053

Future amounts required to pay principal and interest on all bonds and notes payable at June 30, 2005, were as follows:

In thousands	Principal	Interest
Year Ending June 30,		
2006	$ 57,196	$ 70,906
2007	178,933	65,283
2008	237,638	59,419
2009	46,012	52,875
2010	48,060	50,296
2011 – 2015	218,624	218,858
2016 – 2020	218,860	159,117
2021 – 2025	189,319	109,348
2026 – 2030	185,480	57,555
2031 – 2035	104,640	16,248
2036 – 2040	11,865	1,912
2041 – 2045	2,790	117
Unamortized premiums and discounts	(961)	—
Total	$ 1,498,456	$ 861,934

The Authority entered into an interest rate swap agreement to effectively convert $10 million of variable rate debt based on the 3-month LIBOR to fixed rate debt with an effective rate of 7.698%. The Authority is exposed to interest rate risk under the swap agreement if the 3-month LIBOR rate is less than 7.418%. The interest rate swap agreement is set to expire January 2, 2014.

Under the bond resolutions, the Authority has the option to redeem bonds at various premium rates. Generally, the redemption option cannot be exercised prior to the time the bonds have been outstanding for six to ten years. Certain special redemptions, as governed by the bond resolutions, are permitted or required prior to such time.

The bonds and notes are collateralized, as described in the applicable bond and note resolutions, by the revenues, monies, investments, mortgage loans and other assets in the funds and accounts established by the respective bond and note resolutions.

As of June 30, 2005, the remaining principal amounts outstanding on defeased issues are as follows:

In thousands

Issue	Date of Defeasance	Principal Outstanding
1979 Series A Single Family Conventional Bonds	September 1988	$ 39,030
1997 Driver's License Revenue Bonds	October 2004	$ 24,865
1999 Series A State Agencies Facilities Revenue Bonds	June 2005	$ 31,510

During the normal course of business, the Authority issues economic development revenue bonds and multi-family housing revenue bonds on behalf of private companies within the State of Arkansas. The bonds are payable solely from and secured by a pledge of revenues from the private companies to which the bond proceeds were remitted and accordingly, have been excluded from the Authority's financial statements. At June 30, 2005 and 2004, respectively, the bonds outstanding issued under these programs aggregated $424.5 million and $435.0 million.

The Authority pledged $8.8 million and $27.2 million of securities as collateral to the Federal Home Loan Bank for advances in the amount of $8.6 million and $24.4 million at June 30, 2005 and 2004, respectively.

Note 7: Concentrations of Risk in Lending and Loan Receivable Insurance

The Authority, through its normal lending activity, originates and maintains loans receivable which are concentrated primarily in Arkansas. The Authority's policy calls for collateral or other forms of repayment assurance to be received from the borrower at the time of loan origination. Such collateral or other form of repayment assurance is subject to changes in economic value due to various factors beyond the control of the Authority, and such changes could be significant.

Additionally, the Authority is heavily dependent on private insurers for recovery of loan principal should a borrower or borrowers not pay the principal and should any collateral prove to be insufficient in value to provide for full recovery of principal and accrued interest. This dependency is concentrated in a limited number of insurers and the Authority's ability to monitor closely the insurers' financial condition is limited.

Note 8: Retirement Plan

The officials and employees of the Authority participate in a state-wide, multiple-employer public employee retirement system administered by the Arkansas Public Employees Retirement System (the "System"). There is no legal obligation imposed upon the member agencies relative to the operation of the System other than the payment of a percent of the gross salaries of eligible employees participating in the System as an employer contribution. State law provides that Authority contributions for all covered state employees are to be based on 12.54% of gross payroll. All contributions required of the Authority were made for the years ended June 30, 2005, 2004 and 2003. For the years ended June 30, 2005, 2004 and 2003, the Authority's covered payroll and total payroll for all employees amounted to $3.8 million, $3.7 million and $3.7 million, respectively.

