OREGON DEPARTMENT
*of* VETERANS' AFFAIRS

# VETERANS' LOAN PROGRAM ANNUAL FINANCIAL REPORT

ENTERPRISE FUND FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

# Annual Financial Report

## Veterans' Loan Program

## Enterprise Fund of the
## Oregon Department of Veterans' Affairs

*An Agency of the State of Oregon*

**For The Fiscal Years Ended**
**June 30, 2014 and June 30, 2013**


**Cameron Smith**
Director

**Bruce Shriver, CPA**
Chief Financial Officer

**Report Prepared By**

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With the assistance of the
Financial Services Division,
Facilities Services Division,
Veterans' Services Division,
and Public Information Section

Cover Design: Nicole Hoeft, Public Information Section

# TABLE OF CONTENTS

## *INTRODUCTORY SECTION*



## *FINANCIAL SECTION*



## *STATISTICAL SECTION*



## *OTHER REPORTS*

# *INTRODUCTORY SECTION*

Oregon
John A. Kitzhaber, MD, Governor

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October 29, 2014

To the Honorable Governor John A. Kitzhaber, M.D. and Citizens of the State of Oregon:

We are pleased to provide you with the Annual Financial Report of the Oregon Department of Veterans' Affairs *(the "Department")* Loan Program Enterprise fund, for the fiscal years ended June 30, 2014, and June 30, 2013.

This report is organized and presented in four sections. The **Introductory Section** includes this transmittal letter and an organizational chart. The **Financial Section** includes the independent auditor's report, management's discussion and analysis, the financial statements and accompanying notes. The **Statistical Section** includes selected financial and programmatic information, much of which is presented on a multi-year basis. The **Other Reports** section includes the independent auditor's report on compliance and internal control over financial reporting.

Department management assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

The Oregon Secretary of State Audits Division audited the Department's Loan Program Enterprise Fund for the years ended June 30, 2014 and June 30, 2013. Their unmodified opinion on the Enterprise Fund financial statements is included in the Financial Section of this report.

Management's discussion and analysis *(MD&A)* immediately follows the independent auditor's report and provides a narrative introduction, overview and analysis of the basic financial statements. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it.

## OREGON ECONOMY

***Recent Trends –*** According to the September 2014 Oregon Economic and Revenue Forecast from the Oregon Office of Economic Analysis *(OEA)*:

> The U.S. economic recovery remains intact and may finally be exhibiting signs that growth is picking up as job gains across the country are now on pace to be the strongest since 2000. Oregon's employment growth has accelerated sharply over the past year and a half. The state is now adding jobs about one

percentage point faster than the nation, a differential growth advantage Oregon typically enjoys during economic expansions.

Along with more job opportunities come more individuals in search of employment. In the past nine months, Oregon's labor force has increased and added back nearly a quarter of the labor force losses it suffered following the financial crisis. As the labor force increases, it places upward pressure on the unemployment rate, but for a good reason. Even with the stronger job gains, the state's unemployment rate has remained unchanged in 2014.

As the economy continues to improve, an increasing amount of attention is being paid to the Federal Reserve and future path of monetary policy. If economic slack remains, further accommodative monetary policy makes sense, since temporary support has the potential to prevent permanent damage to our productive capacity. Alternatively, if the economy is once again firing on all cylinders, monetary policymakers should turn their attention to fighting inflation rather than supporting growth. A stronger recovery, should it come to fruition, draws the economy closer to full employment and the Fed and monetary policy will take center stage.

***Outlook***

Job growth in Oregon continues to remain relatively strong in 2014 and the outlook is for this growth to persist for two to three years before longer-run demographic trends weigh on growth rates. The character of the forecast remains the same as three months ago, with employment growth rates unchanged through 2016 and small downward revisions to the out years. Job growth in the recent months has tracked the forecast well and the acceleration the state experienced in 2013 is holding steady so far in 2014. With that being said, this economic expansion does not reach the rates of growth Oregon is accustomed to based on previous expansions. During the 1990s, employment grew at over 3 percent per year. During the housing boom, Oregon averaged nearly 2.5 percent over the expansion. So far in the aftermath of the Great Recession, Oregon has averaged just 1.8 percent job growth and the forecast calls for peak growth rates of 2.5 percent over the 2014-2016 time frame.

As the economy continues to improve it will help drive up demand for new houses as household formation increases. Household formation has remained suppressed as individuals and families turned to rental markets and doubled up during the recession. As these individuals find work in an improving economy, their desire to live on their own or away from their parents will lead to increased housing demand. Much of the increase in young Oregonians living at home can be attributed to higher college enrollments. As the Millenials continue to age beyond their early 20s, demand for housing (both rental and ownership) will increase further.

Housing starts in the second quarter totaled nearly 17,000 at an annual pace, however recent construction trends in the industry are running at nearly 14,000 annualized. Recent data reflects a one-time, large increase in multi-family starts in the Portland MSA, above and beyond typical trends in recent years. Regardless, a level of about 21,000 is the long-run average for the state prior to the housing bubble, and the forecast calls for strong growth in the coming few years with starts reaching 16,600 in 2015 and 20,200 in 2016. Over the extended horizon, starts are expected to average a little more than 23,000 per year to meet demand for a larger population and also, partially, to catch-up for the underbuilding that has occurred in recent years. As of today, new home construction is cumulatively about one year behind the stable growth levels of prior decades even after accounting for the overbuilding during the boom.

## MAJOR INITIATIVES

***Current Service Efforts and Accomplishments -*** Article XI-A of the Oregon Constitution outlines the broad duties of the Department. The primary Oregon Revised Statutes (ORS) governing the Department are Chapters 406 through 408.

The ***Veterans' Loan Program*** provides home loans to Oregon veterans at favorable interest rates. Both federal and State laws govern eligibility requirements on who may receive a veterans' home loan. As of June 30, 2014, this Program had approximately 1,934 mortgage loans and contracts outstanding, with a principal balance of approximately $215 million.

The 2014 Oregon Legislature passed House Bill 4025 which clarified the maximum loan limits contained in ORS 407.205 were applicable on a per loan basis rather than a cumulative loan basis for each veteran. This action increases the amount a veteran can borrow if the veteran applies for more than one loan from the Department over his/her lifetime.

The 2013 Oregon Legislature passed legislation which helped broaden veteran participation in the Home Loan program. Senate Bill 34 was passed which now allows a veteran to receive up to four home loans during his or her lifetime, although only one loan may be outstanding at any one time. The previous lifetime loan limit was up to two loans. This change was made primarily to help accommodate those veterans that had to relocate a number of times during their career due to employment changes and also for those veterans whose lifestyle needs may have changed. In addition, Senate Bill 35 was also passed which facilitates the Department being able to offer Federal VA loans. On this type of home loan, the Federal VA “guarantees” a portion of the loan made to a veteran similar to how mortgage insurance works. The Department is still studying whether to initiate making Federal VA loans and the timing of implementation. However, without the aforementioned legislative change, the Department would not be in a position to consider offering Federal VA loans to Oregon’s veterans.

## FINANCIAL INFORMATION

***Enterprise Fund -*** The Veterans' Loan Program is an enterprise fund which is used to account for the Department’s business-type activities.

At June 30, 2014, the Veterans' Loan Program had approximately $439 million in assets and deferred outflows *(primarily consisting of cash and cash equivalents, securities lending cash collateral, and loan and contract receivables)* and approximately $313 million in liabilities *(primarily consisting of general obligation bonds and obligations arising from securities lending)*. Revenues from the Department's home loan program are primarily generated through interest on loans originated and investment income. These revenues are used to pay interest expense on outstanding debt and related program and administrative expenses.

***Debt Administration -*** The Department, with the approval of the State Treasurer's office, has authority to issue general obligation bonds to fund the home loan program. The Department's general obligation bonds are rated as part of the State of Oregon's general obligation bond program. The Department's long-term general obligation bonds are presently rated as follows:

| | |
|---|---|
| Moody's Investor Service | Aa1 |
| Fitch Ratings | AA+ |
| Standard & Poor's | AA+ |

As of June 30, 2014, the Department had approximately $274 million *(par value)* in outstanding bonds. During fiscal year 2014, no bonds were issued and approximately $18 million in bonds were retired.

***Cash Management -*** All monies collected by the Department are turned over to the State Treasurer, who is responsible for the control of cash and the investment of State funds (excluding funds held by the loan cancellation life insurance carrier). On June 30, 2014, the Department's Loan Program cash, cash equivalents *(excluding securities lending collateral),* and investments totaled approximately $201 million.

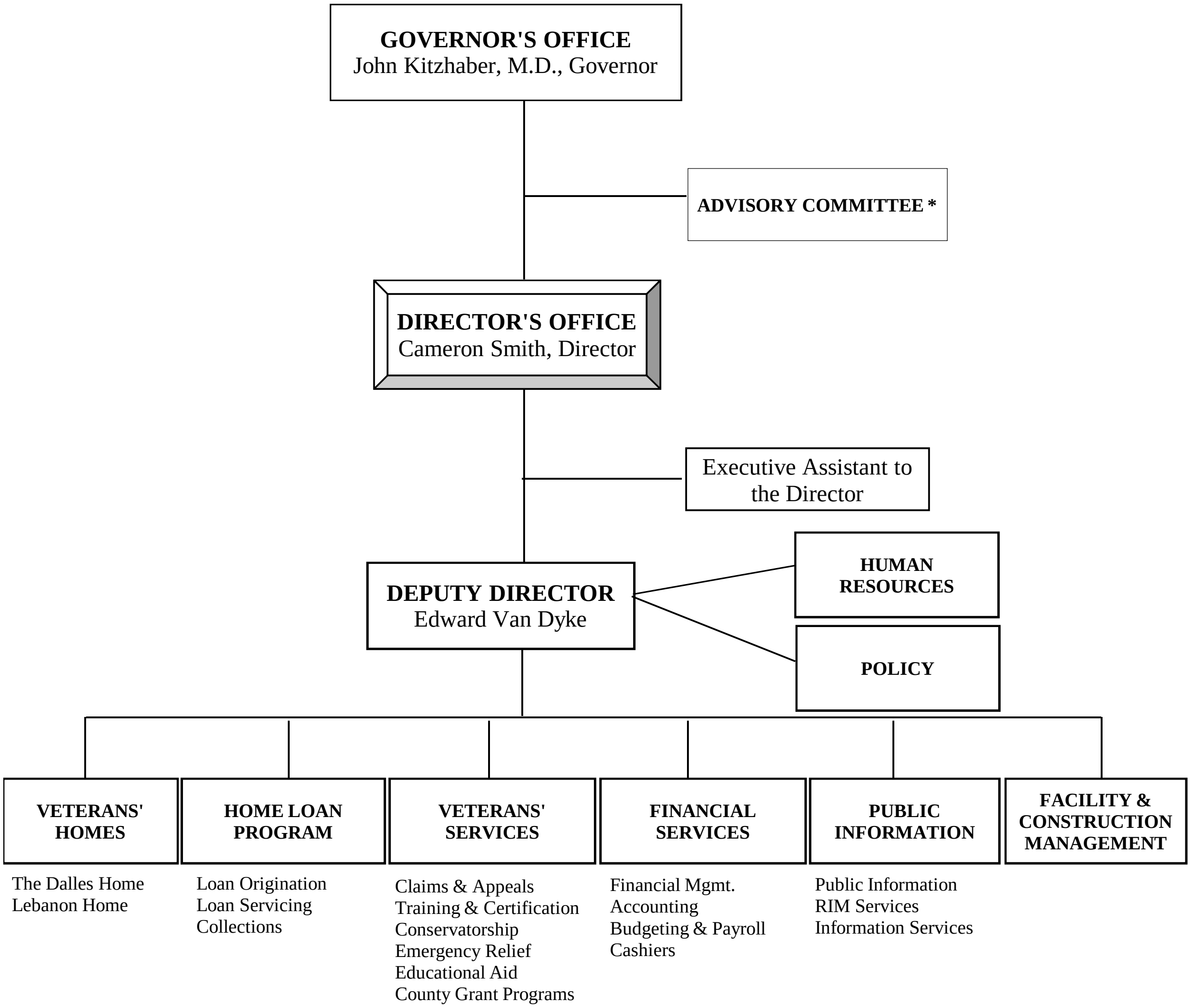
The Oregon Investment Council, of which the State Treasurer is a member, establishes investment policy for all State of Oregon funds. To further Oregon's economic growth, the Council's continuing policy has been to invest locally when investments of comparable yield, quality, and maturity can be found in state without damaging portfolio diversity. Fortunately for Oregonians, State-imposed safeguards minimize the dangers of investing in highly leveraged financial instruments that have been a cause of national concern. The State Treasurer pools all available cash into the Oregon Short-Term Fund from which investments are made in a variety of financial instruments.

***Acknowledgements -*** The preparation of this report reflects the combined efforts of the Department's staff. The professionalism, commitment, and effort of the individuals involved are very much appreciated.

Respectfully submitted,

Cameron Smith
Director

Bruce Shriver
Chief Financial Officer




* The Advisory Committee is a nine-member advisory body appointed by the Governor for four-year terms. The committee advises the Director concerning matters of the operations of the Department and issues affecting veterans and their dependents and survivors who reside in this state.

| Advisory Committee Members | Term Expires | Advisory Committee Members | Term Expires |
|---|---|---|---|
| Irv Fletcher | December 31, 2014 | Trisa Kelly | April 17, 2016 |
| Dennis Guthrie | June 30, 2016 | Gerard Lorang | March 7, 2016 |
| Al Herrera | November 30, 2015 | Mary Mayer | September 14, 2015 |
| Ryan Howell | March 7, 2016 | Kevin Owens | March 7, 2016 |
| Michael Jones | November 30, 2016 | | |

# *FINANCIAL SECTION*

**Office of the Secretary of State**

Kate Brown
Secretary of State

Robert Taylor
Deputy Secretary of State

**Audits Division**

Gary Blackmer
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## Independent Auditor's Report

The Honorable John Kitzhaber, Governor of Oregon

Cameron Smith, Director, Oregon Department of Veterans' Affairs

### Report on the Financial Statements

We have audited the accompanying financial statements of the Veterans' Loan Program, an enterprise fund of the State of Oregon, Department of Veterans' Affairs (Department), as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, as listed in the table of contents.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Veterans' Loan Program, an enterprise fund of the State of Oregon, Department of Veterans' Affairs, as of June 30, 2014 and 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 1, the financial statements of the Veterans' Loan Program are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of the Department of Veterans' Affairs that is attributable to the transactions of the Veterans' Loan Program. They do not purport to, and do not, present fairly the financial position of the State of Oregon as of June 30, 2014 and 2013, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

**Other Matters**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5-9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Department's basic financial statements. The introductory and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2014, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

Office of the Secretary of State, Audits Division

State of Oregon
October 28, 2014

State of Oregon
OREGON DEPARTMENT of VETERANS' AFFAIRS
VETERANS' LOAN PROGRAM
**Management's Discussion and Analysis**

This section of the Oregon Department of Veterans' Affairs' *(the "Department")* Loan Program Annual Financial Report presents our discussion and analysis of financial performance for the Veterans' Loan Program Proprietary Fund during the fiscal year ended June 30, 2014. The selected financial data presented was derived primarily from the financial statements of the Veterans' Loan Program, which have been audited.

