CHAPTER 4. CASH MANAGEMENT

4-1. OVERVIEW.

Cash management is the process of managing the cash flow of a Public Housing Agency (PHA) to optimize its use of funds. This process involves the timing of receipts and disbursements to assure the availability of funds to meet expenditures and to maximize the yield from the investment of temporarily surplus funds. Effective cash management calls for organized planning. Good relations between the PHA and the financial institution can improve the effectiveness of a cash management program.

4-2. SELECTING A BANK--GENERAL.

a. Range of Bank Services.

(1) Commercial banks and savings and loan associations are equipped to provide a number of services to PHAs. The services which they provide are: (1) Collection services (lock box systems, transfer of funds, bank messengers, safe deposit boxes and night depositories); (2) Account services and deposit management (regular checking accounts, concentration accounts and "zero balance accounts" used to speed concentration of collected funds so they can be invested), and special disbursement services (such as payroll processing); (3) Monitoring and recording services (daily account notification, account reconciliation and special computer services); and (4) Investment services (day-of-deposit-to-day-of-withdrawal savings accounts, other time and savings accounts, repurchase agreements, approved money-market instruments and investment advice).

(2) Because of the high level of competition for the investment of short-term funds and the ready availability of such investment services, the investment services mentioned above should not be included in the banking contract when the PHA has the staff to manage its own investments.

b. General Depository Agreement.

The General Depository Agreement (Form HUD-51999) shown in Exhibit 4-1, must be executed by the PHA and the depository. The depository must be a bank or financial institution whose deposits are insured by the Federal Deposit Insurance Corporation (FDIC), Federal Saving and Loan Insurance Corporation (FSLIC), or National Credit Union Administration (NCUA).

c. Reviewing Bank Services.

The PHA can improve its cash management significantly by reexamining its banking relationship. To do this, the PHA should know what bank services it uses and the cost of such services to the PHA. The PHA should plan to solicit periodic competition among banks for providing these services and should plan periodic evaluation of its banking relationship.

d. Minority-Owned Institutions.

In order to promote minority enterprise and to support the Minority Bank Deposit Program (MBDP), the PHA is encouraged to use minority financial institutions to the maximum feasible extent. A list of minority owned banks, savings and loans, and credit unions participating in the MBDP can obtained from the Funds Flow Division, Financial Management Services, Department of Treasury, Liberty Center Building, 404 Fourteen Street, N.W., Washington, D.C. 20227.

e. Arranging for Services.

Banking services shall be arranged by selecting a bank through competitive solicitation to assure the PHA that it receives the banking services provided at the lowest cost. It should be noted, however, that PHAs must designate a single bank account for the deposit of all payments that are received from HUD through Direct Deposit-Electronic Funds Transfer (DD-EFT). (A Standard Form 1199A, Direct Deposit Sign-Up Form, must be submitted to designate this account.) Once the funds are received, they may be transferred to separate accounts according to the applicable program handbook.

(1) Procurement Procedure and Period of Service

Banking services should be periodically solicited through competitive solicitation. The solicitation in the form of a Request for Proposal (RFP) would permit the PHA to evaluate the quality of the services received as well as the price. This periodic process should prevent the bank supplying the services from becoming complacent in its dealings with the PHA.

(2) Solicitation Process.

The solicitation process involves four steps: (1) the PHA must determine the type and quantity of services required; (2) it should prepare a Request for Proposal (RFP) and circulate it to the competing banks; (3) it must review the proposals and make the criteria for selection public; and (4) it should select a bank and execute a depository agreement with it. (See Exhibit 4-1, General Depository Agreement.)

f. Evaluating Cost.

(1) It is difficult to determine bank compensation for services where "packages" of financial services are being requested. Transaction services such as deposit or check processing can be measured and priced on a per unit basis. Investment services are more difficult to price as they usually are tied to fluctuating interest rates. A suggested approach to pricing these services is to "benchmark" or tie the charges to a quoted interest rate. Banks that are not able to give actual costs of specific services should be able to provide estimates.

(2) Usually banks provide a monthly analysis of the activity within its customers account. If a bank's analysis report is inadequate or unclear or incorrect, then the PHA should request a written explanation and/or a format change. The account analysis should contain the following:

(a) A recap of the PHA's monthly activities, listing of the number of deposits processed, the number of checks cleared, the number of returned checks, the number of wire transfers made, etc.

(b) A notation of the monthly cost of the specific activity, as well as the unit price for each activity.

(c) A full explanation and proper documentation of any other charges, such as investment advice, check printing charges, account reconciliation charges, account maintenance charges, etc.

(d) Evidence whether the charges are paid with direct fees or compensating balances.

(e) A complete computation of average daily deposits, average funds in the process of collection, average withdrawals (checks written) and the resultant average daily collected balances.

(f) Show both computation of the bank's reserve requirements and the method (and rate) by which the bank values the PHA's balances if compensating balances are used to defray service charges.

(g) The PHA may recover the excess earnings if compensating balances exceed those necessary to cover the required amount.