The contributory plan has been in effect since the beginning of the System, and is available to all persons who became members before January 1, 1978. The noncontributory plan was effective January 1, 1978, and applies automatically to all persons hired January 1, 1978 to June 30, 2005, in System-covered employment. Employees joining the System prior to July 1, 1997, are vested after ten years of employment. Beginning July 1, 1997, the vesting period for new members was reduced to five years. The System is audited separately, and included therein is financial data and trend information which gives an indication of the extent to which the system is accumulating sufficient assets to pay benefits when due. The report may be obtained by writing to the plan at 124 West Capitol, Suite 400, Little Rock, Arkansas 72201 or by calling (501) 682-7800.

Act 2084 of 2005 establishes a new contributory program for System members first hired on or after July 1, 2005, and those non-contributory members who elect to become contributory. Members participating in the contributory program will contribute 5% of their annual compensation, pre-tax. All active System members employed before July 1, 2005, have until December 31, 2005, to elect coverage under the contributory program.

Note 9: Contingencies

The Authority participates in numerous state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the Authority has not complied with the rules and regulations governing the grants, refunds of any money received may be required, and the collectibility of any related receivable at June 30, 2005 and 2004, may be impaired. In the opinion of the Authority, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants;

therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

The Authority currently participates in an arrangement whereby a liability may be created through prepayments of debt associated with a loan portfolio recorded in the Multi-Family Programs Fund. A portion of the prepayments of loan principal in this portfolio is reinvested in investments to cover future debt service payments associated with this portfolio. Any excess amount is then disbursed to various housing agencies in other states based on a participation agreement.

The Authority has $57.8 million and $65.5 million of amounts recorded as cash and investments in the statement of net assets that will be disbursed to borrowers under loan and lease agreements closed prior to June 30, 2005 and 2004, respectively.

The Authority is a defendant in a number of legal actions. While the final outcome of many of these legal actions cannot be determined at this time, management is of the opinion that the ultimate liability, if any, for these legal actions will not have a material effect on the Authority's financial position.

The Internal Revenue Code of 1986 establishes rules and regulations for arbitrage rebates. The Authority has made provisions for revenues above the rebate limit which must be remitted to the Federal Government.

The Authority offers continuous lending in its HomeToOwn Single Family Program, which offers thirty-year mortgage loans to first time homebuyers, subject to income and purchase price limitations. The Authority allows lenders to reserve funds at a specific interest rate via the Internet. The interest rate is determined by the Authority and can change at any time, based on program volume, conventional mortgage rates, and other factors. At the time of the reservation, the Authority may or may not have corresponding long-term bonds to fund the loans. This exposes the Authority to interest rate risk. At June 30, 2005 and 2004, respectively, the Authority had accepted loan reservations of approximately $47 million and $46 million, for which there were no corresponding long-term bond commitments.

The Internal Revenue Service limits the amount of interest rate spread that an issuer can earn on tax-exempt single family mortgage revenue bonds. In some of its previous bond issues, the Authority earned in excess of the allowed amount. In order to maintain compliance with the IRS, the excess is directed to bond issues earning less than the allowed amount. At June 30, 2005 and 2004, respectively, the present value of excess subsidy was approximately $16.1 million and $13.5 million. In the event the cost of long-term bonds exceeds the reserved loan rates, the Authority would utilize this subsidy to limit losses.

On December 31, 2003, ADFA initiated the funding for the Arkansas Institutional Fund (“AIF”), an institutional fund of funds venture capital program created by the Arkansas General Assembly in 2001. The Venture Capital Investment Act of 2001 authorizes the Authority to assist in increasing the availability of equity and near-equity capital for emerging, expanding, relocating and restructuring enterprises in the state through the creation of an institutional partnership fund. ADFA anticipates that as the funding for the AIF is made over time, there will be outstanding balances that will increase up to a $10 million exposure to the Bond Guaranty Fund. The funding is structured as a guaranteed line of credit with a financial institution with draws occurring on an as-needed basis. The outstanding balances were $2.9 million as of June 30, 2005 and $1.4 million as of June 30, 2004. As of June 30, 2005, there were three approved investments totaling $8.6 million of which $7.1 million has yet to be funded that are anticipated to become part of the AIF.

