INTEROFFICE MEMO

DATE: OCTOBER 23, 2003

TO: RUTH RODRIGUEZ, DIRECTOR, COMMUNITY SERVICES
KEVIN MARCHMAN, EXECUTIVE DIRECTOR, HOUSING AUTHORITY

FROM: VELMA NAVARRO, DIRECTOR OF FINANCE, HOUSING AUTHORITY
JOHN LOWRY, CONSULTANT, CVR

RE: SUMMARY OF ANALYSIS OF CASH SHORTFALL

Per your request, we have reviewed the audited Financial Statements for the years ending December 31, 1999 through 2002, with the goal of determining the cause of the current cash shortfall for the Boulder County Housing Authority (BCHA). The following information is contained within the BCHA Annual Reports for the fiscal years ended 1999 through 2002. The information contained in the Annual Reports is simply a reiteration of totals contained in the combined statements of the audited, annual Financial Statements for the corresponding years. The combined statements represent totals for all BCHA funds, and were the basis of our analysis.

Executive Summary

BCHA has been dependent on Boulder County to cover the last few months of payroll, and does not have adequate cash to pay the County for these expenses. What we have found is that there are not one or two major causes that we can pinpoint for this shortage. Instead, we have determined that the lack of management and financial control over cash expenditures, capital acquisitions and debt administration has led to the lack of adequate cash reserves to cover operations, future debt service, and other BCHA financial obligations.

It is clear to see that the combination the following have all contributed to the cash shortfall that BCHA is experiencing today:

- A significant increase in acquisitions beginning in 2000,
- The rise in debt and associated interest cost,
- The use of operating cash to fund capital acquisitions,
- A rise in non-routine maintenance associated with new acquisitions, and
- A steady increase in staffing from 1999 through 2001 (9 new positions).

There seems to have been an attitude that affordable housing should be provided at any cost.

The following Historical information shows that as of December 31, 2002, BCHA had a negative cash position on the audited balance sheet, a current ratio of .49, and net working capital of negative $619,000, clearly indicating that the organization was insolvent. It also shows the financial condition was not strong when the Authority began the process of Acquisitions and Development which began in earnest in 2000. The financial impact of the Powell and Meadows acquisition in 2000 and requisite build out of the infrastructure of the property provided the final straw. This obvious cash short fall could have been stretched out for a few more months if interim financing received on this property had been enough to cover all of the associated costs. It was not, therefore, and an estimated $605,000 was spent from operating reserves, including approximately $328,000 in the year 2003 which brought the cash issues to the forefront. This is not to say that Powell and Meadow should be the only area of concern. This situation points out the need to change the priority of acquisitions and development to include what effect these activities have on operations.

The BCHA staff will have to take assertive steps towards bringing the cash and reserve position, including current ratio, debt ratio, and working capital to the appropriate industry standard levels. The staff will begin the process of implementing appropriate financial controls and cash management policies that will facilitate this new outlook. In addition, BCHA will be looking to at least three areas to assist in bringing in cash that include:

- Refinancing of the debt portfolio,
- Selling properties that provide a financial drag on the Authority, and
- Changing the business focus from acquisition to operations.

To accomplish this BCHA will need assistance of the BOCC.

Our analysis will be presented in the following categories:

- Historical Review
- Powell Shortfall

Historical Review

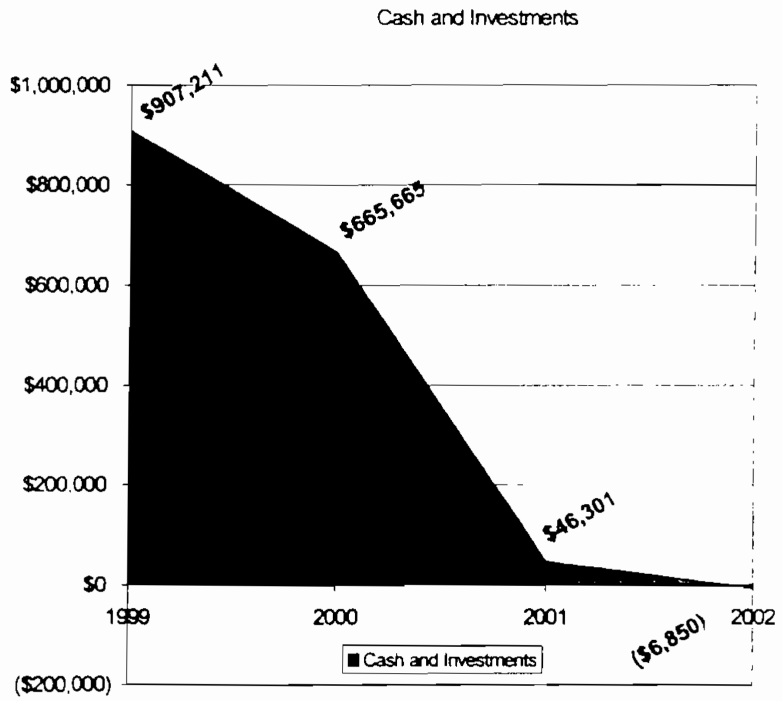
We have examined the Combined Balance Sheets and Combined Statements of Revenue, Expenses and Changes in Retained Earnings for each of the four years ending December 31, 1999 through 2002. We conducted a comparative analysis among the four years, searching for trends and/or significant changes that may provide some direction in uncovering the cause of the current cash shortage experience by BCHA.

The major areas we will present include:

- Cash and investments
- Current Assets compared to Current Liabilities (Current Ratio/Net Working Capital)
- Cash Reserves
- Debt
- Staffing

Cash and Investments

The following graph shows the decline of cash and investment balances for BCHA over the last four years, as presented on the BCHA audited Combined Balance Sheets from the years ending December 31, 1999 through 2002;



This is a clear indication of the time in which the BCHA has begun to experience problems. Some of the reasons for this rapid decline in cash and investments are explained in the following categories.

Current Assets Compared to Current Liabilities (Current Ratio/Net Working Capital)

In order to determine how quickly BCHA is able to access cash, we have analyzed current assets compared to current liabilities to derive the liquidity ratios over the last four years. The following table summarizes our findings;

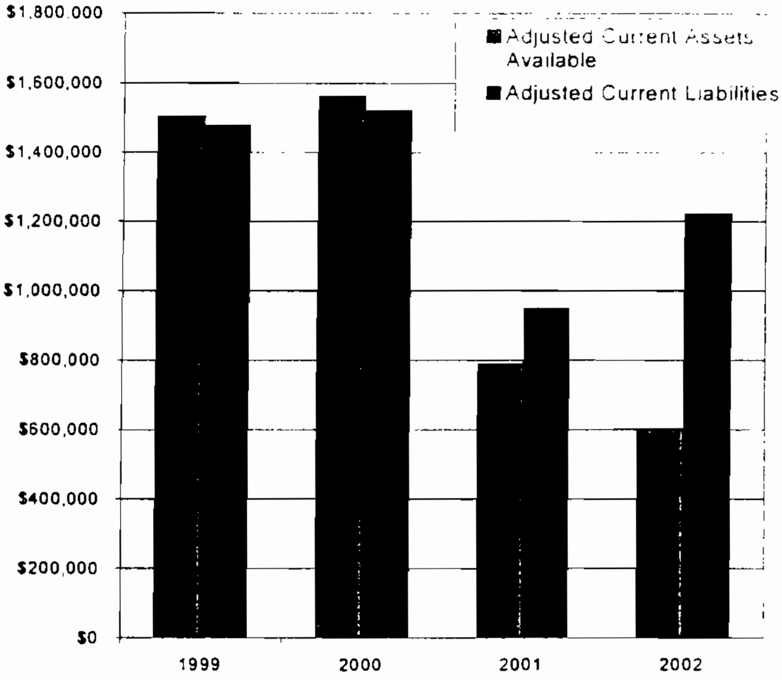
	1999	2000	2001	2002
Current Ratio/Adjusted Current Ratio:				
Current Assets	**$ 4,215,206**	**$ 3,764,915**	**$ 3,062,381**	**$ 3,204,663**
Less restricted Cash, to be used for specific purposes	651,103	864,802	895,141	1,145,032
Less Due From Other Funds	1,475,548	773,378	832,933	932,349
Less Bond Issuance Costs (Non current)	585,560	565,265	544,966	524,673
Adjusted Current Assets Available	**$ 1,502,995**	**$ 1,561,470**	**$ 789,341**	**$ 602,609**
Current Liabilities	**$ 2,954,390**	**$ 2,293,890**	**$ 1,780,892**	**$ 2,154,351**
Less Due to other Funds	1,475,548	773,378	832,933	932,349
Adjusted Current Liabilities	**$ 1,478,842**	**$ 1,520,512**	**$ 947,959**	**$ 1,222,002**
Adjusted Current Ratio	**1.02**	**1.03**	**0.83**	**0.49**
Non Adjusted Current Ratio	**1.43**	**1.64**	**1.72**	**1.49**

The amounts on this table were taken from the BCHA Combined Balance Sheets for each of the years ending December 31, 1999 through 2002.