**FINANCIAL HIGHLIGHTS**

| | *(In Millions)* | | | Change at June 30, 2014 | | Change at June 30, 2013 | |
|---|---|---|---|---|---|---|---|
| | 2014 | 2013 | 2012 | *(In Millions)* | Percentage | *(In Millions)* | Percentage |
| Net Position | $ 125.7 | $ 128.1 | $ 130.7 | $ (2.40) | -1.90% | $ (2.60) | -1.98% |
| Revenues | $ 12.7 | $ 13.7 | $ 15.8 | $ (1.00) | -7.22% | $ (2.10) | -13.29% |
| Expenses | $ 13.8 | $ 15.3 | $ 18.7 | $ (1.50) | -9.77% | $ (3.40) | -18.18% |
| General Obligation Bond Debt *(par value)* | $ 274.2 | $ 291.8 | $ 312.3 | $ (17.60) | -6.03% | $ (20.50) | -6.56% |
| Mortgage Loan Originations | $ 52.0 | $ 27.2 | $ 15.6 | $ 24.80 | 90.92% | $ 11.60 | 74.36% |

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the Veterans' Loan Program's basic financial statements. The basic financial statements include proprietary fund financial statements and notes to the financial statements. The Veterans' Loan Program's basic financial statements do not include department-wide financial statements since only the Veterans' Loan Program proprietary fund is audited within this Annual Financial Report. The Department does have an audited Annual Financial Report on the Veterans' Home Program and that proprietary fund and a minimal portion of governmental funds that are included in the State of Oregon Comprehensive Annual Financial Report located at. Those reports are located respectively at:

- o http://www.oregon.gov/odva/INFO/Pages/AnnualReports.aspx
- o http://www.oregon.gov/DAS/CFO/SARS/Pages/index.aspx

- The Veterans' Loan Program's proprietary fund financial statements include a major enterprise fund, which operates similarly to business activities and follow an accrual basis of accounting.

- The notes to the financial statements provide additional information essential to a full understanding of the data provided in the Veterans' Loan Program's proprietary fund financial statements.

**OVERVIEW OF THE PROPRIETARY FUND FINANCIAL POSITION & OPERATIONS**

*Assets*

Total assets at June 30, 2014 were approximately $437.0 million, a decrease of $18.6 million from June 30, 2013. The change in assets consists primarily of $36.8 million decrease in cash and cash equivalents, a $3.1 million increase in investments, and a $15.5 million increase in net loans and contracts receivable.

Total assets at June 30, 2013 were approximately $455.6 million, a decrease of $28.8 million from June 30, 2012. The change in assets consists primarily of $15.0 million increase in cash and cash equivalents, a $14.5 million decrease in investments, a $8.9 million decrease in securities lending cash collateral, and a $19.7 million decrease in net loans and contracts receivable.

*Liabilities*

Total liabilities at June 30, 2014, were $313.2 million, a decrease of $16.6 million from June 30, 2013. The change in liabilities consists primarily of a decrease of $17.6 million in bonds payable, a decrease of $1.4 million in obligations under securities lending, and an increase of $2.7 million in excess mortgage interest and arbitrage rebate liability.

Total liabilities at June 30, 2013, were $329.7 million, a decrease of $27.0 million from June 30, 2012. The change in liabilities consists primarily of a decrease of $20.5 million in bonds payable, a decrease of $8.9 million in obligations under securities lending, and an increase of $2.5 million in excess mortgage interest and arbitrage rebate liability.

*Statement of Net Position*

The Veterans' Loan Program's proprietary fund financial position and operations for the past three years are summarized below based on the information included in the basic financial statements.

**Veterans' Loan Program - Proprietary Fund**
**Statement of Net Position**

| | Business Type Activity | | |
|---|---|---|---|
| | **2014** | **2013** | **2012** |
| Assets: | | | |
| Current and Other Assets | $ 432,635,271 | $ 451,192,072 | $ 479,983,156 |
| Capital Assets | 4,334,883 | 4,423,663 | 4,463,616 |
| **Total Assets** | $ 436,970,154 | $ 455,615,735 | $ 484,446,772 |
| Deferred Outflow of Resources | $ 1,895,225 | $ 2,250,525 | $ 3,047,423 |
| Liabilities: | | | |
| Long Term Liabilities | $ 294,327,443 | $ 309,745,555 | $ 327,820,013 |
| Other Liabilities | 18,826,106 | 19,972,521 | 28,939,645 |
| **Total Liabilities** | $ 313,153,549 | $ 329,718,076 | $ 356,759,658 |
| Net Position: | | | |
| Invested in Capital Assets | $ 4,334,883 | $ 4,423,663 | $ 4,463,616 |
| Unrestricted | 121,376,947 | 123,724,521 | 126,270,921 |
| **Total Net Position** | $ 125,711,830 | $ 128,148,184 | $ 130,734,537 |

*Loans Receivable*

Total mortgages and other loans receivable increased by $15.5 million in fiscal year 2014. This increase was primarily due to a rebound in the housing market and competitive loan interest rates for borrowers.

Total mortgages and other loans receivable decreased by $19.7 million in fiscal year 2013. This decrease was primarily due to prepayments on outstanding mortgage loans.

*Bonds Payable*

Bonds Payable decreased by $17.6 million *(par value)* from June 30, 2013 to June 30, 2014 and decreased by $20.5 million *(par value)* from June 30, 2012 to June 30, 2013. During fiscal years 2013 and 2014, the Department did not issue any general obligation bonds. For additional details, see the Debt Administration section of the Management's Discussion and Analysis.

*Net Position*

Total Net Position decreased by approximately $2.4 million in fiscal year 2014 and decreased by approximately $2.6 million in fiscal year 2013. The Veterans' Loan Program continued to use available cash from loan repayments to reduce the amount of bonds payable.

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The results of operations for the Veterans’ Loan Program’s proprietary fund is presented below:

**Veterans’ Loan Program - Proprietary Fund**
**Statement of Revenues, Expenses, and Changes in Net Position**

| | Business Type Activities | | |
|---|---|---|---|
| | **2014** | **2013** | **2012** |
| **Revenues:** | | | |
| Interest Income: | | | |
| Mortgage Loans | $ 7,441,010 | $ 8,827,619 | $ 10,494,442 |
| Contracts | 57,000 | 69,347 | 108,784 |
| Investment Income: | | | |
| Interest and Income | 1,565,742 | 2,141,849 | 2,240,221 |
| Change in Fair Value of Investments | 134,407 | 20,790 | 86,837 |
| LCLI Premium Revenue | 493,942 | 605,167 | 715,356 |
| LCLI Processing Fee | 87,000 | 102,000 | 102,000 |
| Other Fees and Charges | 2,324,761 | 1,636,638 | 1,689,093 |
| Conservatorship Fees | 364,090 | 264,161 | 298,380 |
| Gain on Sale of Foreclosed Property | 262,886 | 53,635 | 76,034 |
| **Total Revenues** | $ 12,730,838 | $ 13,721,206 | $ 15,811,147 |
| **Expenses:** | | | |
| Bond Interest | $ 5,847,512 | $ 6,119,393 | $ 7,498,587 |
| Salaries and Other Payroll | 4,052,936 | 4,802,451 | 5,653,694 |
| Bond Costs | 866,823 | 1,020,215 | 1,858,820 |
| Securities Lending Investment Expense | 12,873 | 41,639 | 57,794 |
| Real Estate Owned Expense | 328,002 | 300,065 | 491,313 |
| Services and Supplies | 1,491,581 | 1,253,702 | 1,340,540 |
| LCLI Claims & Admin. Expense | 1,244,045 | 1,294,691 | 1,091,934 |
| Interest | 51,735 | 54,142 | - |
| Depreciation | 100,555 | 98,754 | 108,809 |
| Bad Debt | (1,187,213) | (177,874) | 336,329 |
| Other | 973,850 | 467,545 | 242,959 |
| **Total Expenses** | $ 13,782,699 | $ 15,274,723 | $ 18,680,779 |
| Increase (Decrease) before Contributions, Special and Extraordinary Items, and Transfers | $ (1,051,861) | $ (1,553,517) | $ (2,869,632) |
| Net Transfers from Military Department | - | 14,124 | - |
| Net Transfers to Dept. of Admin Services | (166,321) | (209,608) | (229,185) |
| **Increase (Decrease) in Net Position** | $ (1,218,182) | $ (1,749,001) | $ (3,098,817) |
| **Net Position – Beginning** | $ 128,148,184 | $ 130,734,537 | $ 133,291,503 |
| Cumulative Effect of Change in Accounting Principle | (1,218,172) | - | - |
| Prior Period Adjustment | - | (837,352) | 541,851 |
| **Net Position - Beginning Restated** | 126,930,012 | 129,897,185 | 133,833,354 |
| **Net Position – Ending** | $ 125,711,830 | $ 128,148,184 | $ 130,734,537 |

*Revenues and Expenses*

The Veterans’ Loan Program’s revenue is generated principally from interest earned on mortgage loans and investment income. In fiscal year 2014, revenue generated through the Veterans’ Loan Program totaled approximately $12.7 million, of which approximately $9.2 million, or 72% is from interest income earned on loans and investments. Expenses of the Veterans' Loan Program consist primarily of interest expense on debt incurred to fund lending programs and operational expenses. The total expenses for Veterans' Loan Program activities totaled approximately $13.8 million, of which approximately $5.8 million, or 42% is bond interest expense and $4.1 million, or 29%, is salaries and other payroll expenses.

In fiscal year 2013, revenue generated through the Veterans' Loan Program totaled approximately $13.7 million, of which approximately $11.1 million, or 81% is from income earned on loans and investments. The total expenses for Veterans' Loan Program activities totaled approximately $15.3 million, of which approximately $6.1 million, or 40% is bond interest expense and $4.8 million, or 31.3%, is salaries and other payroll expenses.

*Change in Net Position*

The change in net position for the year ended June 30, 2014 resulted in a decrease of approximately $2.4 million compared to a similar $2.6 million decrease for the year ending June 30, 2013. The primary factors contributing to this change for fiscal year 2014 were the reduction in loan interest and investment income arising from the continuing low interest rate environment and the cumulative effect of a change in accounting principle as described in the Notes to the Financial Statements *(Note 15)*.

The change in net position for the year ended June 30, 2013 resulted in a decrease of approximately $2.6 million compared to a similar $2.6 million decrease for the year ending June 30, 2012. The primary factors contributing to this change for fiscal year 2013 were the reduction in loan interest and investment income arising from the continuing low interest rate environment.

**Debt Administration**

The Oregon Constitution and Oregon Revised Statutes permit general obligation bonds to be issued on the Department's behalf to provide funds for home loans to eligible Oregon veterans.

The Department had approximately $274.2 million *(par value)* and $291.8 million *(par value)* in outstanding general obligation bonds as of June 30, 2014 and 2013 respectively. During fiscal years 2014 and 2013, no general obligation bonds were issued.

Information on the Department's long-term debt can be found in the Notes to the Financial Statements *(Note 5 and 6)*.

**Requests for Information**

This financial report is designed to provide a general overview of the Department of Veterans' Affairs' finances for all those with an interest in the Department's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, Oregon Department of Veterans' Affairs, 700 Summer Street N.E., Salem, Oregon 97301.

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
VETERANS' LOAN PROGRAM
**STATEMENT OF NET POSITION**
PROPRIETARY FUND
JUNE 30, 2014 AND JUNE 30, 2013

| | Enterprise Fund | |
|---|---|---|
| | *Veterans' Loan Program* | |
| | June 30, 2014 | June 30, 2013 |
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and Cash Equivalents | $ 81,418,994 | $ 91,182,217 |
| Cash and Cash Equivalents - Restricted | 2,019,125 | 1,805,833 |
| Securities Lending Cash Collateral | 12,366,201 | 13,766,369 |
| Investments | 10,145,257 | 7,010,850 |
| Receivables: | | |
| Accrued Interest | 1,117,525 | 1,246,755 |
| Loan Cancellation Life Insurance Premiums | 47,253 | 59,058 |
| Other | 80,456 | 38,988 |
| Due from Other Funds | 134,588 | 71,798 |
| Real Estate Owned | 680,635 | 1,087,119 |
| Prepaid Expenses | 6,080 | 2,405 |
| Total Current Assets | 108,016,114 | 116,271,392 |
| **Noncurrent Assets** | | |
| Cash and Cash Equivalents - Restricted | 107,661,208 | 134,842,147 |
| Mortgage Loans and Contracts Receivable (Net) | 212,809,406 | 197,333,478 |
| Other Receivable | 4,148,543 | 1,526,883 |
| Deferred Underwriter's Discount | - | 1,218,172 |
| Capital Assets: | | |
| Building, Property and Equipment | 8,995,981 | 8,984,206 |
| Works of Art and Historical Treasures | 627,021 | 627,021 |
| Accumulated Depreciation | (5,288,119) | (5,187,564) |
| Total Noncurrent Assets | 328,954,040 | 339,344,343 |
| **TOTAL ASSETS** | 436,970,154 | 455,615,735 |
| **DEFERRED OUTFLOW OF RESOURCES** | $ 1,895,225 | $ 2,250,525 |
| **LIABILITIES** | | |
| **Current Liabilities** | | |
| Accounts Payable | $ 144,124 | $ 76,910 |
| Loan Cancellation Life Insurance Premium Payable | 34,124 | 35,571 |
| Loan Cancellation Life Insurance Claims Payable | 42,245 | 190,401 |
| Deposit Liabilities | 1,920,002 | 1,695,262 |
| Accrued Interest on Bonds | 380,999 | 425,153 |
| Obligations under Securities Lending | 12,366,201 | 13,766,369 |
| Pension-Related Debt | 21,100 | 18,300 |
| Compensated Absences Payable | 208,479 | 211,447 |
| Excess Interest and Arbitrage Rebate Payable | 9,024 | - |
| Bonds Payable-Maturing Within One Year (Net) | 3,634,808 | 3,478,108 |
| Matured Bonds Payable | 65,000 | 75,000 |
| Total Current Liabilities | 18,826,106 | 19,972,521 |
| **Noncurrent Liabilities** | | |
| Bonds Payable-Maturing After One Year (Net) | 270,369,127 | 288,111,038 |
| Pension-Related Debt | 776,914 | 800,787 |
| Compensated Absences Payable | 107,398 | 113,856 |
| Excess Interest and Arbitrage Rebate Payable | 21,063,255 | 18,357,159 |
| Other Postemployment Benefits Obligation (Net) | 115,524 | 112,190 |
| Derivative Instrument - Interest Rate Swap | 1,895,225 | 2,250,525 |
| Total Noncurrent Liabilities | 294,327,443 | 309,745,555 |
| **TOTAL LIABILITIES** | 313,153,549 | 329,718,076 |
| **NET POSITION** | | |
| Net Investment in Capital Assets | 4,334,883 | 4,423,663 |
| Unrestricted | 121,376,947 | 123,724,521 |
| **TOTAL NET POSITION** | $ 125,711,830 | $ 128,148,184 |

*The accompanying notes are an integral part of the financial statements.*

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
VETERANS' LOAN PROGRAM
**STATEMENT OF REVENUES, EXPENSES, AND**
**CHANGES IN NET POSITION**
PROPRIETARY FUND
FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

| | Enterprise Fund | |
|---|---|---|
| | *Veterans' Loan Program* | |
| | June 30, 2014 | June 30, 2013 |
| **OPERATING REVENUES** | | |
| Interest Income: | | |
| Mortgage Loans | $ 7,441,010 | $ 8,827,619 |
| Contracts | 57,000 | 69,347 |
| Investment Income | 1,700,149 | 2,162,639 |
| Loan Cancellation Life Insurance Premiums | 493,942 | 605,167 |
| Loan Cancellation Life Insurance Processing Fee | 87,000 | 102,000 |
| Other Fees and Charges | 2,324,761 | 1,636,638 |
| Conservatorship Fees | 364,090 | 264,161 |
| Gain on Sale of Foreclosed Property | 262,886 | 53,635 |
| **TOTAL OPERATING REVENUES** | 12,730,838 | 13,721,206 |
| **OPERATING EXPENSES** | | |
| Bond Interest | 5,847,512 | 6,119,393 |
| Salaries and Other Payroll | 4,052,936 | 4,802,451 |
| Bond Expenses | 866,823 | 1,020,215 |
| Securities Lending Investment Expense | 12,873 | 41,639 |
| Real Estate Owned Expense | 328,002 | 300,065 |
| Services and Supplies | 1,491,581 | 1,253,702 |
| Claims Expense - Loan Cancellation Life Insurance | 1,244,045 | 1,294,691 |
| Interest | 51,735 | 54,142 |
| Depreciation | 100,555 | 98,754 |
| Bad Debt | (1,187,213) | (177,874) |
| Other | 973,850 | 467,545 |
| **TOTAL OPERATING EXPENSES** | 13,782,699 | 15,274,723 |
| **OPERATING INCOME (LOSS)** | (1,051,861) | (1,553,517) |
| **TRANSFERS:** | | |
| Net Transfers from Military Dept. | - | 14,124 |
| Net Transfers to Dept. of Administrative Services | (166,321) | (209,608) |
| **TOTAL TRANSFERS** | (166,321) | (195,484) |
| **CHANGE IN NET POSITION** | (1,218,182) | (1,749,001) |
| **NET POSITION** | | |
| **NET POSITION - Beginning** | 128,148,184 | 130,734,537 |
| Prior Period Adjustment | - | (837,352) |
| Cumulative Effect of Change in Accounting Principle | (1,218,172) | - |
| **NET POSITION - Beginning - As Restated** | 126,930,012 | 129,897,185 |
| **NET POSITION - Ending** | $ 125,711,830 | $ 128,148,184 |