On August 4, 2005, the Authority executed a bond purchase agreement as part of the Economic Development Revenue Bonds 2005 Series A bond issue. The Authority agreed to sell $14.3 million in bonds, closing on August 16, 2005.

Supplementary Information

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Combining Statement of Net Assets
June 30, 2005

In thousands	Single Family Housing Programs	Federal Housing Programs	Multi-Family Programs	Economic Development Bond Guaranty Program
Current Assets				
Cash and cash equivalents	$ 120,756	$ 12	$ 5,702	$ 6,145
Accrued interest receivable	3,871	3	516	293
Accounts receivable	156	384	17	17
Investments – current portion	—	—	—	—
Loans – current portion	—	—	—	—
Total current assets	124,783	399	6,235	6,455
Noncurrent Assets				
Deferred charges	5,956	—	428	—
Investments – unrestricted	—	—	—	—
Investments – restricted	886,903	—	60,260	19,696
Loans, net	20,011	27,682	81,946	44,797
Direct financing leases – restricted	—	—	—	7,121
Real estate owned	—	301	14	1,529
Capitalized assets, net	—	—	—	—
Total noncurrent assets	912,870	27,983	142,648	73,143
Total assets	1,037,653	28,382	148,883	79,598
Current Liabilities				
Accounts payable	493	387	2,070	9
Accrued interest payable	16,925	—	1,420	687
Bonds and notes payable – current portion	11,395	—	15,383	5,708
Total current liabilities	28,813	387	18,873	6,404
Noncurrent Liabilities				
Deferred fees	4,880	—	226	1,818
Bonds and notes payable, net of unamortized premiums and discounts	939,887	—	109,826	55,680
Deposits against financing arrangements	—	—	418	2,082
Total noncurrent liabilities	944,767	0	110,470	59,580
Total liabilities	973,580	387	129,343	65,984
Net Assets				
Restricted by bond resolution	64,073	27,995	19,540	13,614
Invested in capital assets	—	—	—	—
Unrestricted	—	—	—	—
Total net assets	$ 64,073	$ 27,995	$ 19,540	$ 13,614

	State and Health Facilities Programs	Other Economic Development Programs	Tobacco Bond Program	General Fund Programs	Eliminations	Total
	$ 54,027	$ 3,670	$ 4,212	$ 1,832	$ —	$ 196,356
	1,033	41	29	400	—	6,186
	55	6	—	1,420	(914)	1,141
	—	—	—	1,485	—	1,485
	—	—	—	4,646	—	4,646
	55,115	3,717	4,241	9,783	(914)	209,814
	—	—	—	—	—	6,384
	—	—	—	51,109	—	51,109
	57,054	7,444	4,056	—	—	1,035,413
	106,661	9,533	—	18,031	—	308,661
	108,408	—	—	—	—	115,529
	—	—	—	98	—	1,942
	—	—	—	138	—	138
	272,123	16,977	4,056	69,376	0	1,519,176
	327,238	20,694	8,297	79,159	(914)	1,728,990
	145	—	—	410	(914)	2,600
	2,019	42	240	10	—	21,343
	14,775	205	1,165	8,565	—	57,196
	16,939	247	1,405	8,985	(914)	81,139
	—	—	—	—	—	6,924
	262,759	16,508	56,600	—	—	1,441,260
	47,438	51	1,158	1	—	51,148
	310,197	16,559	57,758	1	0	1,499,332
	327,136	16,806	59,163	8,986	(914)	1,580,471
	102	3,888	(50,866)	—	—	78,346
	—	—	—	138	—	138
	—	—	—	70,035	—	70,035
	$ 102	$ 3,888	$ (50,866)	$ 70,173	$ 0	$ 148,519