Current assets include assets that can be turned into cash or used in the next 12 months, such as cash and investments and accounts receivable. Adjusted current assets represent the true current assets of BCHA, as due from other (internal) funds and bond issuance cost amortization have been eliminated.

Current liabilities include BCHA obligations that will come due over the next 12 months. Adjusted current liabilities represent the true current liabilities of BCHA, as due to other (internal) funds has been eliminated.

The adjusted current ratio in this table is a true indication of BCHA's liquidity.



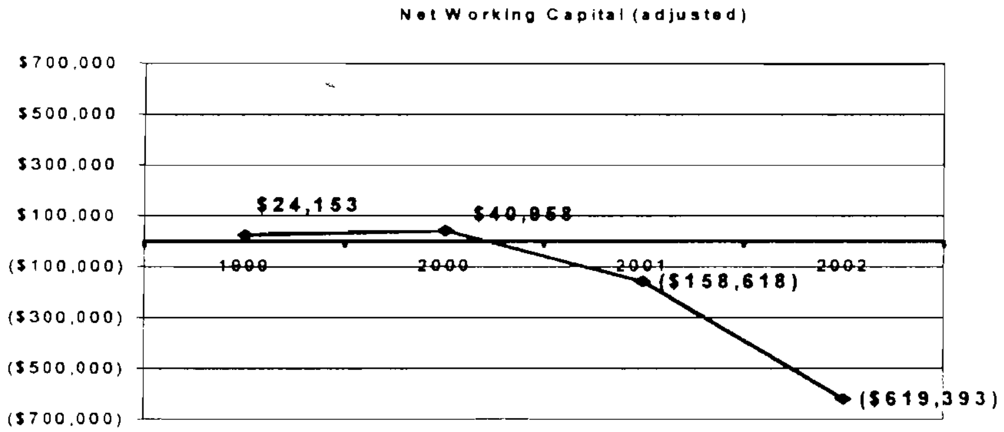
Adjusted Current Ratio	**1.02**	**1.03**	**.88**	**.49**

Current ratio is a common industry measure of financial strength and liquidity. Current ratio should be at least 2 and preferably 3 or higher. A ratio of 1.5 or below is a red flag, while a ratio of 1 or below indicates insolvency.

The adjusted current ratio depicted above represents the adjusted (true) current assets over adjusted (true) current liabilities. As you can see, BCHA's assets have experienced a downward trend, while current liabilities have decreased at a slower rate from 1999 to 2001 and actually increased in 2002. As a result, the current ratio has not been maintained at an adequate level. We recommend that BCHA focus on increasing cash reserves and other current assets while decreasing liabilities until liquidity levels are at a 2 or above.

Another common measure of liquidity is net working capital, which simply represents the current assets less the current liabilities. Net working capital roughly measures the potential reservoir of cash.

BCHA's adjusted (true) net working capital over the last four years is illustrated below:



Cash Reserves

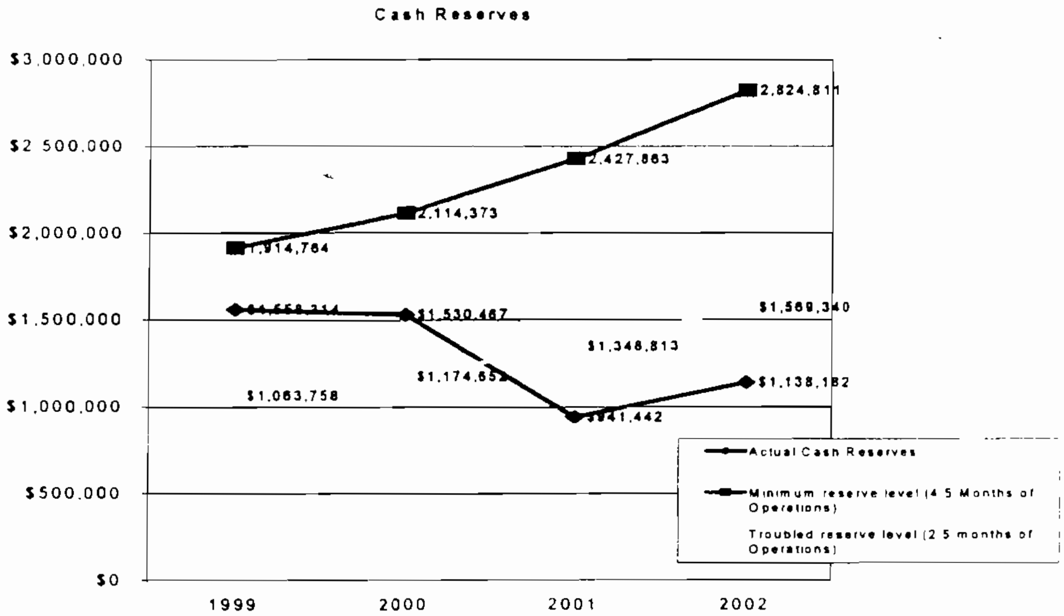
The levels of cash reserves and annual operating costs for the last four years are depicted in the table below:

Actual Cash Reserves	**1999**	**2000**	**2001**	**2002**
Cash and Investments	$ 907,211	$ 665,665	$ 46,301	$ (6,850)
Restriced Cash	651,103	864,802	895,141	1,145,032
Total Cash	**$ 1,558,314**	**$ 1,530,467**	**$ 941,442**	**$ 1,138,182**
Annual Operating Costs	$ 5,451,679	$ 6,068,011	$ 6,978,882	$ 8,081,714
Less Depreciation/Amortization (non cash)	345,642	429,682	504,582	548,884
Total Operating Costs	**$ 5,106,037**	**$ 5,638,329**	**$ 6,474,300**	**$ 7,532,830**
Minimum reserve level (4.5 months of Operations)	$ 1,914,764	$ 2,114,373	$ 2,427,863	$ 2,824,811
Percentage of Reserves to Recommended	**81%**	**72%**	**39%**	**40%**

The amounts on this table were taken from the BCHA Combined Balance Sheets for each of the years ending December 31, 1999 through 2002.

This table shows that the cash reserves have been declining over the last four years. We believe that the standard for future reserve levels should be set at the HUD standard of at least 4.5 months of operating expenses. Cash reserves of 2.5 months of operating expenses or below are the industry indicator for a troubled housing authority, by HUD standards.

The following graph shows actual cash reserves compared to the recommended reserve level of 4.5 months of operations and the troubled reserve level of 2.5 months of operations;



BCHA cash reserves were well below the 2.5 percent threshold at the end of 2002.