*The accompanying notes are an integral part of the financial statements.*

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
VETERANS' LOAN PROGRAM
**STATEMENT OF CASH FLOWS**
PROPRIETARY FUND
FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

| | Enterprise Fund | |
|---|---|---|
| | Veterans' Loan Program | |
| | June 30, 2014 | June 30, 2013 |
| **Cash Flows from Operating Activities:** | | |
| Receipts from Customers | $ 1,587,775 | $ 1,085,117 |
| Receipts from Other Funds for Services | 1,641,034 | 1,504,214 |
| Loan Principal Repayments | 38,222,001 | 47,971,931 |
| Loan Interest Received | 10,335,968 | 11,509,721 |
| Payments to Employees for Services | (4,166,411) | (4,969,190) |
| Payments to Suppliers | (3,507,682) | (2,598,177) |
| Payments to Other Funds for Services | (615,678) | (656,291) |
| Loans Made | (56,863,926) | (29,957,268) |
| Other Receipts (Payments) | 2,683,611 | 2,176,141 |
| Net Cash Provided (Used) in Operating Activities | (10,683,308) | 26,066,198 |
| **Cash Flows from Noncapital Financing Activities:** | | |
| Principal Payments on Bonds | (17,615,000) | (20,515,000) |
| Interest Payments on Bonds | (5,879,895) | (6,127,734) |
| Bond Issuance Costs | (860,671) | (904,230) |
| Principal Payments on Pension-Related Debt | (21,073) | (18,265) |
| Transfers to Other Funds | (166,321) | (195,484) |
| Net Cash Provided (Used) in Noncapital Financing Activities | (24,542,960) | (27,760,713) |
| **Cash Flows from Capital and Related Financing Activities:** | | |
| Acquisition of Capital Assets | (11,775) | (58,801) |
| Net Cash Provided (Used) in Capital and Related Financing Activities | (11,775) | (58,801) |
| **Cash Flows from Investing Activities:** | | |
| Purchases of Investments | (10,000,000) | - |
| Proceeds from Sales or Maturities of Investments | 7,000,000 | 14,500,000 |
| Interest on Investments and Cash Balances | 1,507,173 | 2,259,025 |
| Investment Income from Securities Lending | 12,873 | 41,639 |
| Investment Expense from Securities Lending | (12,873) | (41,639) |
| Net Cash Provided (Used) in Investing Activities | (1,492,827) | 16,759,025 |
| Net Increase (Decrease) in Cash and Cash Equivalents | (36,730,870) | 15,005,709 |
| Cash and Cash Equivalents - Beginning | 227,830,197 | 212,824,488 |
| Cash and Cash Equivalents - Ending | $ 191,099,327 | $ 227,830,197 |
| ***Reconciled to Statement of Net Position:*** | | |
| *Cash and Cash Equivalents - Current* | $ 81,418,994 | $ 91,182,217 |
| *Cash and Cash Equivalents - Current, Restricted* | 2,019,125 | 1,805,833 |
| *Cash and Cash Equivalents - Noncurrent, Restricted* | 107,661,208 | 134,842,147 |
| *Cash and Cash Equivalents - Ending (shown above)* | $ 191,099,327 | $ 227,830,197 |

*(Continued on next page)*

*The accompanying notes are an integral part of the financial statements.*

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
VETERANS' LOAN PROGRAM
**STATEMENT OF CASH FLOWS**
PROPRIETARY FUND
FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

*(Continued from prior page)*

| | Enterprise Fund | |
|---|---|---|
| | Veterans' Loan Program | |
| | June 30, 2014 | June 30, 2013 |
| **Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:** | | |
| Operating Income | $ (1,051,861) | $ (1,553,517) |
| Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities: | | |
| Depreciation and Amortization of Capital Assets | 100,555 | 98,754 |
| Amortization of Bond Premium, Discount and Underwriter's Discount on Called Bonds | 19,789 | 136,046 |
| Interest Received on Investments Reported as Operating Revenue | (1,654,453) | (2,279,876) |
| Investment Expense | 12,873 | 41,639 |
| Interest and Line of Credit Payments on Bonds Reported as Operating Expense | 5,879,895 | 6,127,734 |
| Bond Costs | 860,671 | 904,230 |
| Net Changes in Assets and Liabilities: | | |
| Accounts and Interest Receivable | 99,567 | 235,693 |
| Due from Other Funds | (62,790) | (3,513) |
| Prepaid Items | (3,675) | 6,100 |
| Loans and Contracts Receivable | (18,097,589) | 19,244,648 |
| Foreclosed and Deeded Property | 406,484 | 821,204 |
| Accounts Payable | (125,095) | 54,870 |
| Deposit Liabilities | 223,293 | (144,565) |
| Deferred Revenue | 2,715,120 | 2,496,672 |
| Compensated Absences Payable | (9,426) | (131,466) |
| Post Employment Benefits | 3,334 | 11,545 |
| Total Adjustments | (9,631,447) | 27,619,715 |
| **Net Cash Provided (Used) by Operating Activities** | $ (10,683,308) | $ 26,066,198 |
| | | |
| **Noncash Investing and Capital and Related Financing Activities:** | | |
| Net Change in Fair Value of Investments | $ 134,407 | $ (20,790) |
| Foreclosed Property | 680,635 | 1,807,119 |
| **Total Noncash Investing and Capital and Related Financing Activities** | $ 815,042 | $ 1,786,329 |

*The accompanying notes are an integral part of the financial statements.*

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Reporting Entity**

The Department is a part of the State of Oregon reporting entity. The Department operates under the provisions of the Oregon Constitution Article XI-A and primarily Oregon Revised Statutes *(ORS)* chapters 406, 407, and 408. The Department's Director is appointed by the Governor with input from the Advisory Committee and is subject to confirmation by the Oregon Senate. The Director must be a veteran chosen on the basis of his or her executive and administrative ability. The Advisory Committee is a nine-member board, appointed by the Governor that acts in an advisory capacity to the Director concerning all matters upon which the Director requests counsel. The State Legislature has significant ability to influence funding, approve the Department's budget, and pass laws governing the Department.

In 1944 Oregon voters approved a constitutional amendment that authorized the creation of a Veterans' home and farm loan program. A year later the Department was established to administer this program. The Department's home loan program *(Veterans' Loan Program)* provides home purchase and home improvement loans at favorable interest rates to eligible veterans, within the limitations set forth in Oregon's Constitution and applicable laws. The Veterans' Loan Program is operated through earnings on program loans, which are financed through the sale of tax-exempt general obligation bonds. These bonds are then retired through principal and interest payments received from borrowers and earnings from invested funds.

The Veterans' Loan Program is classified as a proprietary fund activity. The basic financial statements and notes presented herein include only the proprietary fund activities of the Veterans' Loan Program.

**Measurement Focus of Accounting and Basis of Presentation**

The accounts of the Department are organized on the basis of funds. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording assets, liabilities, and equities, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations or restrictions.

The Veterans' Loan Program is accounted for as a Proprietary fund. The focus of Proprietary fund measurement is upon determination of operating income, changes in net position, financial position, and cash flows, which is similar to private-sector business. Proprietary funds are presented using the accrual basis of accounting and the flow of economic resources measurement focus. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recognized when the liabilities are incurred.

The basic financial statements and notes presented have been prepared in conformity with generally accepted accounting principles *(GAAP)* as prescribed by the Governmental Accounting Standards Board *(GASB)*. During the year, the Department implemented GASB Statement 65, *Items Previously Reported as Assets and Liabilities.* The implementation of this statement resulted in a change in accounting principle related to the write-off of underwriter's discounts.

**Budgetary Process**

The Oregon Legislature approves budgets for a biennial period. Operating expenses are subject to limitation and certain bond related expenses are subject to administrative limitation. Both types of limitations lapse at the end of the biennium. For budgetary purposes, these transactions are recognized when received or paid in cash as opposed to when they are susceptible to accrual.

**Cash and Cash Equivalents**

Cash and Cash Equivalents include: cash on hand, cash and investments held by the State Treasury in the Oregon Short-Term Fund *(OSTF)*, cash deposits held by the State's fiscal agent for payment of matured bonds and coupons, and cash deposits held by the agency's loan cancellation life insurance carrier. All monies held in the OSTF are considered to be cash equivalents, which is a cash and investment pool having characteristics of a demand deposit account.

**Investments**

The Department's investments are stated at fair value. Quoted market values and market price information provided by the Oregon State Treasurer's Office were used to value the Department's investments.

**Securities Lending Cash Collateral**

The State Treasurer participates in securities lending with a portion of the OSTF and the Oregon Intermediate Term Pool *("OITP")*. The Department's share of the cash collateral received from broker-dealers is disclosed in the Statement of Net Position as Securities Lending Cash Collateral.

**Receivables**

Receivables are shown net of an allowance for uncollectible accounts. Receivables included are amounts due that represent revenues earned or accrued in the current period. Types included in this classification relate to interest, mortgage loans receivable, loan cancellation life insurance premiums, and other miscellaneous receivables.

**Loan Cancellation Life Insurance**

The Department offers Loan Cancellation Life Insurance *(LCLI)* to approved borrowers and their spouses through a contract with a private insurance company. Historically subsidized from the Oregon War Veterans' Fund *(a dedicated fund of the Department created under Article XI-A of the Oregon Constitution)*, the Department collects the premiums from borrowers and remits collected premiums, less an administrative fee, to the private insurance company. Upon the death of an insured person, either the account balance will be paid in full, or the amount of insurance in force will be paid and applied toward the account balance.

The Loan Cancellation Life Insurance Contingency Fund is a special fund consisting of amounts generated by the group policy and interest earned on the fund balance. Monies in the LCLI account are held and controlled by the insurance carrier during the contract period. The fund stabilizes rate experience developed under the group loan cancellation life insurance policy. An annual accounting of premiums, claims, administrative costs, and interest earnings is provided by the insurance carrier for the fund at June 30.

**Real Estate Owned**
Properties acquired through foreclosure proceedings or by acceptance of deeds in lieu of foreclosure are recorded at the lower of cost or fair market value. Cost is defined as the outstanding principal balance of the mortgage loan or contract on the date of foreclosure.

**Prepaid Expenses**
Prepaid expenses consist of postage on hand at year-end.

**Capital Assets**
Capital assets are recorded at cost. Depreciation is calculated using the straight-line method. Gain or loss on the sale of an asset is determined by taking the difference between the carrying value *(cost less depreciation)* and the sale price. The Veterans' Building is depreciated over its useful life *(50 years)*. Building-related assets are capitalized and then depreciated over the remaining estimated life of the building. Furniture, equipment, depreciable works of art, land improvements, and data processing hardware and software costing $5,000 or more are capitalized and then depreciated over a useful life of five years *(10 years for art work and land improvements)*.

**Pension-Related Debt**
Prior to the formation of the PERS State and Local Government Rate Pool (SLGRP), the State and community colleges were pooled together in the State and Community College Pool (SCCP), while local government employers participated in the Local Government Rate Pool (LGRP). These two pools combined to form the SLGRP effective January 1, 2002. The unfunded actuarial liability (UAL) attributable to the SCCP at the time the SLGRP was formed is maintained separately from the SLGRP and is reduced by contributions and increased for interest charges at the assumed interest rate. The pre-SLGRP liability is essentially a debt owed to the SLGRP by the SCCP employers. The balance of the pre-SLGRP pooled liability attributable to the State is being amortized over the period ending December 31, 2027.

**Compensated Absences Payable**
State policy allows employees to accrue vacation leave at various accrual rates with a maximum accumulation of 350 hours per employee. Employees can be paid up to a maximum of 250 hours of accrued vacation leave at separation from state service.

Accumulated vacation leave and compensatory time *(comp time)* leave is recorded as an expense and a liability of those funds as the benefits accrue to the employees. No liability is recorded for non-vesting, accumulated sick pay benefits.

**Excess Interest and Arbitrage Rebate Payable**
The Department recognizes a liability in its financial records for any excess mortgage interest and investment earnings arising from the use of tax-exempt bond proceeds. The Department records the excess mortgage interest and investment earnings as a reduction of revenue.

**Invested in Capital Assets**
This is the Capital Asset component of Net Position *(equity)* net of accumulated depreciation.

**Operating Revenues and Expenses**

Operating revenues include interest and fees on program loans, as well as earnings on cash and investments. Administrative expenses, depreciation related to capital assets, and bond program related expenses are considered operating expenses. All revenues and expenses not meeting this definition would be reported as non-operating revenues and expenses.

**Bond Expenses**

Bond premiums and discounts associated with a particular bond issue are amortized over the life of the bond issue using the bonds outstanding method of amortization. These expenses are charged or credited to interest expense.

Miscellaneous bond expenses are primarily recorded as expenses when incurred. Included in bond expenses are fees related to variable rate demand bonds, expenses of the matured bond and coupon account with the State's Fiscal Agent, and bond attorney fees.

Expenses of variable rate demand bonds include Standby Bond Purchase Agreement commitment fees and remarketing agent fees. These fees are payable quarterly in arrears.

**Comparative Data and Reclassifications**

Certain amounts presented in the prior year data may have been reclassified in order to be consistent with the current year's presentation. Current year presentation includes a Change in Accounting Principle *(see Note 15)*, which is not reflected in the prior year.

## 2. DEPOSITS AND INVESTMENTS

**Deposits**

Cash and cash equivalents for the Veterans' Loan Program as of June 30, 2014 and June 30, 2013 are included in the table below:

| | Total June 30, 2014 | Total June 30, 2013 |
|---|---|---|
| Book Balance - Cash and Cash Equivalents | | |
| Current unrestricted | $ 81,418,994 | $ 91,182,217 |
| Current restricted | 2,019,125 | 1,805,833 |
| Noncurrent restricted | 107,661,208 | 134,842,147 |
| Combined Book Balance | $ 191,099,327 | $ 227,830,197 |
| Bank Balance - Cash and Cash Equivalents | $ 192,601,263 | $ 228,669,773 |

As of June 30, 2014, the Veterans' Loan Program had a combined total of $177,496,316 held in demand accounts with the State Treasurer and invested in the Oregon Short-Term Fund ("OSTF"). The OSTF is a cash and investment pool that is available for use by all state funds and eligible local governments. State Treasurer demand deposit accounts and time certificates of deposit investments of the OSTF held in state banks are insured up to the Federal Deposit Insurance *(FDIC)* amount of $250,000 for the combined total of all savings deposits. Where interest-bearing balances exceed the FDIC insured amount, the balances are covered by collateral held in a multiple financial institution collateral pool administered by the Oregon Office of the State Treasurer in the Public Funds Collateralization Program *(PFCP)*. Because the pool operates as a demand deposit account, each fund type's portion of this pool is classified on the Statement of Net Position as Cash and Cash Equivalents.

Earnings on the OSTF are allocated based on daily account balances and a variable interest rate determined periodically by the State Treasurer. Securities in the OSTF are primarily held by the State Treasurer's agent in the name of the State of Oregon. Additional information about the OSTF can be found at http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Short-Term-Fund-(OSTF).aspx or by writing to the Oregon State Treasury, 350 Winter St NE Suite 100, Salem, OR 97301-3896.

In addition, the Department held $15,039,947 with an insurance carrier as a reserve for loan cancellation life insurance. These monies are uncollateralized and are not insured under FDIC protection. The Department is required to keep on deposit an amount not less than the annual premium with additional insurance charges becoming effective if the balance drops below 200% of annual premiums. At June 30, 2014 the Department estimated that required balance to be $960,000. That amount is included as Cash and Cash Equivalents – Noncurrent, Restricted. The remainder of the balance at the insurance carrier is unrestricted and is included in Cash and Cash Equivalents – Current. For additional information on these monies *(also called the Loan Cancellation Life Insurance Contingency Fund)* see Note 1.