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Combining Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2005

In thousands	Single Family Housing Programs	Federal Housing Programs	Multi-Family Programs	Economic Development Bond Guaranty Program
Operating Revenues				
Investment income				
Interest and dividends	$ 44,918	$ 1	$ 497	$ 1,135
Loans and direct financing leases	1,848	113	4,351	2,883
Amortization of discounts on loans	—	—	4,452	—
Financing fees	1,148	—	77	695
Net increase (decrease) in the fair value of investments	6,963	—	1,854	(327)
Total investment income	54,877	114	11,231	4,386
Other	105	—	10	—
Total operating revenues	$ 54,982	$ 114	$ 11,241	$ 4,386

State and Health Facilities Programs	Other Economic Development Programs	Tobacco Bond Program	General Fund Programs	Eliminations	Total
$ —	$ 292	$ —	$ 2,401	$ —	$ 49,244
11,409	231	—	1,041	—	21,876
—	—	—	—	—	4,452
—	23	—	3,378	(1,728)	3,593
16	6	—	2,105	—	10,617
11,425	552	0	8,925	(1,728)	89,782
—	6	—	67	—	188
$ 11,425	$ 558	$ 0	$ 8,992	$ (1,728)	$ 89,970

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Combining Statement of Revenues, Expenses and Changes in Net Assets
(Continued)
Year Ended June 30, 2005

	Single Family Housing Programs	Federal Housing Programs	Multi-Family Programs	Economic Development Bond Guaranty Program
Operating Expenses				
Interest on bonds and notes				
Current	$ 40,108	$ —	$ 11,197	$ 3,437
Accreted	300	—	—	—
Total interest on bonds and notes	40,408	0	11,197	3,437
Amortization				
Amortization of discounts and premiums on bonds and notes	147	—	125	—
Amortization of bond and note issuance costs	1,496	—	146	—
Total amortization	1,643	0	271	0
Administrative expenses				
Provision for loan losses	—	2,775	323	1,106
Federal financial assistance programs	—	10,364	—	—
Salaries and benefits	—	—	—	—
Operations and maintenance	—	—	—	—
BMIR program participant expense	—	—	251	—
Other	1,040	270	212	(303)
Total administrative expenses	1,040	13,409	786	803
Total operating expenses	43,091	13,409	12,254	4,240
Operating Income (Loss)	11,891	(13,295)	(1,013)	146
Nonoperating Revenue				
Federal grants	—	13,572	—	—
Income (Loss) Before Transfers In (Out)	11,891	277	(1,013)	146
Transfers In (Out)	(2,491)	—	(2)	(1)
Change in Net Assets	9,400	277	(1,015)	145
Net Assets, Beginning of Year	54,673	27,718	20,555	13,469
Net Assets, End of Year	$ 64,073	$ 27,995	$ 19,540	$ 13,614

State and Health Facilities Programs	Other Economic Development Programs	Tobacco Bond Program	General Fund Programs	Eliminations	Total
$ 11,410	$ 339	$ 2,894	$ 191	$ —	$ 69,576
—	—	—	—	—	300
11,410	339	2,894	191	0	69,876
67	19	—	—	—	358
—	—	—	—	—	1,642
67	19	0	0	0	2,000
—	(35)	—	(457)	—	3,712
—	—	—	—	(651)	9,713
—	—	—	3,836	—	3,836
—	—	—	947	—	947
—	—	—	—	—	251
—	179	—	725	(1,077)	1,046
0	144	0	5,051	(1,728)	19,505
11,477	502	2,894	5,242	(1,728)	91,381
(52)	56	(2,894)	3,750	0	(1,411)
—	—	—	102	—	13,674
(52)	56	(2,894)	3,852	0	12,263
—	—	884	2,494	—	884
(52)	56	(2,010)	6,346	0	13,147
154	3,832	(48,856)	63,827	—	135,372
$ 102	$ 3,888	$ (50,866)	$ 70,173	$ 0	$ 148,519