(h) If compensating balances are insufficient, the resulting charges to the PHA should be enumerated fully along with the expected method by which payment should be made.

g. Payment Methods.

Basically, there are two methods used to pay for banking services. The simplest is to pay the bank each month for services performed. The second method, a compensating balance, in which the bank is not paid directly for services rendered, because the PHA maintains a minimum noninterest-bearing deposit which compensates the bank for the cost of the services provided.

h. Zero Balance Accounts.

Zero Balance Accounts (ZBA) is a system provided by banks to perform accounting transfers which "zero" the balances in each sub-account (i.e. payroll account, receipt account, etc.). When checks are presented against the zeroed sub-accounts, the bank automatically funds them from the main concentration account. Thus, it is unnecessary to maintain balances in individual accounts. The ZBA system provides the PHA with aggregate balance information and reports totals for all accounts as a single balance.

i. Risk of Bank Failure.

Regardless of governmental actions to prevent bank failures, the possibility does exist especially in recessionary periods. The incidence of problem loans at a bank may rise, reflecting the financial difficulties of the bank's loans and resulting in

depressed earnings for the bank. When a bank fails, deposits in amounts exceeding the $100,000 insurance limit are at risk and may not be made whole.

(1) A PHA should make every effort to determine the soundness of its banks even though the information is not readily available.

The Federal regulatory agencies do not make public their evaluations of troubled banks and thrifts. Thrifts and certifications of banks by accountant auditors are no guarantee against failure. Private firms of banking specialists such as Keefe, Bruyette & Woods, Inc. and Cates Consulting Analysts keep comprehensive data on all commercial banks, but the high cost of their analytical service could be prohibitive. Standard & Poor's publishes credit ratings of bank holding companies. The large accounting firms offer a similar service.

(2) A bank's own published financial statements may be the only source of data available.

Statements must be reviewed for any decline in earnings and profitability. Specific items to note in making an evaluation should include: the ratio of equity (net worth) to assets, the return on assets, the adequacy of loan-loss reserves, the percentage of non-performing loans, and the recovery rate of charge-offs (bad loans). The government regulatory agencies vary in their net worth requirements for banks, but generally consider a three percent ratio of equity to total assets an adequate cushion against losses.

4-3. COLLATERALIZATION OF DEPOSITS.

PHAs shall require their depositories to continuously and fully (100%) secure all deposits whether regular, savings, or time that are in excess of the $100,000 insured amount. This may be accomplished by the pledging or setting aside collateral of identifiable U.S. Government securities as prescribed by HUD (see sub-paragraph b, c, and d of paragraph 4-8 of this Chapter). The PHA has possession of the the securities (or the PHA will take possession of the securities) or an independent custodian (or an independent third party) holds the securities on behalf of the PHA as a bailee (evidenced by safe keeping receipt and a written bailment for wire contract) and will be maintained for the full term of the deposit. Such securities shall be owned by the depository and the manner of collateralization shall provide the PHA with a continuing perfected security interest for the full term of the deposit in the collateral in accordance with applicable laws and Federal regulations. Such collateral shall, at all times, have a market value at least equal to the amount of the deposits so secured.

4-4. CASH BUDGET.

a. Justification.

Cash budgeting is important because knowledge of expenditure timing and the extent of cash availability permits the design of an investment strategy. The result of planning should be a cash budget including estimates of the sources and uses of cash over a definite period of time. A cash budget basically is a financial plan to improve cash flow and provide overall financial control. It involves a continuous effort to monitor and specify the flow of cash through the PHA's accounts.

b. Time Period.

A time period must be selected for the cash budget. Although PHA rentals are collected monthly and are the principal source of revenue, aside from the HUD development and modernization funding and operating subsidy payments, a shorter period for cash flow analysis reflecting the frequency of anticipated drawdown of Federal funds is recommended. Separate cash budgets should be developed for operations and for development and modernization programs in order to schedule Federal payments. It is further recommended that the cash budget should be constructed for the entire fiscal year to allow for income and expenditures that may vary from month to month. It is also recommended to budget for shorter periods for the current month or quarter. It should be updated monthly to reflect rental receipts and other new information available to the PHA.

c. Budget Examples .

The Exhibits are for illustration purposes only and do not constitute required formats. Exhibit 4-2 is an example of an Estimated Operating Cost Budget. Exhibits 4-3 and 4-4 illustrate Estimated Development and Modernization Cost Budgets. Exhibit 4-5 is a suggested format for the Net Cash Budget.

d. Estimating Operating Cost.

(1) Exhibit 4-2, Estimated Operating Cost Budget, consists of forecasts of PHA income and expenses by month. A number of techniques can be used to forecast rental income. A table showing the rental income and expenses for the past several years provides a historical perspective that can be used to

project future monthly cash flow. A simple equation can be used to forecast income and expenses on the basis of expected tenant occupancy and rental charges per unit. (Such computations can be performed on ordinary business pocket calculators.) While there may be some situations where more sophisticated forecasting techniques would be useful, the benefits of increased accuracy must be balanced against the increased cost of using more refined techniques. To optimize the flow of cash, invoices should be paid as late as possible under the terms stated without incurring any penalties or losses of discounts.