At June 30, 2014, the Department held $65,000 at the State's Fiscal Agent for redemption of the Department's bonds and coupons that have matured, but have not yet been redeemed. These funds are deposited at the Bank of New York Mellon and are backed by the full faith and credit of the Bank of New York Mellon. Further, these funds, while not collateralized, are insured up to $250,000 per bondholder, as specified by FDIC regulations. This money is included in Cash and Cash Equivalents – Restricted, a current asset. On June 30, 2013, the matured bonds payable balance was $75,000.

**Investments**

The State Treasurer is the investment officer for funds on deposit in the State Treasury. The State's investment policies are governed by statute and are overseen by the Oregon Investment Council. These funds must be invested, and the investments managed, as a prudent investor would, exercising reasonable care, skill and caution. Under an agreement with the State Treasury, the Department's investments do not include common stock. As of June 30, 2014, the Department had $10 million invested in the Oregon Intermediate Term Pool *("OITP")* managed by the State Treasury. The fair market value of the Department's investment in the OITP, as of June 30, 2014 was $10,145,127. A credit rating is not available for OITP. Additional information about the OITP can be found at:
http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Intermediate-Term-Pool-(OITP)-.aspx or by writing to the Oregon State Treasury, 350 Winter St NE Suite 100, Salem, OR 97301-3896.

The schedule below presents the schedule of interest rate risk and credit quality disclosures as of June 30, 2013:

| | | Investment Maturities | | | | |
|---|---|---|---|---|---|---|
| **Investment Type** | **S&P Credit Rating** | **< 1 Year** | **1 - 5 Years** | **6 - 10 Years** | **More Than 10 Years** | **Total Market Value** |
| Corporate Bonds | AA | $ 7,010,850 | - | - | - | $ 7,010,850 |
| **Total Investments** | | $ 7,010,850 | - | - | - | $ 7,010,850 |

<u>Interest Rate and Credit Risk:</u>
Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Policies related to Department funds require investments to be in U.S. Treasury and government agency bonds, notes and bills, state and municipal bonds, corporate bonds, mortgage-backed securities, asset-backed securities, the OSTF and the OITP. Additionally, the investment policy requires that the:

- Overall weighted average credit quality of the dedicated investment portfolio and OSTF should be maintained between Aa3/AA- and Aa1/AA+. There are no requirements for the OITP to maintain a weighted average credit quality;
- All investments must be fixed-income and U.S. dollar-denominated;
- No investments below an investment grade rating of Baa3/BBB- should be purchased; and
- No more than 5% of the Department's combined cash, cash equivalents and investments may generally be invested in any single private company or corporation *(excluding government-sponsored enterprises, providers of guaranteed investment contracts or repurchase agreements, or any investments within the OSTF and OITP)*.

## Restricted Assets

Included in Cash and Cash Equivalents are amounts designated as restricted. Restrictions on the Department's cash and investments can arise from Oregon's constitutional provision or enabling legislation, federal tax law relating to bond proceeds, bond covenants, deposit liabilities and from certain other contractual arrangements. The primary purpose of the restricted assets will be to meet upcoming debt service requirements and other restricted purposes. As of June 30, 2014 and 2013, the Veterans' Loan Program had restricted assets of $109,680,333 and $136,647,980 respectively.

## Securities Lending

In accordance with State of Oregon investment policies, state agencies may participate in securities lending. The Department is currently involved in securities lending with monies invested in the OSTF and OITP. As of June 30, 2013, the Department only had securities lending with monies invested in the OSTF.

Securities lending information related to the Department's Loan Program is provided in the following table:

| | OSTF | OITP | Total June 30, 2014 | Total June 30, 2013 |
|---|---|---|---|---|
| Securities Lending Cash Collateral | $ 11,482,151 | $ 884,050 | $ 11,482,151 | $ 13,766,369 |
| Fair Value of Securities on Loan | $ 18,855,688 | $ 866,743 | $ 18,855,688 | $ 19,234,424 |
| Investments Purchased with Cash Collateral | $ 11,484,287 | $ 884,215 | $ 11,484,287 | $ 13,766,397 |
| Securities on Loan: | | | | |
| U.S. Agency | 5.50% | 24.16% | | 4.08% |
| U.S. Treasury | 88.91% | 0.00% | | 81.06% |
| Domestic Fixed Income | 5.59% | 75.84% | | 14.86% |
| | 100.00% | 100.00% | | 100.00% |

Additional information about OSTF and OITP securities lending can be found in the financial statements at:

- http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Short-Term-Fund(OSTF).aspx; and

- http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Intermediate-Term-Pool-(OITP)-.aspx

**Investment Income**

The following table details the components of Investment Income for the years ended June 30, 2014 and June 30, 2013:

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| Investment Income: Accrual Basis | $ 1,552,869 | $ 2,141,790 |
| Securities Lending Revenue | 12,873 | 41,639 |
| Increase/(Decrease) in Fair Value of Investments | 134,407 | (20,790) |
| Investment Income | $ 1,700,149 | $ 2,162,639 |

## 3. MORTGAGE LOANS AND CONTRACTS RECEIVABLE

Mortgage loans and contracts receivable are secured by real property, which is repossessed if the receivable becomes uncollectible. Most loan and contract agreements made during the period from May 1971 through December 1991 contain a provision authorizing the Department to adjust the interest rate. Loan agreements *(excluding contracts)* made subsequent to December 1991 have fixed interest rates.

The loan and contract receivable portfolio at June 30, 2014 is approximately $215 million. All mortgaged property is located within Oregon. The Department uses the allowance method to estimate uncollectible mortgage loans and contracts receivable. The allowance is periodically adjusted by management to accommodate changes in economic conditions, nonperforming assets, historical loss experience, and other conditions that may affect the ultimate collectability of the mortgage loans and contracts. In 2014 the Department determined the balance of the allowance account to be in line with potential losses for the remaining loan and contract portfolio. Accordingly, the account balance at June 30, 2014, is approximately $2 million. The balance of the allowance account represents approximately 0.93 percent of gross loans and contracts receivable.

The following table details the mortgage loans and contracts receivable and allowance accounts as disclosed on the Statement of Net Position for June 30, 2014 and June 30, 2013.

| | | June 30, 2014 | | June 30, 2013 |
|---|---|---|---|---|
| Loans Receivable | $ | 214,339,612 | $ | 199,896,911 |
| Contracts Receivable | | 476,421 | | 736,567 |
| Total Loans and Contracts Receivable | $ | 214,816,033 | $ | 200,633,478 |
| Less: Allowance for Principal Losses | | (2,006,627) | | (3,300,000) |
| Net Loans and Contracts Receivable | $ | 212,809,406 | $ | 197,333,478 |

Included in mortgage loans receivable are loans that will not amortize at their current monthly payment amounts. These loans became non-amortizing primarily through borrowers' choosing to extend the repayment term of their loans in lieu of accepting increased monthly principal and interest installments resulting from loan interest rate increases. The option to allow a borrower to extend the repayment life of the loan rather than accept an increase in the monthly principal and interest installment amount was the result of legal action brought against the Department by the Associated Oregon Veterans in 1985. As of June 30, 2014, there were 74 non-amortizing accounts with an aggregate principal balance of approximately $7.6 million. This represents approximately 3.6 percent of the total net loans and contracts receivable.

**Troubled Debt Restructurings**

The Department makes every reasonable attempt to keep a borrower in the home purchased under the Veterans' Loan Program. In order to avoid foreclosure, one method of working with borrowers is to temporarily reduce loan payments for borrowers. This is allowed under ORS 407.095. During the year ended June 30, 2014, the Department provided this relief to three borrowers and deferred loan interest income of $24,086. This interest amount was subsequently capitalized on these loans. In total, $645,098 in loans were restructured in this fashion. From these restructured loans the Department received $26,786 in mortgage interest income during the fiscal year. For the year ended June 30, 2013, the Department deferred loan interest income to borrowers of $5,630.

**Mortgage Insurance**

The Department requires borrowers to obtain private mortgage insurance on loans made subsequent to December 1991 if the original loan amount exceeds 80% of the lesser of the appraised value of the property or the purchase price. As of June 30, 2014, the Department had 189 insured accounts with seven private mortgage insurers totaling approximately $40.4 million. The majority of insured accounts are with Mortgage Guaranty Insurance Corporation

(MGIC) with *62%* and Triad Guaranty Insurance (Triad) with *21%*. As of June 30, 2014, the Moody's ratings for MGIC and Triad were "Ba3" and "Not Rated" respectively.

Deferred Payment Obligations

Deferred Payment Obligations (DPOs) have been established through regulatory action for certain Mortgage Insurers to settle current mortgage insurance claims with a combination of cash and withholding a portion of each claim. The intent of DPOs is to ensure the Mortgage Insurer has sufficient ability to pay all current and future claims.

Effective March 31, 2009, the Illinois Department of Insurance required that all valid claims under Triad's mortgage guaranty insurance policies be paid at 60% in cash and 40% by the creation of a deferred payment obligation. As of December 31, 2013, the court supervising the rehabilitation of Triad approved a plan to increase the percentage of cash paid on valid settlements from 60% to 75%. If the financial position of Triad permits, the Illinois Department of Insurance will allow Triad to continue to increase the amount of cash paid on each claim. As of June 30, 2014, the Department had $295,659 as a deferred payment obligation from Triad. As of June 30, 2013, the Department had $449,358 as a deferred payment obligation.

The North Carolina Department of Insurance has required that all valid claims under Republic Mortgage Insurance Company's (RMIC) mortgage guaranty insurance policies be paid at 60% in cash and 40% by the creation of a deferred payment obligation. If the financial position of RMIC permits, the North Carolina Department of Insurance will allow RMIC to increase the amount of cash paid on each claim. As of June 30, 2014 and 2013, the Department had $28,440 as a deferred payment obligation from RMIC.

**Real Estate Owned**

The Department had the following properties acquired through foreclosure or acceptance of deeds in lieu of foreclosure:

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| Number of Properties | 5 | 7 |
| Lower of Cost or Fair Market Value | $ 680,635 | $ 1,087,119 |

## 4. CAPITAL ASSETS

The following table provides detail on the balances and activities of the Veterans' Loan Program capital assets for the year ended June 30, 2014:

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| **Capital Assets Not Being Depreciated:** | | | | |
| Works of Art & Historical Treasures | $ 627,021 | $ - | $ - | $ 627,021 |
| Total Capital Assets Not Being Depreciated | 627,021 | - | - | 627,021 |
| **Capital Assets Being Depreciated:** | | | | |
| Buildings, Property & Equipment | 8,984,206 | 11,775 | - | 8,995,981 |
| Total Capital Assets Being Depreciated | 8,984,206 | 11,775 | - | 8,995,981 |
| **Less Accumulated Depreciation:** | | | | |
| Buildings, Property & Equipment | (5,187,564) | (100,555) | - | (5,288,119) |
| Total Accumulated Depreciation | (5,187,564) | (100,555) | - | (5,288,119) |
| **Total Capital Assets Being Depreciated, Net** | 3,796,642 | (88,780) | - | 3,707,862 |
| **Total Capital Assets, Net** | $ 4,423,663 | $ (88,780) | $ - | $ 4,334,883 |

Depreciation expense at June 30, 2014 and 2013 was $100,555 and $98,754 respectively.

## 5. BONDS PAYABLE AND DEBT SERVICE

The table below provides a summary of general obligation bond transactions of the Department for the fiscal years ended June 30, 2014 and June 30, 2013:

| | | |
|---|---|---|
| Bonds Payable *(Par)* at June 30, 2012 | $ | 312,265,000 |
| Bonds Issued | | - |
| Bonds Retired | | (20,495,000) |
| Bonds Payable *(Par)* at June 30, 2013 | $ | 291,770,000 |
| Bonds Issued | | - |
| Bonds Retired | | (17,605,000) |
| Bonds Payable *(Par)* at June 30, 2014 | $ | 274,165,000 |

Shown below are the components of net bonds payable as disclosed on the Statement of Net Position for June 30, 2014:

| | Current | Noncurrent | Total |
|---|---|---|---|
| Bonds Payable *(Par)* | $ 3,645,000 | $ 270,520,000 | $ 274,165,000 |
| Discount on Bonds Sold | (10,192) | (150,873) | (161,065) |
| Net Bonds Payable | $ 3,634,808 | $ 270,369,127 | $ 274,003,935 |

The following schedule summarizes future debt service requirements to maturity as of June 30, 2014:

| ***Fiscal Year*** | ***Principal*** | ***Interest*** | ***Total*** |
|---|---|---|---|
| 2015 | $ 3,645,000 | $ 4,520,174 | $ 8,165,174 |
| 2016 | 4,300,000 | 4,427,725 | 8,727,725 |
| 2017 | 5,025,000 | 4,321,726 | 9,346,726 |
| 2018 | 6,295,000 | 4,187,587 | 10,482,587 |
| 2019 | 6,570,000 | 4,025,299 | 10,595,299 |
| 2020-2024 | 38,150,000 | 17,092,721 | 55,242,721 |
| 2025-2029 | 48,310,000 | 11,500,484 | 59,810,484 |
| 2030-2034 | 56,455,000 | 7,939,898 | 64,394,898 |
| 2035-2039 | 62,205,000 | 4,819,044 | 67,024,044 |
| 2040-2044 | 38,960,000 | 620,260 | 39,580,260 |
| 2045-2046 | 4,250,000 | 2,143 | 4,252,143 |
| ***TOTAL*** | $ 274,165,000 | $ 63,457,061 | $ 337,622,061 |

Shown below are the outstanding bond issues and their final maturities *(in fiscal years)* as of June 30, 2014:

| | | Original Coupon Rates | | | | Final |
|---|---|---|---|---|---|---|
| **Series** | **Dated** | **From** | **To** | **Issued** | **Outstanding** | **Maturity** |
| 83 | December 2, 2004 | ** | | 30,000,000 | 10,965,000 | 2040 |
| 84 | June 29, 2005 | ** | | 30,000,000 | 30,000,000 | 2040 |
| 85 | June 21, 2006 | ## | | 49,000,000 | 15,140,000 | 2041 |
| 86 | December 19, 2006 | ## | | 31,320,000 | 31,320,000 | 2040 |
| 87A | December 19, 2006 | 3.850 | 4.500% | 13,265,000 | 13,265,000 | 2042 |
| 87B | December 19, 2006 | 4.700 | 4.700% | 5,000,000 | 5,000,000 | 2042 |
| 87C | January 10, 2007 | ## | | 9,045,000 | 9,045,000 | 2028 |
| 88A | September 20, 2007 | 4.550 | 4.900% | 9,650,000 | 9,650,000 | 2027 |
| 88B | September 20, 2007 | ## | | 30,000,000 | 30,000,000 | 2042 |
| 89A | September 20, 2007 | 3.550 | 4.550% | 10,365,000 | 5,895,000 | 2020 |
| 90A | June 24, 2008 | 1.750 | 4.400% | 11,115,000 | 8,060,000 | 2024 |
| 90B | June 24, 2008 | ** | | 38,885,000 | 38,885,000 | 2046 |
| 91 | November 16, 2010 | 0.300 | 4.700% | 53,090,000 | 49,100,000 | 2041 |
| 92A | November 16, 2010 | 0.300 | 4.250% | 20,060,000 | 17,155,000 | 2031 |
| 92B | November 16, 2010 | 4.625 | 4.625% | 10,000,000 | 685,000 | 2039 |
| Total Bonds Outstanding as of June 30, 2014: | | | | | $ 274,165,000 | |

** Interest rates are adjusted weekly based on the weekly rate determined by the Remarketing Agent, not to exceed 12% for Series 83, Series 84 and Series 90B. The interest rate at the end of the fiscal year was 0.04% for Series 83 and 0.05% for Series 84 and Series 90B.

## Interest rates are adjusted daily based on the daily rate determined by the Remarketing Agent, not to exceed 12%. The interest rate at the end of the fiscal year was 0.04% for Series 85, Series 86, Series 87C and Series 88B.

