MINUTES OF THE 26TH MEETING OF THE
TOBACCO SETTLEMENT FINANCING CORPORATION
AUDIT COMMITTEE
HELD ON JANUARY 25, 2012 AT 11:10 A.M.
AT ITS OFFICES AT 641 LEXINGTON AVENUE
NEW YORK, NEW YORK 10022

MEMBER AND DESIGNEES

PRESENT:

Kenneth M. Bialo	Vice Chairman and Member
Elaine McCann	Division of the Budget, representing Robert Megna, Member (via video conference)

ABSENT

Andrew A. SanFilippo	Member

The meetings of the Audit Committees were opened in joint session for consideration of various matters of shared importance. These minutes reflect only those items being considered by the Members of the Tobacco Settlement Financing Corporation. A record of items considered by the other Agencies is contained in the minutes of each Agency respectively.

Naomi S. Bayer announced that Karen A. Phillips had designated her to take Ms. Phillips' place as Vice Chairperson of the State of New York Mortgage Agency (SONYMA) and Steve Weiss to take the position of Vice Chairman of the New York State Housing Finance Agency (HFA) and the New York State Affordable Housing Corporation (AHC). She said that Kenneth M. Bialo would continue his role as Vice Chairman of the New York State Municipal Bond Bank Agency (MBBA) and the Tobacco Settlement Financing Corporation (TSFC).

Vice Chairperson Bayer chaired the committee meetings of SONYMA, Vice Chairman Weiss would chair the committee meetings for HFA and AHC, and Vice Chairman Bialo would chair the committee meetings for MBBA and TSFC. For purposes of convenience, Vice Chairperson Bayer would present the shared information for all of the Agencies. Alejandro J. Valella, Vice President and Deputy Counsel, acted as secretary for the meeting.

Vice Chairman Bialo chaired the meeting for MBBA and TSFC in the absence of a Chairman. Alejandro J. Valella, Vice President and Deputy Counsel of the Agencies, acted as Secretary. The meetings of the Affiliated Agencies were opened in joint session for consideration of various matters of shared importance. These minutes reflect only those items being considered by the Members of the Tobacco Settlement Financing

Corporation. A record of items considered by the other Agencies is contained in the minutes of each Agency respectively.

Mr. Valella noted that Elaine McCann was participating in the meeting by video conference from the Agencies' Offices at Hampton Plaza, 38-40 State Street, Salo Conference Room, Albany, New York. A public notice was given of the time and locations of both venues.

Naomi Bayer, Vice Chairperson of the State of New York Mortgage Agency, (SONYMA), Marge Rogatz and Don Lebowitz, Directors of SONYMA; Thomas Mattox, Member of HFA and AHC, Aida Brewer, Deputy Commissioner and Treasurer, Department of Taxation and Finance; Royce A. Mulholland, Member of HFA and AHC; Darryl C. Towns, President and Chief Executive Officer; and Steven J. Weiss, Member of HFA and AHC, attended the meeting as guests.

Vice Chairman Bialo moved to adjourn the meeting for Executive Session, Ms. McCann seconded the motion, and the Committee entered into Executive Session at 11:15 a.m. pursuant to Section 105(f) of the Open Meetings Law to discuss the financial or employment history of a particular corporation.

Vice Chairman Bialo called for a motion to reconvene from Executive Session. Mr. Valella stated that no votes had been taken in Executive Session and the committee meeting reconvened at 11:44 a.m.

The next item on the agenda was the adoption of the minutes of the 25th Tobacco Settlement Financing Corporation (TSFC) Audit Committee meeting held on December 1, 2011. There were no comments or corrections from the Members and the minutes were deemed approved.

The next item on the agenda was a resolution recommending approval of the Agencies' Financial Statements for Fiscal year 2010-2011. Joanne Hounsell, Senior Vice President and Interim Chief Financial Officer, presented the audited financial statements for SONYMA, HFA, MBBA, and TSFC for the fiscal year that ended on October 31, 2011. She explained that these agencies have ninety days after the end of the financial year in which to file their financial statements with PARIS and with certain State agencies. Ms. Hounsell explained that the New York State Affordable Housing Corporation has a March 31, 2012 fiscal year end and will be presented at the June meeting.