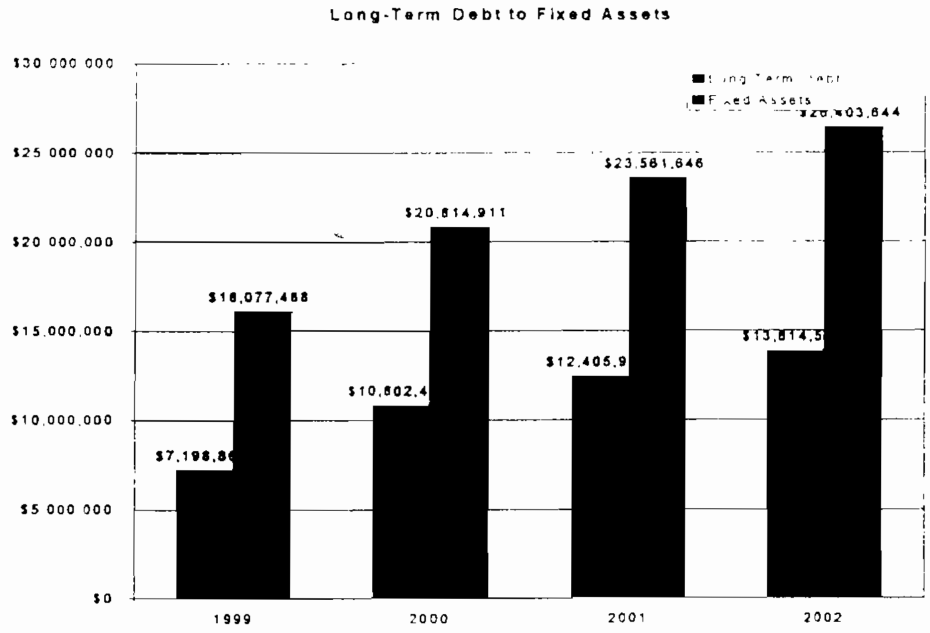
<u>Debt</u>

We analyzed and compared the increase in debt with the increase in long-term assets, over the last four years. The following table summarizes the results;

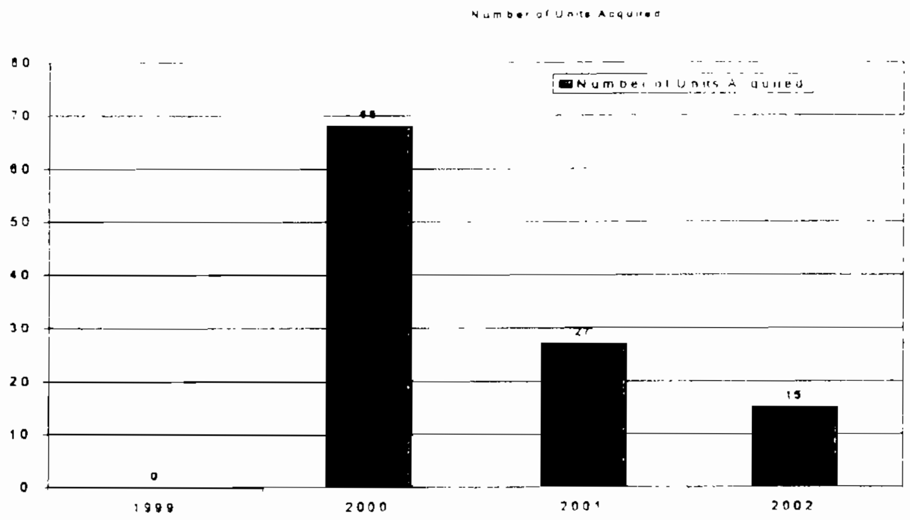
	1999	2000	2001	2002
Long Term Debt	$ 7,198,866	$ 10,802,416	$ 12,405,998	$ 13,814,556
Increase (Decrease) from Previous Years	**(1,559,874)**	**3,603,550**	**1,603,582**	**1,408,558**
Fixed Assets	16,077,488	20,814,911	23,561,646	26,403,644
Increase (Decrease) from Previous Years	**1,668,176**	**4,737,423**	**2,746,735**	**2,841,998**
Difference of Debt to Assets	108,302	(1,133,873)	(1,143,153)	(1,433,440)
Grants (Combined Cash Flow Statement)	586,009	1,102,196	882,086	1,077,100
Estimated Funded from Operations	**$ 694,311**	**$ (31,677)**	**$ (261,067)**	**$ (356,340)**

The amounts on this table were taken from the BCHA Combined Balance Sheets for each of the years ending December 31, 1999 through 2002.

The trend in the increase in debt compared to the increase in long-term assets is depicted in the following graph:



The number of units acquired from 1999 to 2002 is shown below:



The surge in the number of units acquired in 2000 has contributed to the cash reserves shortage in a number of ways. Debt service, including interest expense is significantly higher. Operations and maintenance costs are also higher, as well as the need to use operating cash for capital acquisitions.

According to Note 6: LONG-TERM DEBT that is included in the audited General Purpose Financial Statements of the Housing Authority of the County of Boulder for the year ended December 31, 2002 (performed by Swanhorst & Cutler, LLC), the "future principal payments for the Authority's Notes and Mortgage Loans are as follows:

Year ended December 31,	
2003	$ 306,918
2004	1,156,503
2005	2,409,860
2006	2,427,763
2007	1,067,008
Thereafter	1,958,422
Total	$ 9,326,474

This table is found on page 16 of the audited Financial Statements for BCHA, as indicated above.