## 6. DEMAND BONDS

Included in long-term debt at June 30, 2014 are the following State of Oregon, General Obligation, Veterans' Welfare Variable Rate Demand Bonds, along with selected terms of their Standby Bond Purchase Agreements (SBPAs):

| Series | Outstanding Bond Principal Amount | Liquidity Provider | Scheduled Termination Date | Maximum Interest Commitment | Commitment Fee |
|---|---|---|---|---|---|
| Series 83 | $ 10,965,000 | Bank of Tokyo-Mitsubishi UFJ, Ltd. | 12/30/2016 | 34 days/12% | 0.4250% |
| Series 84 | $ 30,000,000 | Bank of Tokyo-Mitsubishi UFJ, Ltd. | 12/30/2016 | 34 days/12% | 0.4250% |
| Series 85 | $ 15,140,000 | U.S. Bank National Association | 5/31/2016 | 34 days/12% | 0. 3300% |
| Series 86 | $ 31,320,000 | U.S. Bank National Association | 5/31/2016 | 34 days/12% | 0. 3300% |
| Series 87C | $ 9,045,000 | U.S. Bank National Association | 5/31/2016 | 34 days/12% | 0. 3300% |
| Series 88B | $ 30,000,000 | U.S. Bank National Association | 5/31/2016 | 34 days/12% | 0. 3300% |
| Series 90B | $ 38,885,000 | Bank of Tokyo-Mitsubishi UFJ, Ltd. | 12/30/2016 | 34 days/12% | 0.4250% |

These bonds are general obligations of the State of Oregon and are payable from revenues and reserves of the Veterans' Loan Program. The bondholder may tender these bonds on specified dates at a price equal to principal plus accrued interest.

The Department's Remarketing Agent is authorized to use their best efforts to sell the repurchased bonds at face value by adjusting the interest rate on a daily or weekly basis based on their applicable mode. The designated Remarketing Agent for such bonds will determine the interest rate borne by each series of bonds. The Department pays its designated Remarketing Agent a remarketing fee for this service:

| Series | Outstanding Bond Principal Amount | Designated Remarketing Agent | Remarketing Mode | Remarketing Fee |
|---|---|---|---|---|
| Series 83 | $ 10,965,000 | JPMorgan Securities Inc | Weekly | 0.050% |
| Series 84 | $ 30,000,000 | JPMorgan Securities Inc | Weekly | 0.050% |
| Series 85 | $ 15,140,000 | JPMorgan Securities Inc | Daily | 0.070% |
| Series 86 | $ 31,320,000 | JPMorgan Securities Inc | Daily | 0.070% |
| Series 87C | $ 9,045,000 | JPMorgan Securities Inc | Daily | 0.070% |
| Series 88B | $ 30,000,000 | JPMorgan Securities Inc | Daily | 0.070% |
| Series 90B | $ 38,885,000 | JPMorgan Securities Inc | Weekly | 0.070% |

In the event the bonds cannot be remarketed, they will be purchased as specified by the respective SBPA. Under the SBPA for Series 83, 84 and 90B *("Series 83, 84 & 90B SBPA"),* The Bank of Tokyo-Mitsubishi UFJ, Ltd. *(BTMU)* will commit to purchase any Series 83, 84 or 90B unremarketed bonds, subject to certain conditions set forth in the SBPA. Under the SBPA for Series 85, 86, 87C and 88B *("Series 85-88B SBPA"),* U.S. Bank National Association *(USB)*, will commit to purchase any Series 85, 86, 87C or 88B unremarketed bonds, subject to certain conditions set forth in the SBPA.

If a tender advance did occur under the Series 83, 84 & 90B SBPA, it would accrue interest at the bank's base rate *(either the prime lending rate plus 1%, the federal funds rate plus 2%, or 7.5%, whichever is higher)* for the time period up to 30 days; at the bank's base rate plus 0.50% for the time period covering 31 days up to 60 days; at the bank's base rate plus 1% for the time period thereafter. If the tender advance is in default, interest would accrue at the bank's base rate plus 2%. Interest on tender advances must generally be repaid before the principal portion of a tender advance is repaid. In most cases, tender advances are required to be paid off on the earliest to occur of (a) the date the applicable bonds are paid in full; (b) the conversion date of all or a portion of the applicable bonds to a fixed rate, an indexed rate or a non-covered interest rate; or (c) the effective date of delivery of a substitute alternative liquidity facility. Tendered bonds that are unremarketed by the 91st day after the purchase date of the tender advance must be paid in full over a four-year period in eight equal (or nearly equal) semi-annual installments, unless and until the bonds are remarketed or redeemed. If repayment of any tender advances does not occur within the specified timeframes contained in the Series 83, 84 and 90B SBPA, a default would have occurred.

If a tender advance did occur under the Series 85-88B SBPA, it would accrue interest at the bank's base rate *(either the prime lending rate plus 1%, the federal funds rate plus 2%, the SIFMA rate plus 1% or 7% for the time period 31 days after the purchase date and thereafter, whichever is higher)* for the time period up to 30 days; at the bank's base rate plus 1% for the time period covering 31 days up to 90 days; at the bank's base rate plus 1.5% for the time period thereafter. If the tender advance is in default, interest would accrue at the bank's base rate plus 3%. Interest on tender advances must generally be repaid before the principal portion of a tender advance is repaid. In most cases, tender advances are required to be paid off on the earliest to occur of (a) the date the applicable bonds are paid in full; (b) the conversion date of all or a portion of the applicable bonds to a fixed rate, an indexed rate or a non-covered interest rate; or (c) the effective date of delivery of a substitute alternative liquidity facility. Tendered bonds that are unremarketed by the 91st day after the purchase date of the tender advance must be paid in full over a four-year period in eight equal (or nearly equal) semi-annual installments, unless and until the bonds are remarketed or redeemed. If repayment of any tender advances does not occur within the specified timeframes contained in the Series 85-88B SBPA, a default would have occurred.

No tender advances or draws have been necessary to purchase unremarketed bonds under the Series 83, 84 and 90B SBPA or the Series 85-88B SBPA for fiscal years 2014 and 2013. Therefore, no tender advances or draws were outstanding as of June 30, 2014 or 2013.

Each bank's present purchase commitment consists of the payment of the purchase price equal to the principal and accrued interest, if any, on the bonds of the applicable series tendered for purchase and not remarketed on the purchase date. The purchase commitment of each bank may be reduced from time to time upon occurrence of certain events specified in the SBPAs. The Department is required to pay a commitment fee, which is payable quarterly in arrears.

## 7. DERIVATIVE INSTRUMENTS – INTEREST RATE SWAPS

The Department has an interest rate swap in connection with a portion of its Loan Program General Obligation Veterans' Welfare Bonds, Series 84. The swap and underlying floating-rate bonds together create "synthetic" fixed-rate debt.

During fiscal year 2014, the Department did not enter into, terminate, or have any maturities of derivatives.

The fair value balance of the interest rate swap is reported as a deferred outflow of resources and derivative instrument on the Statement of Net Position. Changes to the year-end fair value balance are presented below:

| Description | Notional Amount | Fair Value Balance June 30, 2013 | Fair Value Increase / (Decrease) | Fair Value Balance June 30, 2014 |
|---|---|---|---|---|
| Series 84 | $25,000,000 | $ (2,250,525) | $ 355,300 | $ (1,895,225) |

Because of interest rate decreases after the swap was executed, the fair value as of June 30, 2014 is negative. The fair value of the interest rate swap is estimated using the zero-coupon method. This method calculates the future payments required by the swap, assuming that the current forward rates implied by the yield curve are the market's best estimate of future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for a hypothetical zero-coupon rate bond due on the date of each future net settlement payment on the swap.

**<u>Hedging Instruments</u>**

On June 30, 2014, the Department has the following derivative instruments outstanding:

| Type | Objective | Notional Amount | Effective Date | Termination Date | Terms | Fair Value |
|---|---|---|---|---|---|---|
| Pay – fixed interest rate swap | Hedge of changes in cash flows on the Series 84 bonds, specifically related to changes in municipal tax-exempt interest rates | $25,000,000 | 3/1/2008 | 6/1/2040 | Pay 3.665%; Receive 62.6% of 1-month LIBOR* + .265% | $ (1,895,225) |

* London Interbank Offered Rate

The Series 84 swap was structured with the option where the Department has the right to "cancel" or terminate the swap at par on any payment date, in whole or in part commencing June 1, 2017. This option enhances asset/liability matching and provides flexibility to adjust the outstanding notional amount of the swap over time. The use of derivatives, including interest rate swaps, involves certain risks. These risks include, but are not limited to:

*Credit Risk* – is the risk that a counterparty will not fulfill its obligations. The Department's interest swap is with Morgan Stanley Capital Services *("counterparty")*, which is rated A- and Baa2 by S&P and Moody's respectively.

If the counterparty's credit rating falls below certain levels, the counterparty is required to post collateral to the lower of the following ratings:

| **S&P Rating** | **Moody's Rating** | **Threshold** | **Minimum Transfer Amount** |
|---|---|---|---|
| AA- or higher | Aa3 or higher | Infinite | N/A |
| A+ | A1 | $ 10,000,000 | $ 1,000,000 |
| A | A2 | $ 5,000,000 | $ 1,000,000 |
| A- | A3 | $ 2,500,000 | $ 1,000,000 |
| BBB+ or below or not rated | Baa1 or below or not rated | $ - | $ 100,000* |

*Minimum Transfer Amount shall be $0 if, and for so long as, neither Moody's nor S&P rate the long-term unsecured, unsubordinated, debt securities of Morgan Stanley.

Since the fair value of the swap as of June 30, 2014, is negative, the counterparty is not required to post collateral.

According to the State of Oregon Swap Policy, the State may require collateralization or other credit enhancements to secure any or all swap payment obligations, where the Oregon State Treasurer determines such security is necessary to limit the credit risk or otherwise protect the interests of the State.

*Interest Rate Risk* – is the risk that changes in interest rates will adversely affect the fair values of a government's cash flows. The Department is exposed to interest rate risk on its pay-fixed, receive variable interest rate swap. As the one-month LIBOR rate decreases, the Department's net payment on the swap increases.

*Basis Risk* – is the risk that arises when variable rates of a hedging derivative instrument and a hedged item are based on different reference rates. The variable-rate debt hedged by the Department's interest rate swap is variable-rate demand obligation *(VRDO)* bonds that are remarketed weekly. The Department is exposed to basis risk on its pay-fixed interest rate swap that is hedging the VRDO bonds, because the variable-rate payments received by the Department are based on a rate other than the interest rates the Department pays on the VRDO bonds. At June 30, 2014, the interest rate on the Department's variable-rate hedged debt is 0.05%, while the 62.6% of one-month LIBOR plus 0.265% is 0.359526%.

*Termination Risk* – is the risk that a hedging derivative instrument's unscheduled end will affect a government's asset and liability strategy or will present the government with potentially significant unscheduled termination payments to the counterparty. The Department or its counterparties may terminate the interest rate swap if the other party fails to perform under the terms of the contract.

**Cash Flows**

As interest rates fluctuate, variable-rate bond interest payments and net swap payments will differ between the fixed payments paid to the counterparty and the variable rate paid to the Department. Using interest rates as of June 30, 2014, debt service requirements of the variable-rate debt *(on the notional amount of the swap)* and net swap payments are as follows:

| *Fiscal Year* | *Principal* | *Interest* | *Interest Rate Swap (Net)* | *Total* |
|---|---|---|---|---|
| 2015 | $ - | $ 12,500 | $ 827,600 | $ 840,100 |
| 2016 | 410,000 | 12,450 | 817,622 | 1,240,072 |
| 2017 | 445,000 | 12,206 | 803,221 | 1,260,427 |
| 2018 | 480,000 | 11,994 | 787,461 | 1,279,455 |
| 2019 | 505,000 | 11,751 | 770,992 | 1,287,743 |
| 2020-2024 | 3,085,000 | 54,519 | 3,566,194 | 6,705,713 |
| 2025-2029 | 4,245,000 | 45,504 | 2,955,035 | 7,245,539 |
| 2030-2034 | 5,850,000 | 33,140 | 2,113,146 | 7,996,286 |
| 2035-2039 | 8,035,000 | 16,105 | 955,694 | 9,006,799 |
| 2040 | 1,945,000 | 655 | 16,386 | 1,962,041 |
| ***TOTAL*** | $ 25,000,000 | $ 210,824 | $ 13,613,351 | $ 38,824,175 |

**Contingent Features**

If the State of Oregon's unsecured, unenhanced general obligation debt rating reaches certain levels, the Department is required to post collateral to the lower of the following ratings:

| S&P Rating | Moody's Rating | Threshold | Minimum Transfer Amount |
|---|---|---|---|
| A- or higher | A3 or higher | Infinite | N/A |
| BBB+ or below | Baa1 or below | $0 | $100,000* |

*Minimum Transfer Amount shall be $0 if, and for so long as, neither Moody's nor S&P rate the applicable Department's debt.

## 8. CHANGES IN LONG TERM LIABILITIES

The following table provides detail on the long-term liability activity as of June 30, 2014:

| | Beginning Balance | Increases | Decreases | Ending Balance | Due Within One Year |
|---|---|---|---|---|---|
| Bond Principal | $ 291,770,000 | $ - | $ (17,605,000) | $ 274,165,000 | $ 3,645,000 |
| Bond Discount | (180,854) | - | 19,789 | (161,065) | (10,192) |
| Total Bonds Payable | 291,589,146 | - | (17,585,211) | 274,003,935 | 3,634,808 |
| Pension-Related Debt | 819,087 | - | (21,073) | 798,014 | 21,100 |
| Compensated Absences Payable | 325,303 | - | (9,426) | 315,877 | 208,479 |
| Excess Mortgage Interest & Arbitrage Rebate Payable | 18,357,159 | 2,715,120 | - | 21,072,279 | 9,024 |
| OPEB Obligation (Net) | 112,190 | 3,334 | - | 115,524 | - |
| Total Long-Term Liabilities | $ 311,202,885 | $ 2,718,454 | $ (17,615,710) | $ 296,305,629 | $ 3,873,411 |

## 9. INTERFUND TRANSACTIONS

At June 30, 2014 and 2013, the Veterans' Loan Program had outstanding interfund receivables of $134,588 and $71,798 respectively, which was due from the Veterans' Home Program for services performed by department employees related to the operation of the Oregon Veterans' Home. The balances are shown as a "Due from Other Funds" on the Statement of Net Position.

## 10. EMPLOYEE RETIREMENT PLAN

The Oregon Public Employees Retirement System *(PERS)* provides retirement plans for Department employees. PERS is administered by the Public Employees Retirement Board *(Board)*, as required by Chapters 238 and 238A of the Oregon Revised Statutes *(ORS)*. A copy of the Oregon Public Employees Retirement System annual financial report may be obtained from Fiscal Services Division, PERS, PO Box 23700, Tigard, Oregon 97281-3700.

PERS Pension

Employees of the Department who were plan members before August 29, 2003 participate in the PERS Pension, a cost-sharing multiple-employer defined benefit pension plan. The PERS retirement allowance is payable monthly for life and may be selected from several retirement benefit options as established by ORS Chapter 238. Options include survivorship benefits and lump sum payments. PERS also provides death and disability benefits.

Oregon Public Service Retirement Plan

The 2003 Oregon Legislature created the Oregon Public Service Retirement Plan *(OPSRP)*, also a cost-sharing multiple-employer plan. OPSRP is a hybrid pension plan with two components: the Pension Program *(defined benefit)* and the Individual Account Program *(defined contribution)*. Department employees hired after August 28, 2003, participate in OPSRP after completing six months of service. The OPSRP Pension Program provides a monthly pension payable for life as well as death and disability benefits as established by ORS Chapter 238A.

Beginning January 1, 2004, PERS members became members of the Individual Account Program *(IAP)* portion of OPSRP. PERS members retain their existing PERS accounts, but member contributions are now deposited in the IAP account rather than into the member's PERS account. All covered employees are required by state statute to contribute a percentage of their salary to the IAP. Current law permits employers to pay the employee contribution, which the Department does.

For the PERS Pension and the OPSRP Pension, the Department is required by ORS 238.225 and ORS 238A.220, respectively, to contribute actuarially computed amounts as determined by the Board. The funding policies provide for monthly employer and contributions. Rates are subject to change as a result of subsequent actuarial valuations.