Ms. Hounsell explained that in her presentation, she would be referring to the Financial Statements Presentation ("the Presentation") that had been distributed prior to the meeting, the Audit Board mailing, and the updated blacklined HFA financials and notes in the Directors' folders.

Ms. Hounsell began by reviewing page two of the Financial Statement Presentation, which outlines the agenda for the Financial Statement Presentation.

Marian Zucker, President of Finance and Development, then took over the presentation. She began on the Markets Overview page of the Presentation and explained that the capital markets in which the agency operates continue to be unstable. She further explained that certain events of the year led to a flight to quality by investors, which led to record-low Treasury rates, which continue to this day. In addition, Ms. Zucker stated that the U.S. housing sector continues to struggle because of an increased emphasis on rental housing and other factors, though there has been an increase in sustained home sales. Ms. Zucker further noted that in the municipal market there was an outflow of capital from investors and both the long and short-term markets has record-low municipal rates, which are continuing to drop. Additionally, Ms. Zucker stated that municipal volume last year was at a ten-year low, and new borrowings and refundings were also down. Sue further stated that there was also a decrease in volume in housing issuance, and the single-family programs of many HFA's around the country are slowing down, and with that their bond issuance. Ms. Zucker explained that the critical drivers of the agencies' activities were the record-low interest rates, use of NIBP resources, the bank downgrade activity, and the increase in 80/20 multifamily demand.

Ms. Zucker stated that because of the low-interest rate environment, there had been savings opportunities for the agencies through one refinancing for TSFC and two refinancings for SONYMA. Ms. Zucker then reviewed HFA's NIBP Utilization, which resulted in proceeds that were used to finance twenty nine loans and 4,077 units. She also noted that a further $16M is remaining to be used for the St. Phillips project. Ms. Zucker then reviewed SONYMA's NIBP utilization and noted that the agency fully used its NIBP utilization in March and that part of that was used to reduce the agency's floating rate exposure and to originate new mortgages. Further, Ms. Zucker explained that the NIBP rate advantage allowed SONYMA to be competitive against traditional rates and allowed HFA to minimize its use of subsidy dollars. Ms. Zucker also noted that the SONYMA is exploring launching a conventional program.

Ms. Hounsell then provided the Financial Statements Overview. She reviewed page 14 of the Presentation, which shows the bonds issued for HFA, SONYMA, MBBA, and TSFC.

Ms. Bayer asked how much of this was new money and how much was refunding of the total amount. Ms. Zucker responded that the full amount of TSFC was refunding and almost half of SONYMA was refunding.

Ms. Hounsell then reviewed pages 15-17 of the Presentation, which provided a snapshot of distribution of $17 billion in bonds outstanding as of October 31, 2011, demonstrate the relative wealth of the agencies, and show the change in net position of the agencies over the last four years.

Ms. Hounsell explained that all the agencies now have the caption "component unit of the State of New York," in keeping with leading practices. This caption indicates that the agencies' financials are included in the State's financials. Further, Ms. Hounsell

stated that the agencies have all early-adopted GASB Statement No. 63, which is "Accounting for the Financial Reporting for Derivative Instruments", and provides guidance on reporting deferred outflows and deferred inflows separate and apart from assets and liabilities dealing with derivatives. Ms. Hounsell explained that as a result, what was called the "Balance Sheet" is now called "Statement of Net Position," what was called "Fund Balance" or "Net Assets" is now referred to as "Net Position," and the equation "Assets = Liabilities + Fund Balance" has now evolved to "Assets + Deferred Outflows of Resources – Liabilities and Deferred Inflows of Resources = Net Position." Ms. Hounsell stated that these changes will apply to SONYMA and HFA, where there is derivative reporting.

George Leocata, Senior Vice President of SONYMA, provided the SONYMA Program and Portfolio Information. He explained that page 19 of the Presentation is a comparison of the 2011 Loan Reservations to the 10-year average. He explained the impact of the NIBP on loan reservations – earlier in the year, the reservations were higher than the ten-year average but as the money ran out in April the reservations decreased because the conventional market rates were so low that it was difficult to compete with the conventional market.

Ms. Bayer asked whether the demand was rate, and not term, sensitive because the terms of the loans and the underwriting did not change. Mr. Leocata responded that New York State is very rate-sensitive.