(2) Line 1 (Rental Dwelling is the total of estimated rental income in each month of the fiscal year. (Subtract Tenant Accounts Receivable). Scheduled rent increases should be reflected in the forecast. Line 2 (Excess Utilities) is the projected monthly sum of cash from charges for excess utility consumption and reflects the seasonal pattern of such charges. Line 3 (Interest on General Fund Investments) is the projected amount of funds from approved investments. Line 4 (Other Income) includes income from the operation of the project which cannot be otherwise classified, i.e., penalties for delinquent payments, sales and services to tenants, rental of equipment, charges for community space, charges to other programs for the use of central office management and maintenance space, profits from vending machines and laundry facilities. Line 5 (Total Estimated Income) is the sum of Line 1 through 4. In each case, the amount used should be the amount expected to be actually collected and not the amount due. If payments are delayed, the estimated operating cost should reflect the delay.

(3) Line 6 (Salaries and Wages) is the net amount paid after all payroll deductions and withholdings. It is treated in this manner because of timing differences between paying employees and making Federal deposits and other payments of withholdings from employees'pay. The forecasts should take into account anticipated changes in the number of employees (particularly seasonal changes) and anticipated salary and wage changes. Line 7 (Payroll Taxes) should include such expenses as Federal Income Tax withheld, State Income Tax withheld, Federal Insurance Compensation Act (FICA) tax withheld plus the PHA portion, and unemployment taxes, if applicable. These payments

should be reviewed to assure the longest deferral of payment possible under the law. Line 8 (Employee Benefit Plans) includes payments for employee health benefits, group life insurance premiums, and pension plan payments. Forecasts should reflect anticipated rate changes affecting costs of the plans, changes in the number of covered employees and changes in

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the employee benefit package. As with other expenses, the PHA should arrange to make all contractual payments for its employee benefit plans as late as possible. Line 9 (Material and Supplies) includes office supplies, supplies for vehicles (gas, oil, tires, etc.) and maintenance materials and supplies.

(4) Line 10 (Utilities) includes estimated payments for all utilities provided: electricity, gas or oil, sewage, water, telephone, trash collection, etc. The utility payments should be scheduled to take advantage of the cash discounts offered and to avoid any penalties. Adjustments should be made to reflect seasonal variations. Line 11 (Contracts) consists of expenses for contracts for tenant services and other services. Line 13 (Insurance Payments) consists of payments for premiums on each insurance policy. Line 13 (Payments in Lieu of Taxes (PILOT) has been predetermined (see paragraph 6-6, PHA preparation of HUD-52267 - Computation of Payments in Lieu of Taxes (PILOT)). Line 14 (Other Routine Expenses) consists of scheduled expenses not classified elsewhere. Line 15 (Nonroutine and Other Expenses) includes expenses that are not recurring and not covered in the modernization budget. The cash manager should work with the manager in developing estimates of cash needs for capital expenditures.

(5) Line 16 (Total Estimated Expenses) is the sum of Lines 6 through 15. Line 17 (Net Cash Flow from Operations) is the result of Line 5 (Total Estimated Income) deducted from Line 16 (Total Estimated Expenses).

e. Estimating Development and Modernization Cost.

Exhibit 4-3, Estimated Development and Modernization Cost Budget consists of forecasts of PHA planned development and modernization cost by month. Form HUD-52826, Schedule/Report of Modernization Expenditures and Form HUD-5372, Construction Progress Schedule showing monthly planned expenditures can be used to project future monthly cash flow. The subtotals of development and modernization should be totalled, then entered in row titled "Total Costs". The row titled "HUD Advances" is the amount of funds requested on the Form HUD-54O2 "Requisition for Funds". This amount is Line 2 of Exhibit 4-5.

Exhibit 4-4, Daily Estimated Development and Modernization Cost Budget consists of actual invoices and cost incurred by PHA for development and modernization cost by the date the payments shall be made. Column 1 (Date), enter the date the payments are due to the creditor. Column 2 (Project Number), enter the project or modernization number for the project that requires payment. Under that column, enter the total amount requested on

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that date. Column 3 (Total) is the total amount requested for all projects on that particular date. Row (Total) is the amount of cash available at the end of the month. It is possible to invest these funds on a daily basis, therefore funds may not be available for investment for a monthly cash flow projection analysis.

f. Cash Flow Budget Projections.