The required State employee contributions and the required state employer contributions, shown as a percentage of covered salary, for the PERS multiple-employer plans are as follows for fiscal year 2014: the Employee rate is 6.00%; the PERS Pension Employer rate is 9.00%; and the OPSRP rate is 7.45%.

Combined employer contributions for the years ended June 30, 2014, 2013, and 2012 were approximately $216,000, $302,400, and $337,000 respectively, equal to the required contributions each year.

Combined employee contributions for the years ended June 30, 2014, 2013, and 2012 were approximately $156,000, $197,900, and $222,000 respectively.

## 11. OTHER POSTEMPLOYMENT BENEFIT PLANS

Department employees may be eligible to participate in health insurance plans and other benefit plans after retirement, collectively known as Other Postemployment Benefits *(OPEB)*. OPEB plans are offered through the Public Employees Retirement System *(PERS)* as established by Oregon Revised Statutes *(ORS)* 238.410 and the Public Employees Benefit Board *(PEBB)* as established by ORS 243.302. A copy of the Oregon Public Employees Retirement System annual financial report may be obtained from Fiscal Services Division, PERS, PO Box 23700, Tigard, Oregon 97281-3700

Retirement Health Insurance Account

The Retirement Health Insurance Account *(RHIA)* is a cost-sharing multiple-employer OPEB plan which provides a payment of up to $60 toward the monthly cost of health insurance for eligible PERS members. To be eligible for the RHIA subsidy, the member must: (1) have eight years or more of qualifying service in PERS at the time of retirement or receive a disability allowance as if the member had eight years or more of creditable service in PERS, (2) receive both Medicare parts A and B coverage, and (3) enroll in a PERS-sponsored health insurance plan.

The Department is required by statute to contribute actuarially computed amounts as determined by PERS. Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for the fiscal year ended June 30, 2014 was 0.59% for Tier 1 and Tier 2 employees and 0.49% for OPSRP employees, which is embedded within the total PERS contribution rate.

Combined employer contributions for the years ended June 30, 2014, 2013, and 2012 were approximately $14,200, $18,500 and $20,800 respectively, equal to the required contributions each year.

The Legislature has the sole authority to amend the benefit provisions and funding policy for the RHIA plan.

<u>Retiree Health Insurance Premium Account</u>
The Retiree Health Insurance Premium Account *(RHIPA)* is a single-employer OPEB plan that provides for payment of the average difference between the health insurance premiums paid by retired state employees, under contracts entered into by the PERS Board, and health insurance premiums paid by state employees who are not retired. Retired state employees are qualified to receive the RHIPA subsidy if they had eight or more years of qualifying service in PERS at the time of retirement or are receiving a disability pension calculated as if they had eight or more years of qualifying service, but are not eligible for federal Medicare coverage.

The Department is required by statute to contribute actuarially computed amounts as determined by PERS. Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for the fiscal year ended June 30, 2014 was 0.27% for Tier 1 and Tier 2 employees and 0.20% for OPSRP employees, which is embedded within the total PERS contribution rate. The Department's actual contribution for the years ended June 30, 2014, 2013, and 2012 were approximately $6,200, $4,800 and $5,400 respectively, which was equal to the actuarial required contribution.

The Legislature has the sole authority to amend the benefit provisions and funding policy for the RHIPA plan.

<u>Public Employees Benefit Board Plan</u>
The PEBB plan is an agent multiple-employer plan, which offers medical, dental, and vision benefits to eligible retired employees. Retired employees not eligible for Medicare are eligible for PEBB coverage if the retiree is receiving a service or disability benefit from PERS or another state system, is eligible to receive a retirement allowance from PERS and has reached the earliest retirement age under ORS Chapter 238, or is eligible to receive a service allowance or pension under any system offered by the state and has attained the earliest retirement age under that system. The PEBB Plan funding policy provides for contributions at amounts sufficient to fund benefits on a pay-as-you-go basis. Active employees do not make contributions. Participating retirees pay their own monthly premiums based on a blended

premium rate since retirees are pooled together with active employees for insurance rating purposes.

ORS 243 assigns PEBB the authority to establish and amend the benefit provisions of the PEBB Plan. As the administrator of the PEBB Plan, PEBB has the authority to determine postretirement benefit increases and decreases.

## 12. LEASE COMMITMENT AND RECEIVABLES

The Department leases office space to other state agency tenants at its headquarters in Salem. For the fiscal year ended June 30, 2014, the total rental income received from tenants was $817,760.

| | Lease Effective Date | Lease Termination Date | Future Rental Income |
|---|---|---|---|
| Tenant 1 | July 1, 2013 | June 30, 2015 | $ 164,247 |
| Tenant 2 | July 1, 2013 | June 30, 2015 | 356,792 |
| Tenant 3 | July 1, 2013 | June 30, 2015 | 60,175 |
| Tenant 4 | July 1, 2013 | June 30, 2015 | 147,555 |
| Tenant 5 | August 1, 2013 | June 30, 2015 | 98,514 |
| Total | | | $ 827,283 |

The approximate historical cost of this office space is $2,739,145 with a carrying value of $1,349,328 *(historical cost less accumulated depreciation of $1,389,817).*

## 13. RISK FINANCING

The State of Oregon administers property and casualty insurance programs covering State government through its Central Services Fund *(Insurance Fund)*. The Insurance Fund services claims for direct physical loss or damage to State property; tort liability claims brought against the State, its officers, employees, or agents; worker's compensation; employee dishonesty; and faithful performance coverage for certain key positions required by law to be covered, and other key positions.

As a state agency, the Department participates in the Insurance Fund. The cost of servicing insurance claims and payments is covered by charging an assessment to each State entity based on its share of services provided in a prior period. The total statewide assessment for the cost of servicing is based on independent biennial actuarial forecasts and administrative expenses, less any available fund balance in the Insurance Fund from the prior biennium.

Risk Management Division of the Department of Administrative Services is the State's manager for self-insurance, insurance and risk control. Risk Management Division investigates, evaluates and resolves claims for damage to state property and for loss or injury to the public arising out of state activities. Division staff consult with and advise state agencies on claim related loss control issues. State agencies are responsible for informing Risk Management Division in a timely fashion when they become aware that property or liability damage has occurred.

During the fiscal years ended June 30, 2014 and June 30, 2013 there has been no significant reductions in insurance coverage in any risk category. Also, for the past ten fiscal years *(July 1, 2004 through June 30, 2014)* there have been no claims that exceeded the Department's property or liability coverage.

## 14. PRIOR PERIOD ADJUSTMENTS

During fiscal year ended June 30, 2013, the Department recorded a prior period adjustment of $837,352. This adjustment consisted of recording the Department's portion of statewide pension related debt.

## 15. CHANGE IN ACCOUNTING PRINCIPLE

Implementation of GASB Statement 65, *Items Previously Reported as Assets and Liabilities*¸ resulted in a change in accounting principle related to the write-off of underwriter's discounts. As of June 30, 2014, the Department wrote-off its underwriter's discount through a change in accounting principle on the Statement of Revenues, Expenses, and Changes in Net Position in the amount of $1,218,172.

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# *STATISTICAL SECTION*

***UNAUDITED***

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

**ASSETS, LIABILITIES AND NET POSITION**

PROPRIETARY FUND - VETERANS' LOAN PROGRAM

FOR THE FISCAL YEARS ENDED 2005 - 2014

| **ASSETS & DEFERRED OUTFLOWS** | June 30, 2014 | June 30, 2013 | June 30, 2012 | June 30, 2011 |
|---|---|---|---|---|
| **Current Assets** | | | | |
| Cash and Cash Equivalents *(1)* | $ 81,418,994 | $ 91,182,217 | $ 70,538,060 | $ 92,654,442 |
| Cash and Cash Equivalents - Restricted | 2,019,125 | 1,805,833 | 1,970,398 | 3,107,401 |
| Securities Lending Cash Collateral | 12,366,201 | 13,766,369 | 22,652,458 | 67,609,488 |
| Investments | 10,145,257 | 7,010,850 | 14,525,830 | 3,540,625 |
| Investments - Restricted | - | - | - | 5,005,250 |
| Receivables: | | | | |
| Accrued Interest | 1,117,525 | 1,246,755 | 1,485,707 | 1,641,564 |
| LCLI Premiums | 47,253 | 59,058 | 70,243 | 71,655 |
| Other | 80,456 | 38,988 | 24,542 | 24,638 |
| Due from Other Funds | 134,588 | 71,798 | 68,285 | 66,147 |
| Real Estate Owned | 680,635 | 1,087,119 | 1,908,323 | 1,570,465 |
| Prepaid Expenses | 6,080 | 2,405 | 8,506 | 6,946 |
| **Total Current Assets** | $ 108,016,114 | $ 116,271,392 | $ 113,252,352 | $ 175,298,621 |
| **Noncurrent Assets** | | | | |
| Cash and Cash Equivalents - Restricted | $ 107,661,208 | $ 134,842,147 | $ 140,316,030 | $ 139,488,446 |
| Investments | - | - | 7,005,810 | 21,783,303 |
| Investments - Restricted | - | - | - | 3,269,211 |
| Mortgage Loans and Contracts Receivable (Net) | 212,809,406 | 197,333,478 | 217,022,740 | 247,018,965 |
| Notes Receivable | - | - | - | - |
| Other Receivable | 4,148,543 | 1,526,883 | 1,082,269 | 523,531 |
| Deferred Underwriter's Discount | - | 1,218,172 | 1,303,955 | 1,937,005 |
| Capital Assets: | | | | |
| Building, Property and Equipment | 8,995,981 | 8,984,206 | 8,925,405 | 8,954,357 |
| Works of Art and Historical Treasures | 627,021 | 627,021 | 627,021 | 85,170 |
| Accumulated Depreciation | (5,288,119) | (5,187,564) | (5,088,810) | (5,008,953) |
| **Total Noncurrent Assets** | $ 328,954,040 | $ 339,344,343 | $ 371,194,420 | $ 418,051,035 |
| Deferred Outflow of Resources *(2)* | $ 1,895,225 | $ 2,250,525 | $ 3,047,423 | $ 1,808,678 |
| **TOTAL ASSETS & DEFERRED OUTFLOWS** | $ 438,865,379 | $ 457,866,260 | $ 487,494,195 | $ 595,158,334 |
| **LIABILITIES** | | | | |
| **Current Liabilities** | | | | |
| Accounts Payable | $ 144,124 | $ 76,910 | $ 167,851 | $ 237,200 |
| Line of Credit Payable | - | - | - | - |
| LCLI Premium Payable | 34,124 | 35,571 | 40,635 | 58,000 |
| LCLI Claims Payable | 42,245 | 190,401 | 19,406 | 90,094 |
| Deposit Liabilities | 1,920,002 | 1,695,262 | 1,834,763 | 1,976,620 |
| Accrued Interest on Bonds | 380,999 | 425,153 | 450,338 | 964,913 |
| Obligations Under Securities Lending | 12,366,201 | 13,766,369 | 22,652,458 | 67,609,488 |
| Claims and Judgements Payable | - | - | - | - |
| Pension-Related Debt *(3)* | 21,100 | 18,300 | - | - |
| Compensated Absences Payable | 208,479 | 211,447 | 301,467 | 296,022 |
| Excess Interest and Arbitrage Rebate Payable | 9,024 | - | - | - |
| Bonds Payable - Maturing Within One Year (Net) | 3,634,808 | 3,478,108 | 3,377,727 | 3,302,227 |
| Matured Bonds Payable | 65,000 | 75,000 | 95,000 | 1,072,780 |
| **Total Current Liabilities** | $ 18,826,106 | $ 19,972,521 | $ 28,939,645 | $ 75,607,344 |
| **Noncurrent Liabilities** | | | | |
| Bonds Payable - Maturing After One Year (Net) | $ 270,369,127 | $ 288,111,038 | $ 308,656,156 | $ 371,039,732 |
| Claims and Judgements Payable | - | - | - | - |
| Pension-Related Debt *(3)* | 776,914 | 800,787 | - | - |
| Compensated Absences Payable | 107,398 | 113,856 | 155,301 | 152,496 |
| Excess Interest and Arbitrage Rebate Payable | 21,063,255 | 18,357,159 | 15,860,488 | 13,170,925 |
| Other Postemployment Benefits Obligation (Net) | 115,524 | 112,190 | 100,645 | 87,656 |
| Derivative Instrument - Interest Rate Swap *(2)* | 1,895,225 | 2,250,525 | 3,047,423 | 1,808,678 |
| **Total Noncurrent Liabilities** | $ 294,327,443 | $ 309,745,555 | $ 327,820,013 | $ 386,259,487 |
| **TOTAL LIABILITIES** | $ 313,153,549 | $ 329,718,076 | $ 356,759,658 | $ 461,866,831 |
| **NET POSITION** | | | | |
| Net Investment in Capital Assets | $ 4,334,883 | $ 4,423,663 | $ 4,463,616 | $ 4,030,574 |
| Net Assets, Unrestricted | 121,376,947 | 123,724,521 | 126,270,921 | 129,260,929 |
| **TOTAL NET POSITION** | $ 125,711,830 | $ 128,148,184 | $ 130,734,537 | $ 133,291,503 |
| **TOTAL LIABILITIES AND NET POSITION** | $ 438,865,379 | $ 457,866,260 | $ 487,494,195 | $ 595,158,334 |

*(1) Current Cash and Cash Equivalents amounts have been adjusted for deposit liabilities.*

*(2) Starting in fiscal year 2010, derivatives reported separately as required by GASB Statement 53.*

*(3) Starting in fiscal year 2013, pension-related debt reported separately as required by GASB Statement 27.*