Don Lebowitz asked what would be the benefit of a conventional program. Mr. Leocata responded that he would review two programs, one offered by Fannie Mae, where Fannie Mae is offering special products to HFA's that gives them pricing and underwriting advantages. He also explained that the advantage of an FHA product is the down-payment assistance product.

Mr. Leocata reviewed page 20 of the Presentation, which demonstrates the Annual Production by Loan Program. He explained that the Achieving the Dream program in particular has had the highest volume production. The chart on page 21 demonstrates the annual production of all the programs and shows that it has been consistent throughout the years. Further, Mr. Leocata stated that there has been progress in the amount of loans made to minorities, which is demonstrated by the chart on page 22 of the Presentation, mainly because the agency's activity in New York City has increased over the last three years. Mr. Leocata then stated that the agency's portfolio continues to do well and the delinquency rate continues to go up slightly, which is typical for the end of the year.

Mr. Valella asked whether in terms of other single-family housing finance agencies, SONYMA is at the top. Mr. Leocata confirmed this based on Moody's reporting of state housing finance agencies. Ms. Bayer then asked what else the agency could be doing to add more value to the residents of the state by taking on more risk. Mr. Leocata said that he will go over this. Thomas H. Mattox then asked to what extent there is a relationship between relatively low delinquency rates and the agency taking on more

risk and instituting more targeted programs. Ms. Bayer then stated that the agency should view risk opportunistically with program expansions to see what else the agency could be doing. Mr. Leocata stated that the agency had recently expanded the veterans' program to include active service-members. Commissioner Darryl C. Towns then stated that there is an opportunity for targeted housing with regard to troop members that are returning home, because there is a need for housing in that community. He stated that through development and synergy with regional councils, the agency would be able to provide such targeted housing. Mr. Lebowitz then asked how the delinquency rates are related to regions. Mr. Leocata responded that performance does change by region, which may be correlated to jobs. Mr. Lebowitz then stated that when making decisions about expansion, the agency should consider these regional factors because in certain areas, it would mean taking on more risk. Royce Mulholland then discussed ways that such risk could be managed.

Mr. Leocata then discussed the delinquencies by program, demonstrated on page 24 of the Presentation. He reiterated that the Achieving the Dream program is the agency's best-performing program. He then discussed mortgage insurance. Mr. Leocata noted that Moody's recently changed its methodology for rating insurance companies, and Genworth and MIF continue to do the bulk of mortgage insurance for the agency.

Michael Friedman, Senior Vice President, then reviewed the Mortgage Insurance Fund. He stated that in comparing the mortgage recording tax collections for the past four years, the table on page 26 demonstrates that the collections "bottomed-out" in Fiscal Year 2010. He further stated that based on the first two months of 2012, it appears that the agency is on track to receive about $79M in surtax. He explained that based on this and prior years, $80M is probably the normal amount of surtax that the agency will receive, which is just enough to fund reserves for new commitments and new claims. Mr. Friedman then explained that the agency's project commitments by loan amount have been decreasing modestly, which is in synch with HFA. Lastly, Mr. Friedman reviewed the agency's project commitments by units, which, when factoring out the 14,476 NYCHDC units from 2010, have been fairly constant over the past two years.

Genevieve D'Agostino, Senior Vice President, then reviewed where the agency stands now with liquidity providers on its $545M outstanding variable rate debt. She said aid that the outstanding debt decreased and the debt among the three providers is fairly similar.

Gary Weinstock then referred to the Audit and Governance Committee Book, tab 2, which contains the financial statements for all the entities, the first one being SONYMA. Mr. Weinstock stated that he would focus on the Management Discussion and Analysis Section ("MD&A") for all the agencies. Mr. Weinstock explained that his presentation will be drawn from the draft financial statements. He began with reviewing the condensed financial statements that are on page 11 of the Audit and Governance Committee Book. Mr. Weinstock then explained that as previously noted, the name of the statement has been changed from "Balance Sheet" to "Statement of Net Position" so as to accommodate the swap transactions. Mr. Weinstock then discussed the Statement of Net

Position and the Net Position Summary Schedule, and noted that as in previous fiscal years, the agency's primary assets are the loans receivable and that the primary remainder of the total assets are the investments held in reserve in the MIF. Mr. Weinstock then discussed the agency's liabilities. He stated that bonds payable declined primarily as a result of refundings and bond issuance declined as a result of the agency's participation in the NIBP program. Mr. Weinstock also noted that there are unused proceeds in the student loan program and that if any funds remain in the student loan program on May 11, 2012, the agency will have to use those funds to redeem bonds on August 1, 2012.