Exhibit 4-5, Net Cash Budget, utilizes the Estimated Operating Cost Budget (Exhibit 4-2) and Estimated Development and Modernization Cost (Exhibit 4-3 or 4-4) to forecast the funds available for PHA cash balances and investments. (For illustration purposes only, not a required format.) Line 1 is identical to Line 17 of Exhibit 4-2 (Net Cash Flow From Operations). Line 2 (Estimated Cash Available From Development and Modernization) is identical to the Row (HUD Advances) of Exhibit 4-3 or Row (Totals) of Exhibit 4-4 (Estimated Development and Modernization Cost Budget). For the first month, Line 3 (Cash Balance at the Beginning of the Month) is the cash balance available as of the first day of the PHA fiscal budget year. The value for the remaining months is Line 4 (Cumulative Cash) for the preceding month. Line 4 (Cumulative Cash) is the sum of Lines 2 and 3. Line 5 (Target Level Cash) is the amount of funds that the PHA determines is needed on hand for transaction purposes or safeguard against cash shortages. Line 6 (Cash Surplus or Need) is the result of Line 5 (Target Level Cash) deducted from Line 4 (Cumulative Cash). If a negative value results, then a cash defiency problem may become apparent and investing funds should be delayed until the cash surplus is available and consistent. If a positive value results then it is an indication of funds available for investment. The invested funds should be scheduled to mature at the time of projected cash needs.

g. Factors for Cash Flow Budget Projections.

These factors should be taken into consideration in determining future cash needs. These factors will also assist in determining the frequency, amount and timing of operating subsidy payments.

(1) Collection of rental income (including late rent payments);

(2) Seasonal variation in utility bills;

(3) Approximate dates of recurring payments, i.e., salaries, wages and benefits;

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(4) Approximate dates of utility and employee benefits payments;

(5) Drawdown of/provision for the operating reserve;

(6) Adjustments of prior year's operating subsidy eligibility (i.e., Utility and Target Investment Income Adjustments.

h. Further Guidance.

One publication covering cash management for local governments is:

Improving Cash Management in Local Government: A Comprehensive Approach. By: Frank M. Patitucci and Michael H. Lichtenstein.
Published by: Municipal Finance Officers Association (Government Finance Officers Association)

4-5. INVESTMENT OF FUNDS.

a. Funds Available for Investment.

Funds on deposit in the General Fund are comprised of four components: (1) funds for current transaction purposes, (2) development and/or modernization funds, (3) funds exceeding those necessary for the daily operation of the PHA which are considered available for investment and (4) any operating reserved funds. As a general rule, the average amount on deposit in the General Fund cash accounts (the targeted maximum cash balance) should be the amount needed on hand for transaction purposes or as a safeguard against cash shortages.

b. Requirement in Annual Contributions Contract.

Section 401(E) of the Annual Contributions Contract (ACC) requires that excess funds on deposit in the General Fund shall be invested in investment securities selected by the PHA and approved by HUD. This section defines excess monies as funds in excess of prudently estimated needs for the next 90 days. The requirement does not take into account modern cash management techniques which will allow a reduction in nonearning assets and the requirements of Target Investment procedures of the Performance Funding System (PFS) which require a fuller

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investment of assets in calculating operating subsidies. In the interest of good cash management, non-interest/bearing deposits should be reduced to the amount necessary to maintain a good banking relationship.

c. Assigning Responsibility for the Cash Management and Investment Program.

A major factor contributing to the success of the investment program is the delegation of responsibility and authority for developing and executing it. The PHA should compare the cost of establishing a cash management program in-house if qualified professional staff are available to contracting out. If PHAs contract for cash management and investment services, then the organization should have qualified personnel to achieve cost-effectiveness. Commercial banks and savings and loans association now offer such services.

4-6. CASH MANAGEMENT INCENTIVES .

a. Introduction.

Good cash management, which is an objective of management, creates responsibilities for the use of funds. Such responsibilities are placed on both the PHA and HUD for a successful program to benefit both. The primary goals of cash management are to assure the availability of cash for transaction needs, preserve the value of cash resources and earn the maximum return on funds until disbursed.

b. Temporary Funds Available for Investment.

(1) Each PHA with an average cash balance of $10,000 or more shall invest such funds in HUD-Approved Investment Securities (see Paragraph 4-8 of this Chapter) in order to at least meet the PFS Target Investment requirements (24 CFR Section 990.109 (e)).

(2) See Handbook 7475.13, Performance Funding System (PFS), regarding reporting requirements for projecting investment income for the purpose of calculating PFS operating subsidy eligibility. These requirements mandate a minimum investment income (Target Investment Income) for calculating operating subsidies and allow PHAs to retain investment income in excess of the required amount. PHAs should review these requirements carefully in developing their cash management programs.

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c. Monitoring.

The Office of Finance and Management, PIH, will oversee the overall cash management policy and programs for Public Housing. Actual monitoring of each PHA's cash management will continue to be the responsibility of the respective Field Office.

4-7. INVESTMENT STRATEGY.

a. HUD-Approved Investments.

A list of investments approved by HUD for the investment of PHA funds is contained in Paragraph 4-8 of this Chapter. PHAs are required to choose from these financial instruments. Within the HUD approved instruments, PHAs are permitted to modify their investment policy without prior HUD approvals. The choice of investments from the approved list should be made using the criteria developed in the remainder of this paragraph.

b. Determination of Investment Type.