| June 30, 2010 | June 30, 2009 | June 30, 2008 | June 30, 2007 | June 30, 2006 | June 30, 2005 |
|---|---|---|---|---|---|
| $ 89,880,157 | $ 63,666,685 | $ 87,234,247 | $ 80,795,986 | $ 68,536,698 | $ 73,133,598 |
| 4,601,059 | 5,454,658 | 6,685,594 | 6,308,466 | 5,775,565 | 6,211,795 |
| 91,912,913 | 209,834,541 | 220,256,145 | 171,313,426 | 56,088,643 | 84,522,242 |
| 10,903,602 | 22,126,185 | 2,511,661 | - | - | - |
| 15,004,650 | 25,537,018 | 56,189,591 | 95,073,362 | 100,656,772 | - |
| | | | | | |
| 1,957,271 | 2,157,552 | 2,945,247 | 2,753,190 | 3,240,750 | 3,876,695 |
| 87,229 | 92,070 | 107,214 | 147,259 | 170,762 | 185,655 |
| 24,407 | 13,256 | 10,817 | 10,875 | 34,301 | 11,731 |
| 67,428 | 72,172 | 63,499 | 73,850 | 138,755 | 494,164 |
| 1,429,235 | 591,530 | 9,842 | - | - | 96,048 |
| 7,970 | 5,379 | 16,145 | 39,796 | 27,271 | 8,115 |
| $ 215,875,921 | $ 329,551,046 | $ 376,030,002 | $ 356,516,210 | $ 234,669,517 | $ 168,540,043 |
| | | | | | |
| $ 166,349,089 | $ 413,146,725 | $ 372,930,995 | $ 402,707,726 | $ 419,260,547 | $ 428,157,516 |
| 7,845,319 | 15,815,890 | - | 2,544,843 | 2,564,209 | - |
| 13,127,161 | 25,520,715 | 84,613,906 | 30,074,187 | 26,342,808 | 134,928,764 |
| 274,950,313 | 298,087,844 | 306,408,188 | 283,736,757 | 266,034,069 | 284,220,290 |
| - | - | - | 123,428 | 176,040 | 360,000 |
| 449,742 | 270,279 | 2,391,606 | 1,712,187 | 1,931,151 | 481,294 |
| 1,914,482 | 2,025,039 | 2,158,705 | 1,847,213 | 1,991,927 | 1,929,928 |
| | | | | | |
| 8,911,904 | 8,911,904 | 9,484,489 | 9,563,859 | 9,949,641 | 9,945,155 |
| 85,170 | 85,170 | 85,170 | 85,170 | 85,170 | 85,170 |
| (4,891,793) | (4,774,826) | (5,226,182) | (5,269,006) | (5,647,415) | (5,391,789) |
| $ 468,741,387 | $ 759,088,740 | $ 772,846,877 | $ 727,126,364 | $ 722,688,147 | $ 854,716,328 |
| $ 2,249,775 | $ - | $ - | $ - | $ - | $ - |
| $ 686,867,083 | $ 1,088,639,786 | $ 1,148,876,879 | $ 1,083,642,574 | $ 957,357,664 | $ 1,023,256,371 |
| | | | | | |
| $ 228,675 | $ 240,559 | $ 358,119 | $ 292,260 | $ 301,996 | $ 361,717 |
| - | - | 1,000,000 | 30,835,000 | 1,000,000 | - |
| 67,779 | 86,853 | 99,208 | 103,602 | 135,470 | 171,010 |
| 243,351 | 108,999 | 108,164 | 254,704 | 13,762 | 137,379 |
| 2,107,611 | 2,200,352 | 2,187,904 | 2,005,195 | 1,637,899 | 1,503,156 |
| 1,046,013 | 1,249,984 | 3,201,652 | 6,144,051 | 8,234,121 | 9,891,835 |
| 91,912,913 | 209,834,541 | 220,256,145 | 171,313,426 | 56,088,643 | 84,522,242 |
| - | - | - | 875 | - | - |
| - | - | - | - | - | - |
| 289,901 | 283,340 | 279,685 | 287,513 | 294,236 | 252,202 |
| 487,548 | 452,944 | 268,193 | 105,259 | 212,771 | - |
| 2,006,453 | 2,041,454 | 41,454,365 | 61,353,153 | 62,250,115 | 62,727,149 |
| 2,425,669 | 3,167,453 | 4,398,482 | 4,199,669 | 4,002,196 | 4,537,629 |
| $ 100,815,913 | $ 219,666,479 | $ 273,611,917 | $ 276,894,707 | $ 134,171,209 | $ 164,104,319 |
| | | | | | |
| $ 438,887,949 | $ 730,324,401 | $ 735,100,855 | $ 677,075,220 | $ 701,016,462 | $ 738,766,577 |
| - | - | - | - | 15,518 | - |
| - | - | - | - | - | - |
| 149,343 | 139,556 | 137,755 | 141,611 | 98,079 | 108,087 |
| 10,486,694 | 5,766,794 | 3,180,198 | 1,561,754 | 891,286 | 402,055 |
| 76,075 | 63,679 | 33,247 | - | - | - |
| 2,249,775 | - | - | - | - | - |
| $ 451,849,836 | $ 736,294,430 | $ 738,452,055 | $ 678,778,585 | $ 702,021,345 | $ 739,276,719 |
| $ 552,665,749 | $ 955,960,909 | $ 1,012,063,972 | $ 955,673,292 | $ 836,192,554 | $ 903,381,038 |
| | | | | | |
| $ 4,105,281 | $ 4,222,248 | $ 4,343,477 | $ 4,380,023 | $ 4,387,396 | $ 4,638,536 |
| 130,096,053 | 128,456,629 | 132,469,430 | 123,589,259 | 116,777,714 | 115,236,797 |
| $ 134,201,334 | $ 132,678,877 | $ 136,812,907 | $ 127,969,282 | $ 121,165,110 | $ 119,875,333 |
| $ 686,867,083 | $ 1,088,639,786 | $ 1,148,876,879 | $ 1,083,642,574 | $ 957,357,664 | $ 1,023,256,371 |

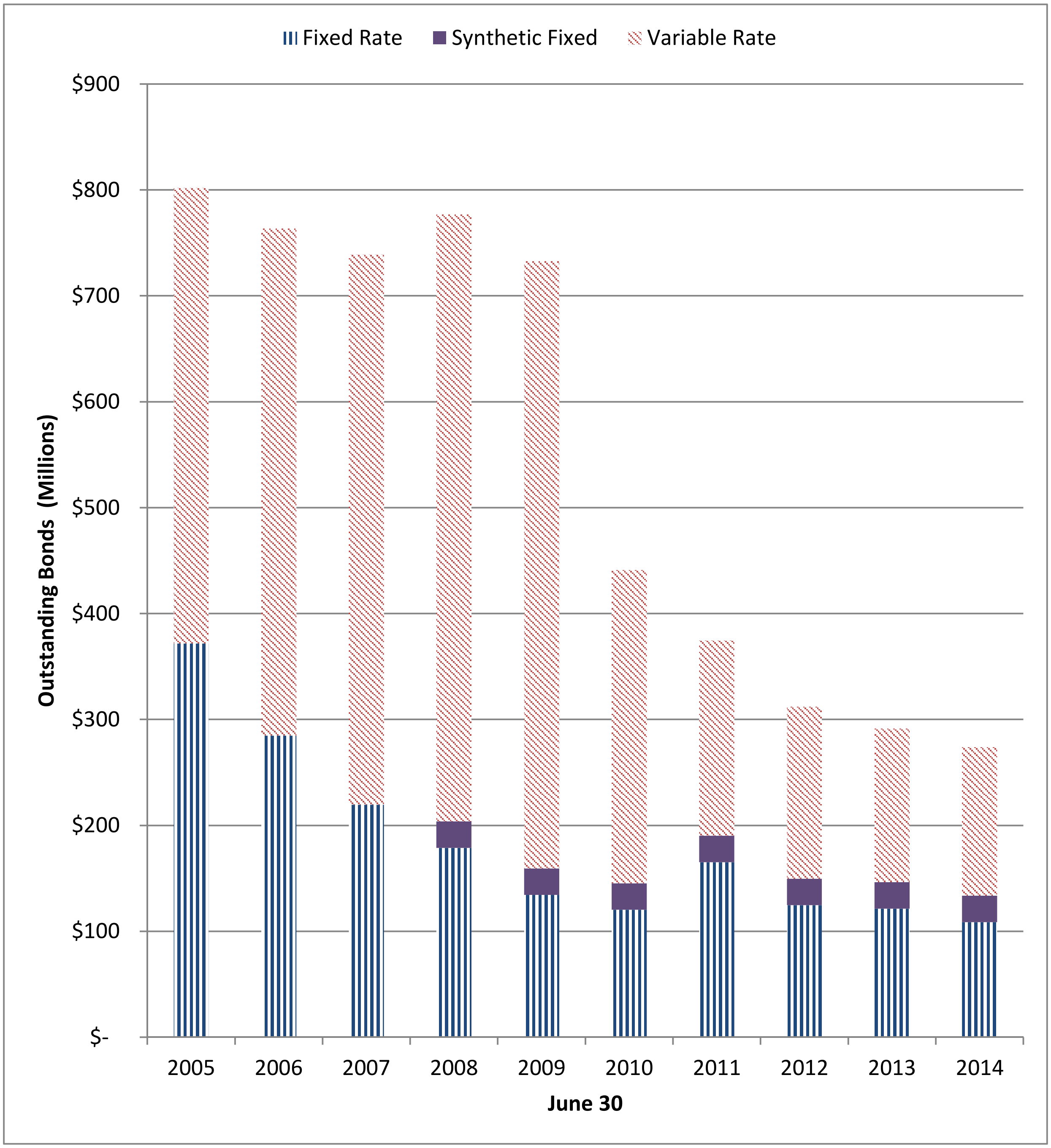
***UNAUDITED***
STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
**REVENUES, EXPENSES AND CHANGES IN NET POSITION**
PROPRIETARY FUND - VETERANS' LOAN PROGRAM
FOR THE FISCAL YEARS ENDED 2005 - 2014

| | June 30, 2014 | June 30, 2013 | June 30, 2012 | June 30, 2011 |
|---|---|---|---|---|
| **OPERATING REVENUES** | | | | |
| Mortgage Loan Interest Income | $ 7,441,010 | $ 8,827,619 | $ 10,494,442 | $ 11,797,640 |
| Contract Interest Income | 57,000 | 69,347 | 108,784 | 139,828 |
| Other Interest Income | - | - | - | - |
| Investment Income | 1,700,149 | 2,162,639 | 2,327,058 | 4,043,049 |
| Gain on Sale of Foreclosed Property | 262,886 | 53,635 | 76,034 | 295,954 |
| Loan Cancellation Life Insurance Premiums | 493,942 | 605,167 | 715,356 | 822,503 |
| Loan Cancellation Life Insurance Processing Fees | 87,000 | 102,000 | 102,000 | 102,000 |
| Other Fees and Charges | 2,324,761 | 1,636,638 | 1,689,093 | 1,516,602 |
| Conservatorship Fees | 364,090 | 264,161 | 298,380 | 289,939 |
| **TOTAL OPERATING REVENUES** | $ 12,730,838 | $ 13,721,206 | $ 15,811,147 | $ 19,007,515 |
| **OPERATING EXPENSES** | | | | |
| Bond Interest | $ 5,847,512 | $ 6,119,393 | $ 7,498,587 | $ 8,520,503 |
| Interest on Line of Credit | - | - | - | - |
| Salaries and Other Payroll | 4,052,936 | 4,802,451 | 5,653,694 | 5,717,843 |
| Bond Expenses | 866,823 | 1,020,215 | 1,858,820 | 1,378,103 |
| Securities Lending Investment Expense | 12,873 | 41,639 | 57,794 | 232,258 |
| Real Estate Owned Expense | 328,002 | 300,065 | 491,313 | 259,411 |
| Services and Supplies | 1,491,581 | 1,253,702 | 1,340,540 | 1,744,035 |
| Claims Expense - Loan Cancellation Life Insurance | 1,244,045 | 1,294,691 | 1,091,934 | 1,155,382 |
| Interest | 51,735 | 54,142 | - | - |
| Depreciation | 100,555 | 98,754 | 108,809 | 117,160 |
| Bad Debt | (1,187,213) | (177,874) | 336,329 | 360,478 |
| Special Payments | - | - | - | - |
| Other | 973,850 | 467,545 | 242,959 | 117,585 |
| **TOTAL OPERATING EXPENSES** | $ 13,782,699 | $ 15,274,723 | $ 18,680,779 | $ 19,602,758 |
| **OPERATING INCOME (LOSS)** | $ (1,051,861) | $ (1,553,517) | $ (2,869,632) | $ (595,243) |
| **NONOPERATING INCOME (EXPENSES)** | | | | |
| Net Transfers to Dept. of Administrative Services | $ (166,321) | $ (209,608) | $ (229,185) | $ (225,977) |
| Net Transfers from Military Dept. | - | 14,124 | - | - |
| Net Transfers from/(to) General Fund | - | - | - | - |
| Gain/(Loss) on Early Extinguishment of Debt | - | - | - | - |
| | (166,321) | (195,484) | (229,185) | (225,977) |
| **CHANGE IN NET POSITION** | $ (1,218,182) | $ (1,749,001) | $ (3,098,817) | $ (821,220) |
| **NET POSITION** | | | | |
| Beginning Net Position | $ 128,148,184 | $ 130,734,537 | $ 133,291,503 | $ 134,201,334 |
| Prior Period Adjustment | - | (837,352) | 541,851 | (88,611) |
| Cumulative Effect of Change in Accounting Principle | (1,218,172) | - | - | - |
| Beginning Net Position, Restated | $ 126,930,012 | $ 129,897,185 | $ 133,833,354 | $ 134,112,723 |
| Ending Net Position | $ 125,711,830 | $ 128,148,184 | $ 130,734,537 | $ 133,291,503 |

| | June 30, 2010 | June 30, 2009 | June 30, 2008 | June 30, 2007 | June 30, 2006 | June 30, 2005 |
|---|---|---|---|---|---|---|
| | $ 11,445,675 | $ 16,014,046 | $ 17,611,704 | $ 17,526,662 | $ 17,561,219 | $ 21,225,116 |
| | 209,608 | 302,145 | 434,945 | 593,760 | 806,376 | 1,169,324 |
| | - | - | 3,219 | 7,595 | 10,953 | 19,050 |
| | 6,964,830 | 4,673,050 | 33,154,407 | 37,675,500 | 28,198,335 | 18,013,534 |
| | 34,542 | 35,160 | - | - | 7,551 | 139,199 |
| | 962,230 | 1,142,192 | 1,356,657 | 1,626,287 | 1,962,357 | 2,523,140 |
| | 102,000 | 102,000 | 102,000 | 180,000 | 180,000 | 220,834 |
| | 1,733,649 | 1,841,337 | 2,155,231 | 2,131,847 | 1,941,079 | 947,834 |
| | 284,381 | 294,951 | 313,493 | 333,974 | 354,808 | 334,340 |
| | $ 21,736,915 | $ 24,404,881 | $ 55,131,656 | $ 60,075,625 | $ 51,022,678 | $ 44,592,371 |
| | $ 8,495,161 | $ 15,702,350 | $ 26,856,570 | $ 34,581,972 | $ 35,121,631 | $ 37,103,554 |
| | - | 49,948 | 721,945 | 279,906 | 525,600 | 159,267 |
| | 5,642,344 | 5,773,576 | 5,953,581 | 5,445,234 | 5,239,879 | 4,793,870 |
| | 1,117,848 | 1,247,214 | 1,242,882 | 1,581,932 | 1,129,971 | 1,324,123 |
| | 320,983 | 1,270,291 | 6,678,572 | 6,266,412 | 2,910,155 | 2,199,165 |
| | 130,125 | 29,547 | 2,324 | 2,267 | 9,485 | 47,490 |
| | 1,867,440 | 1,665,656 | 1,971,272 | 2,133,903 | 2,174,420 | 1,776,839 |
| | 1,266,568 | 1,938,157 | 2,312,867 | 2,717,581 | 2,952,064 | 4,637,009 |
| | - | - | - | - | - | - |
| | 116,967 | 113,378 | 160,174 | 156,656 | 255,626 | 359,441 |
| | 936,600 | - | - | (545,135) | (918,401) | (1,104,080) |
| | - | (1,106) | 98,674 | - | - | - |
| | 94,516 | 325,670 | 687,994 | 645,158 | 332,471 | 170,187 |
| | $ 19,988,552 | $ 28,114,681 | $ 46,686,855 | $ 53,265,886 | $ 49,732,901 | $ 51,466,865 |
| | $ 1,748,363 | $ (3,709,800) | $ 8,444,801 | $ 6,809,739 | $ 1,289,777 | $ (6,874,494) |
| | $ (225,906) | $ (230,438) | $ - | $ (5,567) | $ - | $ - |
| | - | - | 98,824 | - | - | - |
| | - | (185,941) | 300,000 | - | - | - |
| | - | (7,851) | - | - | - | - |
| | (225,906) | (424,230) | 398,824 | (5,567) | - | - |
| | $ 1,522,457 | $ (4,134,030) | $ 8,843,625 | $ 6,804,172 | $ 1,289,777 | $ (6,874,494) |
| | $ 132,678,877 | $ 136,812,907 | $ 127,969,282 | $ 121,165,110 | $ 119,875,333 | $ 126,749,827 |
| | - | - | - | - | - | - |
| | - | - | - | - | - | - |
| | $ 132,678,877 | $ 136,812,907 | $ 127,969,282 | $ 121,165,110 | $ 119,875,333 | $ 126,749,827 |
| | $ 134,201,334 | $ 132,678,877 | $ 136,812,907 | $ 127,969,282 | $ 121,165,110 | $ 119,875,333 |