Mr. Weinstock discussed the Statement of Revenues, Expenses, and Changes in Net Position, which is on page 14 of the Audit and Governance Committee Book, and explained that, as previously noted, the term "Net Position" was previously "Net Assets." Mr. Weinstock referenced a schedule on page 30 that demonstrates the net position changes from 2008-2011. Mr. Weinstock explained that the chart demonstrates that the amounts have remained constant, except that interest expense increased, and he explained the reason for that increase and noted that the interest rate should stabilize in future years. Mr. Weinstock then discussed page 31, which demonstrates SONYMA's net position.

Ms. Bayer asked about the loss from the early extinguishment of debt, which is evident on page 14. Mr. Weinstock explained that with the refunding, there is sometimes an accounting loss on the debt, and confirmed that the net positive from the refunding makes up for that.

Ms. Zucker then presented information on HFA, which is on page 33 of the Presentation. Ms. Zucker discussed the units financed and explained that more than half of the units were market unit rates. She further explained that the agency was able to create more affordable units because of subsidy support and that the number of affordable units appears lower because there was a lot more activity than usual in December 2011, which does not get included in the fiscal year calculations. Ms. Zucker then reviewed the Projects Financed, which appears on page 34 of the Presentation.

Mr. Weiss asked whether Ms. Zucker had any information on the use of volume cap. Ms. Zucker stated that she does not have that information. Mr. Weiss explained that there have been arguments made about the use of volume cap for 80/20 and it would be helpful to understand how the volume cap is being used and if there has been excess. Elaine McCann and Ms. Zucker stated that they would attempt to get that information.

Mr. Weiss then asked how the usage of the NIBP program compares to other states, in particular to the extent that there was unused NIBP. Ms. Zucker stated that New York was one of the first states to fully deplete their single-family allocations. Mr. Weiss asked how that was allocated to the states. Ms. Zucker stated that she did not have that information but that the agencies, SONYMA and HFA, had requested more but did not receive it.

Ms. Hounsell discussed the HFA Audited Financial Statements. She noted that in Executive Session, the committee discussed an internal control matter cited by the

auditors as a significant deficiency. Mr. Valella stated that the Board is aware of the matter and that it did not need to be discussed in depth. Ms. Hounsell said that the committee could address questions on this issue to the external auditors during their presentation.

Mr. Weinstock then discussed the HFA Financial Statements, focusing on the MD&A. Mr. Weinstock noted that the agency's overall financial position remains strong and mortgage receipts have been sufficient to pay the debt service due. He also stated that consistent with prior years, mortgage loans receivable are the agency's primary asset. Further, Mr. Weinstock stated the bonds payable represent the agency's primary liability. Mr. Weinstock then reviewed the Statement of Revenues, Expenses, and Changes in Net Position in the Board book. Mr. Weinstock explained that the agencies' net assets declined, primarily as a result of funding of subsidy loans and increased liability for post-employment retirement benefits and a one-time $3.5M payment made to the state. Further, Mr. Weinstock noted that due to lower interest-rates provided by NIBP, there was less of a need for subsidy loans in 2011 compared with 2010. He stated that the largest components of income and expense are interest income and interest expense, which is demonstrated on page 36 of the Presentation.

Mr. Weiss asked about the decrease of subsidy loans dispersed. Mr. Weinstock explained that this decrease was because there was less need for subsidy loans this year because of the NIBP program, which provided lower interest-rates so the mortgages were able to be closed with less of a subsidy requirement.

Mr. Weinstock reviewed page 37 of the Presentation, which shows the growth of the Affordable Housing Resolution since it was put into effect in 2008. Mr. Weinstock stated that it has grown in the amount of interest income and interest expense proportionally to the agency.