The determination of the best types and mixtures of investments is dependent on several factors. The primary objective is safety. Once that objective is attained, the optimum return on the investment should be consistent with the goals of the cash management program of the PHA. The factors that should be taken into account include the following:

(1) Safety.

Safety is achieved through adherence to the list of permitted investments which are backed by the full faith and credit of, or a guarantee of principal and interest by, the U.S. Government, a Government agency or issued by a Government-sponsored agency, coupled with an appropriate maturity date.

(2) Yield.

The PHA should strive to achieve the highest yield consistent with the other factors of the investment policy. Tax-exempt securities are not appropriate for investment by a PHA because it would not benefit from the tax advantage.

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(3) Liquidity.

All investments must be capable of being liquidated on one day's notice. Therefore, no investments may be made which impose a longer notice period for redemption or which are not readily marketable.

(4) Maturity.

Investments should be scheduled to mature when the funds are needed. Sale of securities prior to maturity should be avoided due to the inherent risk. (If the market interest rate increases above the yield on the investment, the market value of the securities will decline.) Investments shall be limited to securities maturing in periods of up to one year, or such lesser period that coincides with expected disbursements by the PHA, but not beyond the current financing cycle. PHAs may invest in securities up to three years for the investment of operating reserves.

(5) Amount.

The best type of investment depends, to some degree, on the amount available for investment because certain investments require a large initial amount.

(6) Administrative Cost.

In choosing an investment, a PHA must consider the administrative work involved, particularly with regard to investments of short duration. Substantial amounts can be invested for periods as short as one or two days. However, the administrative costs with small amounts may be greater than the return on the investment, thus would not be justified. Administrative costs will be higher with a more frequent turnover of investments and must be taken into account together with the yield and term in determining the optimum investment strategy.

c. Cash Management by the PHA.

The PHA should compare the return from an in-house cash management program with a program managed by an agent. If the PHA finds that administrative costs of an in-house program are such that the net yield on investments is less than that obtainable through an alternative, the general rule is that the PHA should use that alternative.

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d. Cash Management by an Agent.

As an alternative to an in-house cash management program, a PHA may enter into a contract with an approved governmental unit such as a State agency established for this purpose (see Paragraph 4-8(g) Municipal Depository Fund of this Chapter) or another PHA, or a financial institution (excluding investment bankers and brokerage houses) to administer its cash management program. Such a program may include any of the functions of cash management, i.e., receipts, disbursements and investments. Such a contractual arrangement will give a small PHA the expertise and administrative skills which it would not otherwise be expected to have and often can make a cash management program cost-effective.

e. Low-Income Public Housing Development and Modernization Funds.

A PHA engaged in Low-Income Public Housing Development or Modernization programs shall not request funds from HUD in excess of their needs for two 30-day periods. Therefore, a PHA shall not consider investing such funds in securities maturing before 30 days unless it has been determined that such securities can be redeemed at par prior to the maturity date and that the yield will be at least equal to that of shorter term securities than available for investment.

4-8. APPROVED INVESTMENT SECURITIES.

a. Introduction.

In most cases, purchases of securities shall be a date which coincides with expected disbursements by the PHA.

For the purpose of investing operating reserves, issues shall be limited to maturities three years or less. Although some of the following securities have maturities longer than three years, they can be traded in the secondary market.

b. Direct Obligations of the Federal Government Backed by the Full Faith and Credit of the United States.

(1) U.S. Treasury Bills.

These securities are short-term obligations which a PHA or its agent may purchase directly. Treasury Bills with 3-month and 6-month maturities are issued weekly and those with 9-month and 12-month maturities are issued monthly. The minimum denomination is $10,000. They are issued on a discount basis and are redeemed at par upon maturity.

U.S. Treasury Bills are available for purchase at any time after issuance from investment departments of banks and from dealers in investment securities. Purchases may be made conveniently using the PHA's depository bank. Treasury Bills may be acquired by subscription on the issue date from a Federal Reserve Bank or branch in amounts not in excess of $200,000. Detailed information is contained in the weekly or monthly announcements which may be received regularly upon application to a Federal Reserve Bank or branch.

(2) U.S. Treasury Notes and Bonds.

These securities are issued periodically by the Treasury Department through Federal Reserve Banks and branches. They are medium to long-term obligations which a PHA or its agent can only purchase in the secondary market to assure that they will mature at a date which coincides with scheduled disbursements by the PHA. Outstanding issues may be purchased from banks or dealers in investment securities at the market price which on any given day may be more or less than the face amount.

(a) U.S. Treasury Notes.

These notes mature in not less than one and not more than 10 years from the issue date and bear interest at fixed rates payable semi-annually.

(b) U.S. Treasury Bonds.

These bonds mature after ten years from the issue date and bear interest at fixed rates payable semiannually. Many issues of bonds are redeemable on call by the Treasury Department before maturity. The yield of such issues usually is computed to the first call date which may be as much as 5 years prior to maturity.

c. Obligations of Federal Government Agencies.