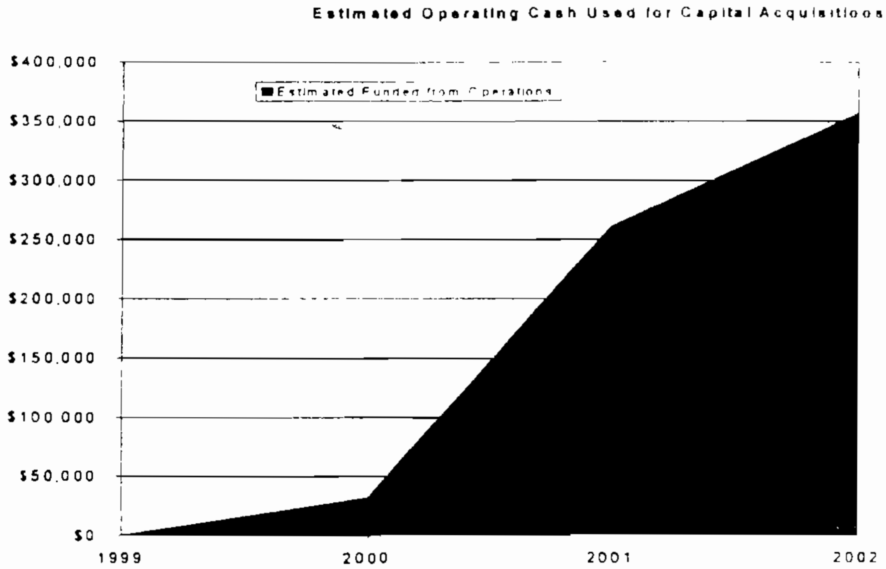
According to the auditors' report, the funds needed to cover debt service in the next few years are substantial, and represent levels that are 4 to 8 times the magnitude of current debt service levels. This is future obligation of cash is due to the considerable amount of debt BCHA was obligated to cover over the last few years. These amounts represent principle only, and do not include interest.

The portion of assets that is not covered by new debt financing has either been funded via grants or with operating cash. The following table shows the estimated portion funded with each of these sources.

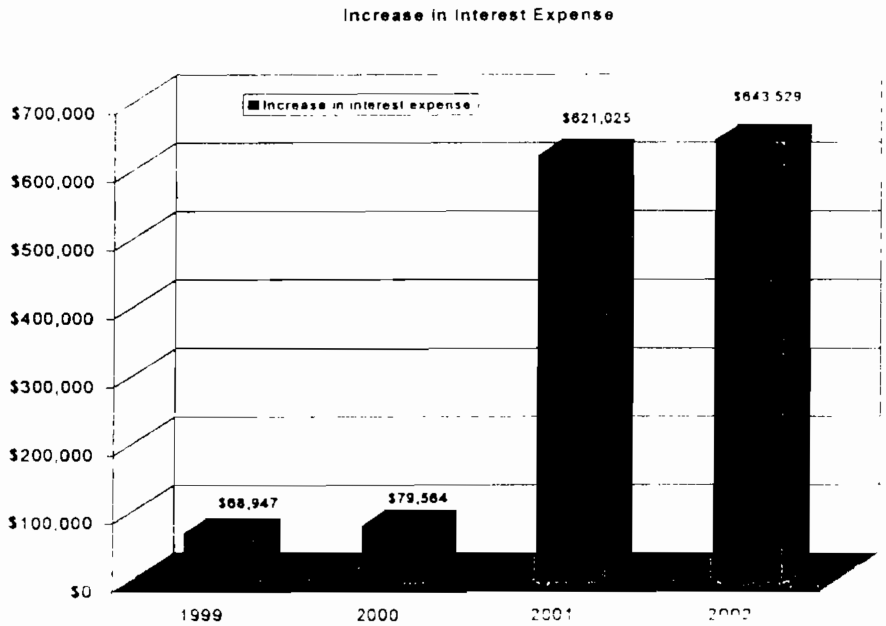
	1999	2000	2001	2002
Difference of Debt to Assets	$ 108,302	$ (1,133,873)	$ (1,143,153)	$ (1,433,440)
Grants (Combined Cash Flow Statement)	586,009	1,102,196	882,086	1,077,100
Estimated Funded from Operations	**$ 694,311**	**$ (31,677)**	**$ (261,067)**	**$ (356,340)**

Based on data obtained from the BCHA Combined Balance Sheets for each of the years ending December 31, 1999 through 2002.