Mr. Weinstock then reviewed the financial statements of MBBA. He stated that during the past two years, for the first time since 2003, MBBA issued bonds. Mr. Weinstock stated that the proceeds from the bonds were used to purchase general obligations of participating municipalities, and this is recorded as "bonds purchased" on the balance sheet. Further, Mr. Weinstock stated that MBBA reports a deficit resulting from the accounting treatment of bond premium, and the fees received by MBBA increased as a result of ongoing regular fees that are coming in from the new bond issues and a one-time fee received by MBBA relating to the TSFC refunding. However, in response to a question, Mr. Weinstock noted that although TSFC is a subsidiary of MBBA, the agencies' financial statements are not consolidated.

Mr. Weinstock reviewed the TSFC financial statements. He stated that during the past year, TSFC issued refunding bonds to refund a portion of the 2003 A & B bonds. The issuance resulted in an accounting gain. Mr. Weinstock also stated that no funds were distributed to the state and the agency had sufficient funds to pay the debt service on its related bonds. Mr. Weinstock then reviewed page 41 of the Presentation, which shows the MSA receipts compared to payments to bondholders.

Mr. Bialo asked about the difference between the actual debt service line, which includes the turbo payments, and the scheduled debt service line. Mr. Weinstock stated that the difference is the inclusion of the turbo payments.

The agencies' external auditors from Ernst & Young then gave their presentation. David Milkosky, the Coordinating Partner on the engagement, began the presentation for Ernst & Young and introduced the other members of the Ernst & Young group. Mr. Milkosky reviewed the audit results in the Presentation Booklet (the "Booklet"). Mr. Milkosky began by reviewing the deliverables on page three. He stated that all of the opinions are unqualified for the current year. Mr. Milkosky stated that the audit of AHC, which has a fiscal year end of March 31, will be conducted in April. Additionally, Mr. Milkosky stated that the single audit, which is not due until 180 days after year-end, is currently being done and Ernst & Young expects that all deadlines will be met. Mr. Milkosky then stated that all other required reports have been completed or will be completed at the same time as the single audit.

Mr. Milkosky then provided a brief overview of the areas that Ernst & Young spent a significant amount of time on during their audit. The amount spent on IT time was more than 300 hours and the total audit hours for all the entities were more than 2,000 hours. Mr. Milkosky also explained that the firm Mitchell & Titus assisted on the audit.

Mr. Milkosky then explained that Ernst & Young spent time on validating the mortgage and loans receivables, ensuring compliance with the Public Authorities Law of 2009, and on bond rating considerations. He noted that with regard to bond ratings, the need to replace credit enhancers is occurring across all public-sector entities. Mr. Milkosky explained that this is important from an audit perspective because if the credit enhancement times out in the next ensuing audit year, then some of the bonds need to be classified as short term versus long term. Mr. Milkosky stated that there are no issues in this area.

Mr. Milkosky also noted that nothing changed in the firm's audit approach from when the original audit approach was designed, and the firm is constantly looking at risk areas during the course of the audit but everything stayed effectively the same during the course of the year and there were no unrecorded audit differences identified.

With regard to required communications, Mr. Milkosky explained that all of the agencies' and Ernst & Young's responsibilities were met. Additionally, Mr. Milkosky explained that there were no agency policies that were significantly different from standard professional practice requirements, and there were a number of bond offerings issued during the course of the year, which Ernst & Young reviewed.

Mr. Milkosky then explained that after the issuance of two new GASB statements, Ernst & Young worked to ensure that the standards discussed in those statements were implemented properly. Additionally, Mr. Milkosky explained that Ernst & Young

ensured that all accruals and reserves across all the entities were proper, and that Ernst & Young used outside service agencies to make sure that the assumptions that were used were proper assumptions. Mr. Milkosky then stated that: there were no significant differences with management, there were no unrecorded misstatements and there was a standard representation letter that management has, there were no independence matters to report, there were no fraud issues, there were no material weaknesses in internal accounting controls, and there were no other findings.

Louis Roberts then discussed the audit results by area and by key risk identifiers. Mr. Roberts explained that pages 11-12 of the Booklet highlighted where the firm spent a lot of its time and on which areas it focused. Mr. Roberts stated that the firm had communicated these areas to the committee in the fall when they discussed the audit plan, and there were no changes in approach to the audit since then. Further, Mr. Roberts stated that the firm had no difficulties in conforming to the established audit procedures. He then explained that page 13 of the Booklet explained the effects on the agencies of a new GASB pronouncement dealing with termination provisions with respect to derivatives.