(1) Federal Financing Bank (FFB).

The Federal Financing Bank is authorized to purchase obligations held by Federal agencies and to issue obligations to the public.

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(2) Government National Mortgage Association (GNMA) Mortgage-Backed Securities (GNMA I and GNMA II).

The securities, guaranteed by GNMA are issued by an issuer (a GNMA-approved mortgage lender). The securities are backed by a pool of government-insured or guaranteed mortgages. The holders of the securities receive monthly payments of principal and interest. The minimum denomination issued is $25,000. The difference in GNMA I and GNMA II is that the GNMA II payment date is on the 20th of the month and the GNMA I payment date is on the 15th; GNMA II uses a central paying agency whereas GNMA I has individual issuers sending checks to investors; and GNMA II has interest rates that vary within a one percent range. The maximum maturity for GNMA I and GNMA II is 30 years, except that GNMA I project loans mature in 40 years.

(3) Government National Mortgage Association (GNMA) Mortgage-Backed Securities Program Mortgage-Backed Bonds (MBS).

These obligations, guaranteed by GNMA, have been issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). They have been issued in maturities varying from one to 25 years, but have not been sold since 1973. They were in denominations of $25,000, $100,000, $500,000, and $1,000,000.

(4) GNMA Participation Certificates.

These securities, guaranteed by GNMA, were sold by GNMA as the trustee with various other Federal agencies as trustors. They represent beneficial interest in future payments of principal and interest on mortgage pools. Their maturities range between one and 20 years and the minimum denomination is $5,000.

(5) Maritime Administration Merchant Marine Bonds, Notes, and Obligations.

These securities are issued by shipping companies and are backed by the full faith and credit of the U.S. Government. Each issue is further secured by a first preferred ship or fleet mortgage. Maturities and denominations vary.

(6) Small Business Administration (SBA) Small Business Investment Corporation (SBIC) Debentures.

When authorized by appropriation acts, the SBA may guarantee principal and interest payments on debentures of

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SBIC. The SBA may also pool these debentures and sell SBA-guaranteed debentures. These issues have maturities of 10 years and are issued in $10,000 denominations.

(7) Tennessee Valley Authority (TVA) Power Bonds and Notes.

These securities are secured by a first charge on net power proceeds. Payment of interest and principal on them is ranked ahead of annual payments to the U.S. Treasury. They have been issued in multiples of $1,000.

d. Securities of Government-Sponsored Agencies.

(1) Farm Credit Consolidated System-Wide Discount Notes.

These notes are the secured joint and several obligations of the Farm Credit System which consists of the Federal Land Banks, the Federal Intermediate Credit Banks, and the Banks for Cooperatives. They are issued in denominations of $5,000 and maturities are authorized from 5 to 365 days.

(2) Federal Farm Credit Banks Consolidated System-wide Bonds.

These bonds are the secured joint and several obligations of the Farm Credit Banks. Their issuance supersedes individual bond issues by the Federal Land Banks, the Federal Intermediate Credit Banks, and the Banks for Cooperatives. They are issued in multiples of $1,000 for maturities in excess of 13 months and in multiples of $5,000 for shorter maturities.

(3) Federal Land Banks Consolidated Bonds.

These bonds are the secured joint and several obligations of the Federal Land Banks. They are issued in multiples of $1,000 and with maturities ranging from 1 to 15 years. The last issuances matures in 1997.

(4) Federal Home Loan Banks Consolidated Obligations.

These securities are the secured joint and several obligations of the Federal Home Loan Banks comprised of:

(a) Bonds

which have maturities of one year or more. They are issued in multiples of $10,000, $25,000, $100,000 and $1,000,000.

(b) Notes

which have maturities of less than one year. They are issued in multiples of $10,000, $25,000, $100,000 and $1,000,000.

(c) Discount Notes

which have maturities ranging from 30 to 170 days. They are issued in denominations of $100,000 and $1,000,000.

(5) FHLMC Mortgage Participation Certificates (PC) (Guaranteed)

These certificates represent undivided interest in specific fixed rate, first lien conventional and residential mortgages. FHLMC provides monthly interest and principal payments. The final payment is the first of the month and year in which the last monthly payment on the last maturing mortgage is scheduled to be be paid.

(6) Federal National Mortgage Association (FNMA) Debentures.

These debentures are issued in denominations ranging from $10,000 and with maturities ranging from 20 to 25 years.

(7) FNMA Notes.

The minimum investment in these notes is $50,000 with maturities ranging from 1 to 20 years.

(8) FNMA Short-Term Discount Notes.

These notes are similar to commercial paper and are tailored to the individual needs of investors. They are sold at published rates with maturities of 30 to 270 days and in denominations ranging from $5,000.

(9) FNMA Capital Debentures.

These debentures are subordinated to the noncapital debentures, notes, and short-term discount notes. They were last issued in 1975 in a $10,000 minimum denomination and with maturities of 5 and 25 years.

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(10) FNMA Convertible Capital Debentures.