**UNAUDITED**
**OREGON DEPARTMENT OF VETERANS' AFFAIRS**
**VETERANS' LOAN PROGRAM**

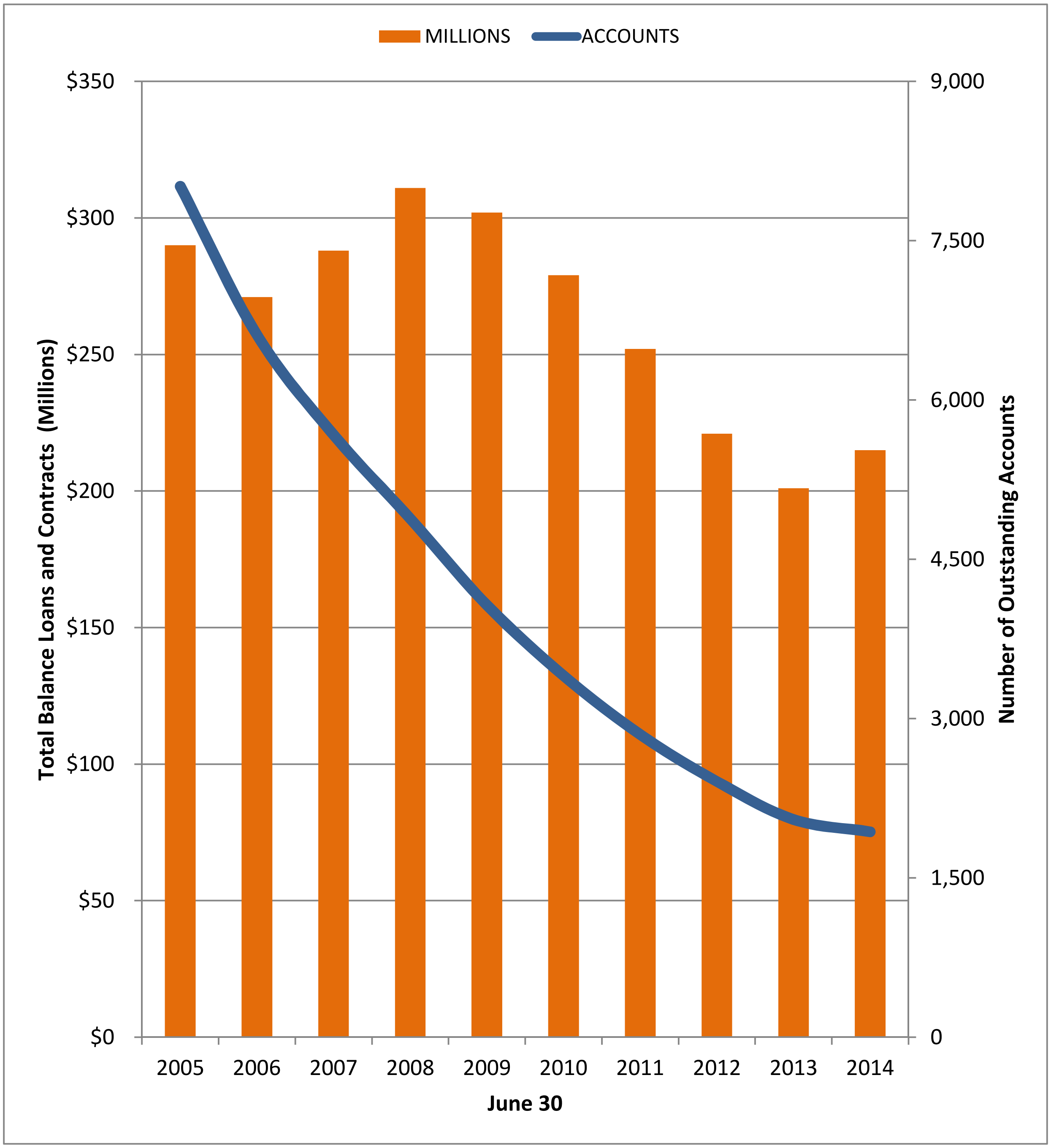
## PRINCIPAL BALANCE OF BONDS OUTSTANDING




**Source: Statistical Reports and Financial Statements of the Oregon Department of Veterans' Affairs.**

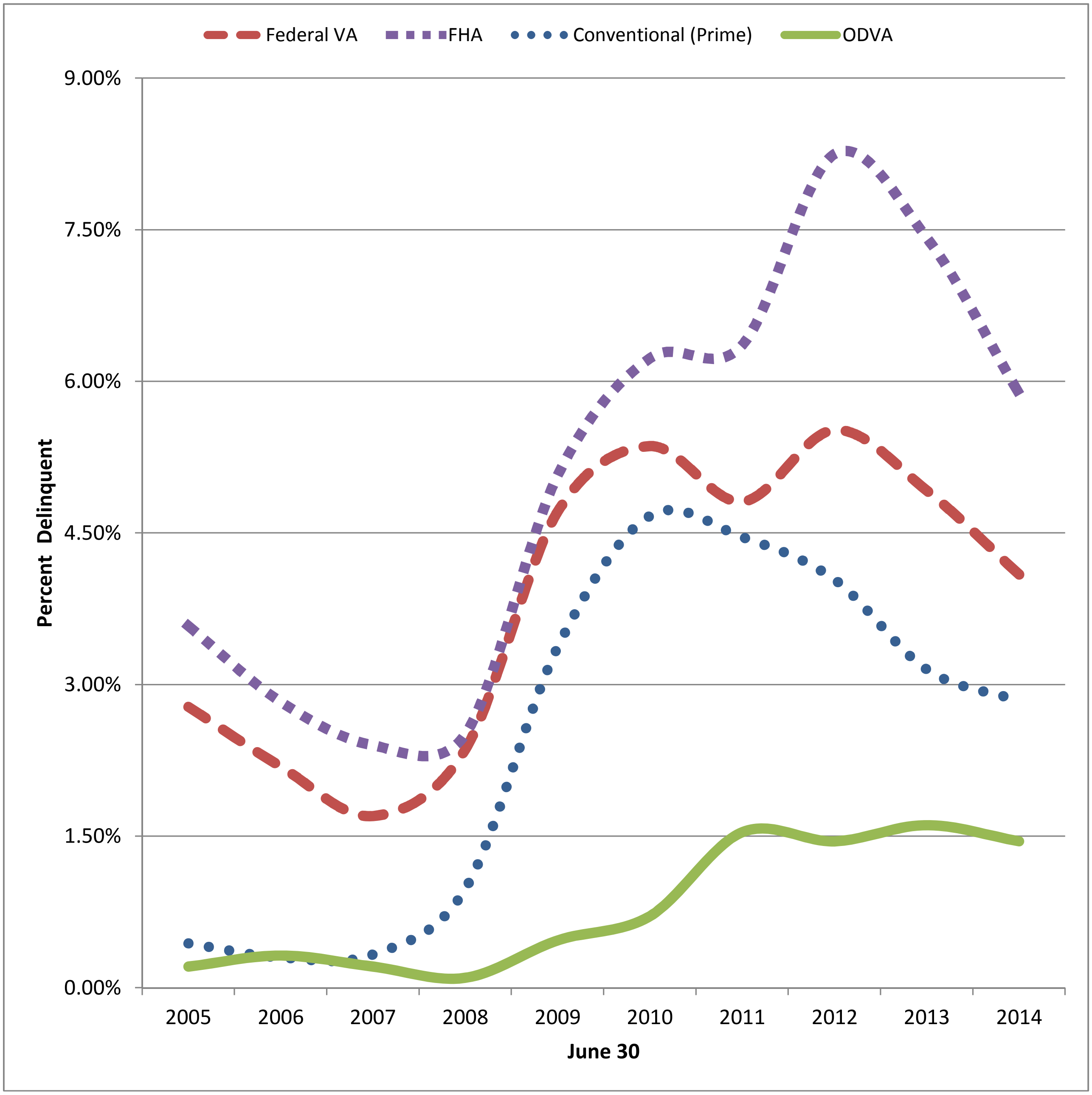
**UNAUDITED**
**OREGON DEPARTMENT OF VETERANS' AFFAIRS**
**VETERANS' LOAN PROGRAM**

**LOANS AND CONTRACTS OUTSTANDING**




**Source: Statistical Reports and Financial Statements of the Oregon Department of Veterans' Affairs.**

## LOAN AND CONTRACT 90+ DAY DELINQUENCIES



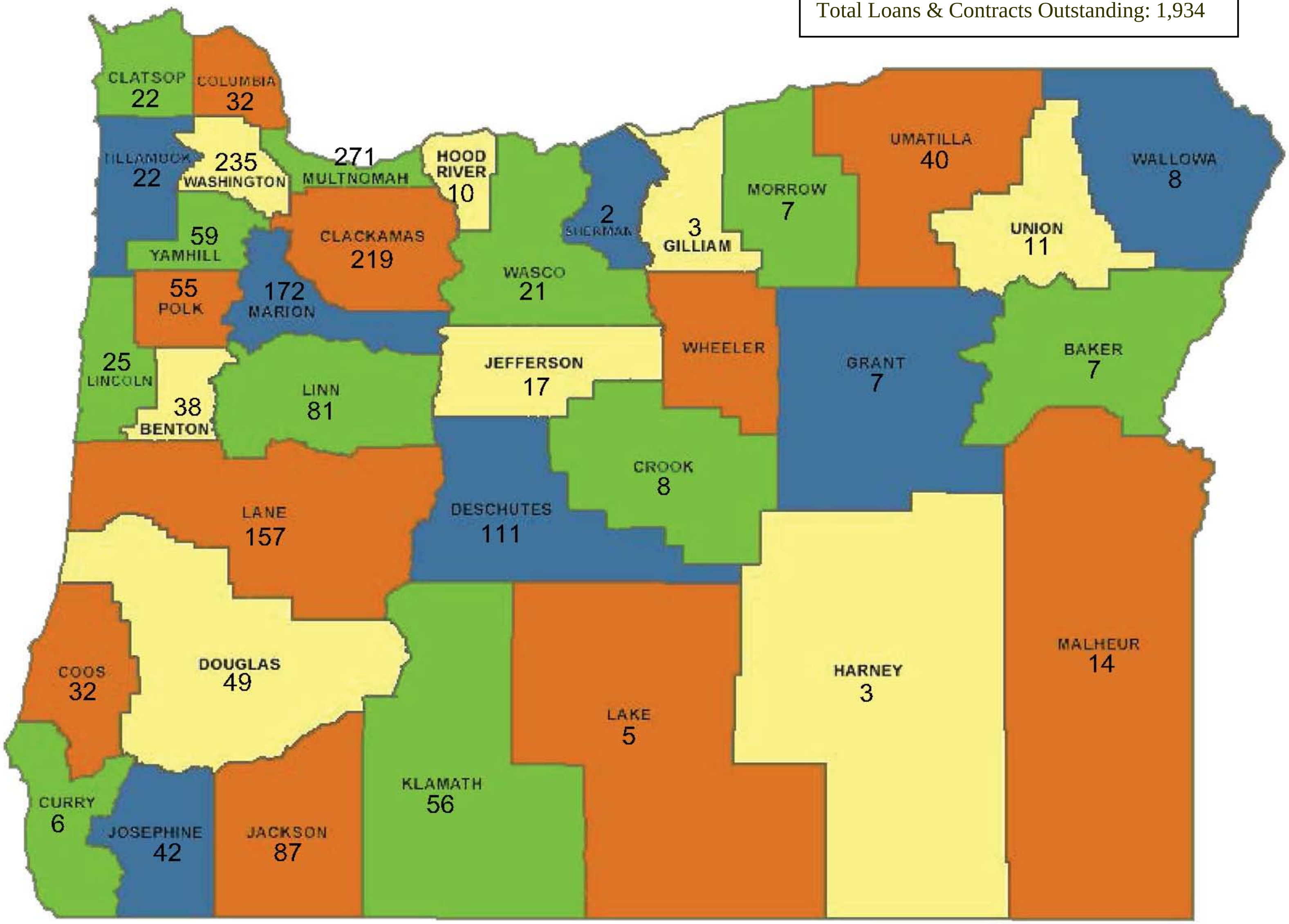

**Source: Statistical Reports of the Oregon Department of Veterans' Affairs.**

***90+ Day Delinquencies include past due loans and loans in foreclosure. Comparison includes Oregon data only.***

**UNAUDITED**
**OREGON DEPARTMENT OF VETERANS' AFFAIRS**

**LOANS AND CONTRACTS OUTSTANDING BY COUNTY**
**AS OF JUNE 30, 2014**

Total Loans & Contracts Outstanding: 1,934




**Source: Statistical Reports of the Oregon Department of Veterans' Affairs**

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# *OTHER REPORTS*

**Office of the Secretary of State**

Kate Brown
Secretary of State

Robert Taylor
Deputy Secretary of State

**Audits Division**

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(503) 986-2255
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## Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Honorable John Kitzhaber, Governor of Oregon

Cameron Smith, Director, Oregon Department of Veterans' Affairs

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Veterans' Loan Program, an enterprise fund of the State of Oregon, Department of Veterans' Affairs (Department), as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated October 28, 2014.

### Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

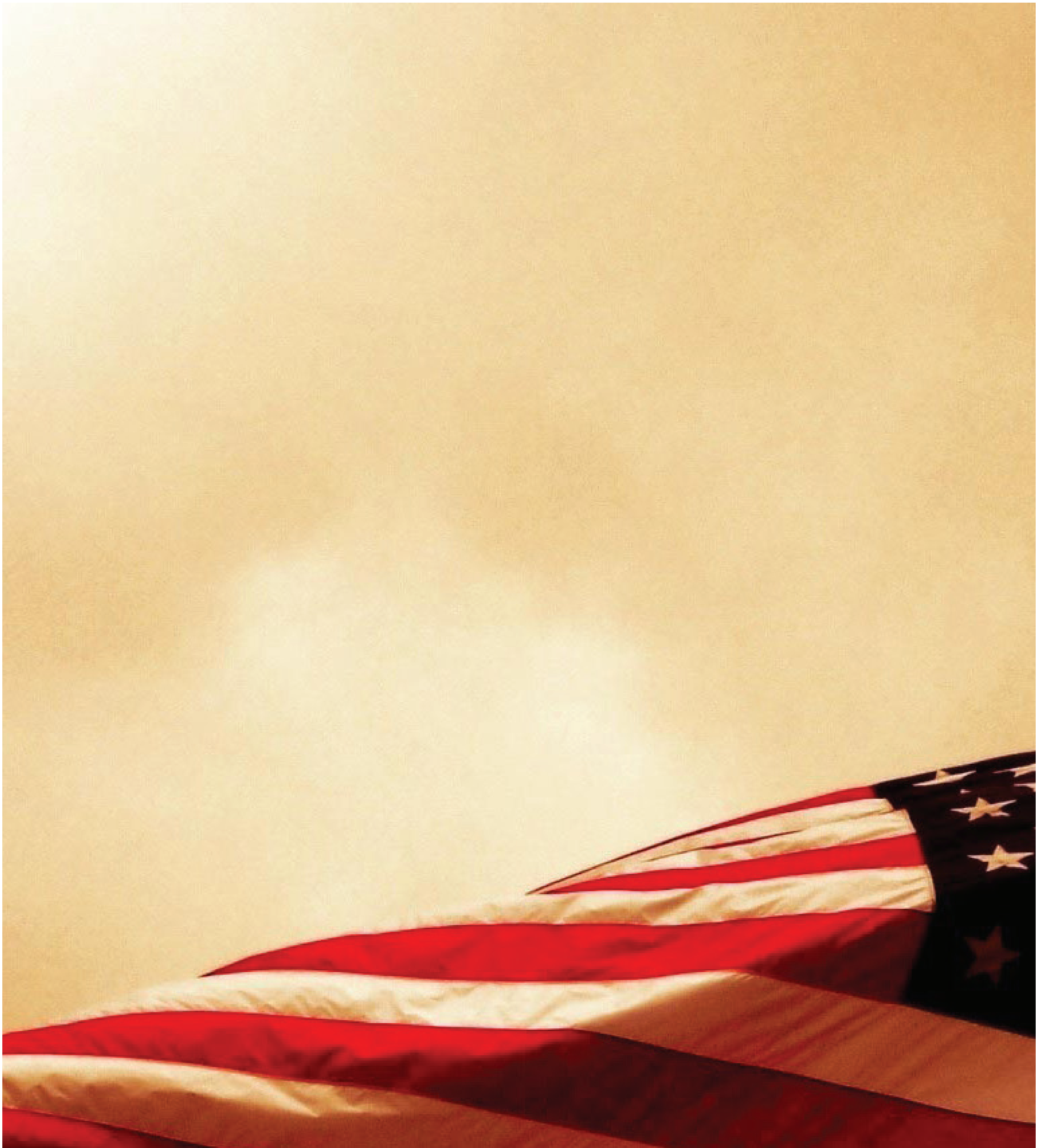
As part of obtaining reasonable assurance about whether the Department's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Office of the Secretary of State, Audits Division

State of Oregon
October 28, 2014



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