Mr. Roberts then discussed page 14, which deals with fraud considerations and how fraud would be identified and validated. He reported that there were no issues with fraud.

Mr. Milkosky then reviewed the Schedule of Investments document. He explained that there was one significant deficiency that was noted related to loan participation agreements, although it was not a material weakness. Mr. Milkosky explained that the fix for this issue is more communication between departments relating to entering into and severing agreements.

Mr. Weiss then asked when this issue occurred. Mr. Milkosky explained that the agreements are written by project, and when that project is complete, generally the developer will work out its separate loan with a private provider and sever the loan agreement with HFA. Mr. Weiss asked, in terms of providing notice, what could be done to facilitate more internal communication. Mr. Valella stated that the Legal Department can now provide this information because they are now aware that this recording pattern is being used.

Mr. Weiss then asked how Ernst & Young determined that this issue was not "material," though they had determined that it was a "significant deficiency." Mr. Milkosky explained the process and the regulations that govern Ernst & Young's reporting. He explained that based on these regulations, this issue could not be classified as just a "deficiency" because its size made it a material disclosure item.

Barry Sears, the IT lead for the financial audit, then reviewed Ernst & Young's IT strategy. He explained that the focus of IT is on the financial systems that support the financial audit, which consist mainly of three internal and one external system. Mr. Sears explained that the IT work focuses in two areas: change management and security. He explained that with regards to the security of the system, the work involves monitoring

who gets what access, how users to the system are administered, and creating sustainable systems. Further, Mr. Sears explained that IT works with the audit team to do substantive work as well, for example, ensuring that no one enters the system to change any information and is then able to hide the changes that were made. Mr. Sears stated that based on the IT department's testing of the system, they can be fairly sure this did not happen and can reasonably express assurance that the systems are appropriately controlled.

Aida Brewer tasked whether the systems are home-grown or off-the-shelf systems, whether they are old or relatively new, and whether they have audit fields in them for people who went in and might have affected the data. Mr. Seves replied that the systems are a mix. He explained that the third-party system is ADP, a vendor primarily used for payroll, and that none of the observations were in that particular area. In addition, Mr. Sears explained that IT uses FoxPro and two homegrown systems – one for SONYMA and one for mortgages.

Mr. Milkosky then reviewed the status of prior-year recommendations. He noted that management either has remediated or is in the process of remediating all of the prior-year comments. He noted that the one issue that will take some time is the Accounting Policies and Procedures manual.

Ms. Bayer then asked whether they are progressing appropriately on all the items and Mr. Milkosky stated that they are.

Mr. Lebowitz then raised the issue of consolidating the financial statements of TSFC and MBBA because TSFC is a subsidiary of MBBA. He asked to what extent Ernst & Young has considered consolidating these statements. Mr. Milkosky replied that from a leading practice perspective, separating the financial statements is a typical set-up for government agencies and he has not seen any movement to consolidate the financial statements of different entities. Mr. Milkosky stated that this is so because the component units are part of various different state coffers and have separate purposes. Mr. Milkosky further noted that there is no downside to consolidating, but it is usually not done because of state direction and because of decisions by the State Comptroller. Various members agreed that there was no reason to change the system and Mr. Milkosky stated that it would not be possible to make the change without statutory direction because under state law, they are all legally distinct entities.

Vice Chairman Bialo moved to adopt the resolution; Ms. McCann seconded the motion, and the following resolution was adopted unanimously:

A RESOLUTION OF THE NEW YORK STATE HOUSING FINANCE AGENCY, STATE OF NEW YORK MORTGAGE AGENCY, STATE OF NEW YORK MUNICIPAL BOND BANK AGENCY AND TOBACCO SETTLEMENT FINANCING CORPORATION AUDIT COMMITTEES AUDITED FINANCIAL STATEMENTS FOR FISCAL YEAR 2011

The next item on the agenda was an information item regarding the Sixth Annual Evaluation by the Audit Committees. Ms. Bayer explained that there is a questionnaire in the packet that needs to be filled out by the Members, and that it should be returned before the next Board meeting. Sue Mookram confirmed that she would ensure the questionnaires were e-mailed to everyone along with the deadline.

There being no unfinished business, Vice Chairman Bialo moved to adjourn; Ms. McCann seconded the motion, and the meeting was adjourned at 1:25 p.m.

Secretary