These debentures are subordinated to all senior obligations, including non-convertible capital debentures. There was one 25-year issue in September 1971 maturing in 1996.

(11) Student Loan Marketing Associations (SLMA) Obligations.

SLMA issues obligations comprises of guaranteed student loans as follows:

(a) Floating Rate and Master Notes.

These notes bear interest at rates that vary with the 91-day Treasury Bill rate. Short-term borrowings have an original or remaining term maturity of one year or less.

(b) The Series E and F Floating Rate Notes.

These notes bear interest at rates which vary with the 91-day Treasury Bill, except that each issue has fixed minimum and maximum rates known as interest rate "collars" for any quarterly interest period.

(c) Zero Coupon Notes.

These notes are shown at net proceeds adjusted for accretion of discount.

e. Demand and Savings Deposits.

Demand and savings deposits at commercial banks, mutual savings banks, savings and loan associations and credit unions are permitted for PHA funds provided that the entire deposit is insured by the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Share Insurance Fund (NCUSIF) or by the Federal Savings and Loan Insurance Corporation (FSLIC). A deposit in excess of the insurance coverage may be made at a depository institution provided that it is 100 percent collateralized by any of the securities listed under subparagraphs b, c, and d of this paragraph. Care should be taken that withdrawals may be made on demand without loss of interest and without penalty.

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f. Money-Market Deposit Accounts.

Money-Market Deposit Accounts at depository institutions that may not be insured fully by the FDIC, NCUSIF, or FSLIC are permitted provided that the certificates are fully backed by 100 percent collateral consisting of securities listed under subparagraphs b, c, or d of this paragraph. When accounts exceed the $100,000 insurance limitation, their safety also may depend on the PHA's control of the underlying collateral which must consist of clearly identified (not pooled) U.S. Government securities. Possession of the collateral securities and a continuous perfected security interest may be the only sure protection against loss in case of bank failure.

g. Municipal Depository Fund.

A Municipal Depository Fund (Fund) or Local Government Investment Pool which is established by States, municipalities, units of local government or other political subdivisions to serve as an investment fund for PHAs is permitted. The securities purchased by a Fund shall be on the HUD-approved list of investment securities. PHAs shall have either an undivided or divided interest in securities comprising the Fund. The Fund shall be under the control of the Investment Company Act of 1940, and its objective shall be clearly stated. The investment objective of the Fund shall be to obtain as much income as possible consistent with the preservation and conservation of capital. The Fund shall disclose clearly the basis of earnings and how they are distributed. PHAs shall obtain a statement of potential default and risk and a clear demonstration that withdrawals from the Funds will not be so restricted as to impair a PHA's day-to-day cash management needs. The management fee shall be fixed at a reasonable amount and management shall be passive. PHAs shall limit the amount of funds invested in the Fund to no more than 30 percent of a PHA's available investment funds. The Fund shall disclose the relationships of the investment advisor, manager, trustees, custodian and transfer agent. Each financial advisory relationship shall be evidenced by a written document executed prior to, upon, or promptly after the inception of the financial advisory relationship, or promptly after the creation or selection of the issuer. If the issuer does exist or has not been determined at the time the relationship commences, that written document shall set forth the basis of compensation for the financial advisory services to be rendered.

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h. Super NOW Accounts.

Super NOW accounts have been available and approved for public funds since January 1983. They offer a relatively high market rate and are fully transactional (have no limitations on the number of checks or transfers). Insurance and collateral requirements are as above for subparagraph e Demand and Savings Deposits.

i. Certificates of Deposit.

(1) Certificates of Deposit are permitted at depository institutions that are insured by an agency of the Federal Government. Caution must be exercised for certificates exceeding the $100,000 insurance limit or when the term is longer than 30-90 days. Although the certificates rate of return may be attractive for larger amounts and longer terms, U.S. Treasury securities offer superior safety and liquidity for the same amounts and terms.

(2) Certificate amounts above $100,000 are permitted provided that the excess is 100 percent collateralized by clearly identified (not pooled) U.S. Government

securities. Possession of the collateral securities and a continuous perfected security interest may be the only sure protection against loss in case of bank failure.

(3) Brokered deposits should be avoided because it is no longer possible to get $100,000 of insurance on a number of deposits placed by brokers.

J. Repurchase Agreements.

Repurchase (repos) agreements for a term not to exceed 30 days may be entered into with Federally insured depository institutions to purchase and sale of securities identified under subparagraphs b, c, and d. A repurchase agreement is an agreement negotiated with a bank usually for a short period (1 to 7 days) wherein securities approved for investment are purchased from that bank at a stated price with the bank agreeing to repurchase them on a specified date for a specified amount. The minimum may vary, although it is usually $100,000. There are three main types: (1) fixed term, where both parties are bound to the negotiated time period, (2) demand, where the agreement stays in effect until terminated by either party, and (3) day-to-day, where daily renewal is by mutual consent and 24-hour notice is required for termination. The PHA should review existing and future repos for compliance with the following certifications. Prior approval by HUD is not necessary,

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however, the repos seller depository or its agency must provide a written certification to HUD, Assistant Secretary for Public and Indian Housing (Office of Finance and Management), the Field Office, and to the PHA (OMB Approval Number 2577-0099).