Beginning in 2000, operating cash was being used to fund capital acquisitions, and the estimated amount has increased significantly each year. The pattern of this increase is consistent with the pattern of the cash shortfall depicted earlier. Thus, it is safe to say that operating cash reserves have been adversely affected by capital acquisitions, as depicted in the graph below.



Due to the sizeable increase in debt from 2000 to 2002, interest expense has increased significantly over that same period. This increase has also had a considerable, negative effect on operating cash reserves.



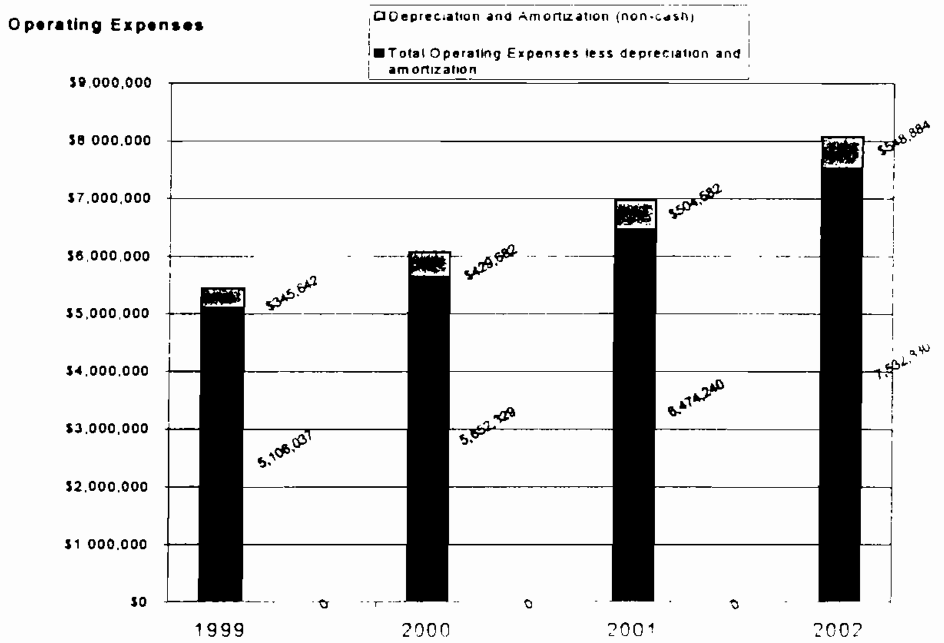
Staffing

A historical view of BCHA's increase in staffing levels is depicted in the following table:

	1999	2000	2001	2002
Total increase in number of positions for corresponding year only	3	3	3	0
Number of Staff at beginning of period	33	36	39	42
Total positions funded by BCHA	36	39	42	42
Percentage increase	9.09%	8.33%	7.69%	0.00%
Estimated annual dollar increase since 1998 (not including increases for merit, bonus, etc.)	$ 59,300	$ 141,512	$ 175,773	$ 230,012

The annual increase in positions for BCHA were provided by Boulder County Human Resources. This data represents the staff funded by BCHA only.

The increases in staffing levels over the four-year period from 1999-2002 have affected operating expenditures and available cash. The following table shows the increase in operating expenses over the last four years. The increased staffing is included in these totals.



	1999	2000	2001	2002
Total Operating Expenses (in millions)	**$5.45**	**$608**	**$6.98**	**$8.08**

The amounts depicted in this table were taken from the BCHA Combined Statements of Revenue, Expenses and Changes in Retained Earnings for each of the years ending December 31, 1999 through 2002

Powell Shortfall

As we discussed earlier, the level of acquisitions has risen to the point of increased debt and an operating cash shortage beyond sustainable levels. The acquisition of the Powell building represents a significant portion of that burden. Powell was acquired for approximately $1.56 million in 2000. Our analysis resulted in projected total operating cash outlays incurred by BCHA of approximately $605,000, of which approximately $328,000 will be expended in 2003.

Again, by changing the business focus from acquisitions and development to operations, BCHA can turn itself around and bring the cash balances, reserves, current ratio, debt ratio and net working capital to the industry standard levels outlined throughout this memo. Immediate changes are needed in order to make this happen.