(1) that the depository's repo program complies with applicable Federal and State statutes and regulations and that the program does not involve sales or loans of Federal securities by securities dealers that are not regulated or that report to the Federal Reserve Board;

(2) that the depository owns the underlying Federal securities (approved for repurchase under Paragraph 4-8 of this Chapter) when the repo interest is sold and that the value of the securities is equal to or greater than the amount the PHA pays for the repo;

(3) that the PHA has possession of the securities (or the

PHA will take possession of the securities) or an independent custodian (or an independent third party) holds the securities on behalf of the PHA as a bailee (evidenced by a safe keeping receipt and a written bailment for hire contract), from the time the repo interest is sold to the PHA and will be (or is expected to be) maintained for the full term of the repo;

(4) that the repo agreement and any related documents identify specific Federal securities related to the specific repo purchased by the PHA;

(5) that the repo interest does not represent any interest in a pool or fund of Federal securities for which registration under the Investment Company Act of 1940 may be required;

(6) that the PHA will have a continuous perfected security interest in the underlying Federal securities under State or Federal law for the full term of the repo (disclosing the method by which perfection has or will be accomplished, i.e., by possession, filing, registration of book-entry securities and/or Federal preemption of State law by Federal regulation);

(7) that the depository or a reporting dealer selling the repo has not received any adverse financial report from a credit reporting agency, State or Federal regulatory agency; and

(8) that the depository will not substitute other securities as collateral, except to increase the value of the repo security to match the repos's purchase price.

k. Sweep Accounts.

Sweep Accounts is a contractual agreement between a bank and a PHA which provides that the bank will regularly "sweep" or transfer any available collected balances from the PHA's account into repurchase agreements. The Sweep Accounts agreement shall include all the certification provided in the Repurchase Agreement and adherence to paragraph 4-3, Collateralization of Deposits.

l. Separate Trading of Registered Interest and Principal of Securities.

Separate Trading of Registered Interest and Principal of Securities (STRIPS) are Treasury-based zero-coupon securities which consist of interest or principal on U.S. Treasury securities. STRIPS were issued in minimum increments of $1,000. STRIPS pays no interest until maturity and the rate of return is "locked in" at the time of purchase. The delivery of STRIPS is accomplished by wire transfer through the Federal Reserve book-entry system. STRIPS shall be in the name of the PHA.

4-9. INVESTMENT OF FUNDS HELD BY HOUSING AGENCY FISCAL AGENTS.

a. Approved Type of Investments.

Funds held by the Fiscal Agent in any of the trust funds shall be invested in strict accordance with the Resolution establishing such funds. Where the Resolution contains no provision concerning the investment of funds, the funds shall be invested in securities approved for General Fund Investment provided such investment will mature or may be redeemed at the option of the purchaser at not less than the purchase price on or prior to the date such funds are required to be disbursed by the Fiscal Agent.

b. Description of Funds.

The funds established by PHA resolutions authorizing the issuance of bonds to finance the development cost of projects are as follows:

(1) Debt Service Fund.

This Fund is established pursuant to the Annual Contributions Contracts and PHA Resolutions providing for the issuance of new PHA bonds. The Fiscal Agent is explicitly required under the form of the Fiscal Agency Agreement entered into since 1964 to purchase and sell investment securities as the PHA, with the approval of the Federal Government, may direct.

(2) Advance Amortization Fund.

(a) Since 1952, the form of Fiscal Agency Agreement in use requires the Fiscal Agent to invest funds on deposit in the Advance Amortization Fund as the PHA, with the approval of the Federal Government, may direct.

(b) With respect to the investment of funds resulting from a consolidated sale of bonds by an Agency Authority, only the Agency Authority of HUD may issue investment instructions to the Fiscal Agent. These instructions shall be consistent with Paragraph 4-7 and 4-8 of this Chapter.

(3) Annual Contributions Reduction Account (sometimes called Supplementary Revenues Account); Bond Service Account; Series A Reserve Fund; General Bond Reserve Fund; Rental Debt Service Fund; and Excess Lands Account.

The Resolution authorizing Series A and Series B Bonds issued prior to 1951 established these funds and the Resolution usually contains limitations on the investment of funds on deposit in one or more of such accounts.

c. Investment Register.

An investment register or other record shall be maintained by the PHA or its agent as provided in Chapter 4 of the Low-Rent Housing Accounting Handbook RHA 7510.1.

d. Internal Controls.

PHAs should develop internal controls on investments as provided in Chapter 3, Sections 1 and 2 of the Low-Rent Housing Accounting Guide, HM G 7511.1.

EXHIBIT 4-1 Page 1 of 2

General Depository Agreement

GRAPHICS MATERIAL IN ORIGINAL DOCUMENT OMITTED

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