HUD APPROVED BANKING INSTRUMENTS

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

   a. U.S. Treasury Bills

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

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

   b. U.S. Treasury Notes and Bonds

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

      1. U.S. Treasury Notes

      These notes mature in not less than one (1) and not more than ten (10) years from the issue date and bear interest at fixed rates payable semi-annually.

      2. U.S. Treasury Bonds

      These bonds mature after ten (10) years from the issue date and bear interest at fixed rates payable semi-annually. Many issues of bonds are redeemable on call by the Treasury Department before maturity. The yield of such issues usually is computed to the first call date which may be as much as five (5) years prior to maturity.

2. Obligations of Federal Government Agencies:

   a. Federal Financing Bank (FFB)

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

b. Government National Mortgage Association (GNMA), Mortgage Backed Securities (GNMA I and GNMA II)

The securities, guaranteed by GNMA are issued by an issuer (a GNMA-approved mortgage lender).

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

c. GNMA Participation Certificates

These securities, guaranteed by GNMA, were sold by GNMA as the trustee with various other Federal agencies as trusters. They represent beneficial interest in future payments of principal and interest on mortgage pools. Their maturities range between one (1) and twenty (20) years and the minimum denomination is $5,000.

d. Maritime Administration Merchant Marine Bonds, Notes, Obligations

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

e. Small Business Administration (SBA) , Small Business Investment Corporation (SBIC) Debentures

When authorized by appropriation acts, the SBA may guarantee principal and interest payments on debentures of SBIC. The SBA may also pool these debentures and sell SBA-guaranteed debentures. These issues have maturities of ten (10) years and are issued in $10,000 denominations.

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

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

3. Securities of Government Sponsored Agencies:

a. Farm Credit Consolidated System Wide Discount Notes

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

b. Federal Farm Credit Banks Consolidated System-wide Bonds

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

c. Federal Home Loan Banks Consolidated Obligations

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

1. Bonds

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

2. Notes

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

3. Discount Notes

Discount notes which have maturities ranging from thirty (30) to one-hundred seventy (170) days. They are issued in denominations of $100,000 and $1,000,000.

d. FHLMC Mortgage Participation Certificates (PC) (Guaranteed)

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

e. FHLMC Collateralized Mortgage Obligations (CMOs)

CMOs are general obligations of FHLMC that are secured by a single pool of conventional mortgages owned by FHLMC. CMOs are issued in several classes with varying stated maturities. Semiannual principal payments are allocated to each class of the CMOs in the order of the stated maturity of each

class so that no principal payments are made to holders of a class until classes with an earlier maturity are retired.

f. Federal National Mortgage Association (FNMA) Debentures

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

g. FNMA Notes

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

h. FNMA Short-Term Discount Notes

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

i. FNMA Capital Debentures

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

j. Student Loan Marketing Associations (SLMA) Obligations

SMLA issues obligations comprising of guaranteed student loans as follows:

1. Floating Rate and Mater Notes

These notes bear interest at rates that vary with the 91-day Treasury Bill rate. Short-term borrowing have an original or remaining term maturity of one (1) year or less.

2. The Series E and F Floating Rate Notes

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

3. Zero Coupon Notes

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

4. Demand and Savings Deposits

Demand and savings deposits at commercial banks, mutual savings banks, savings and loan associations and credit unions are permitted for HA funds provided that the entire deposit is insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund (NCUSIF). A deposit in excess of the insurance coverage may be made at a depository institution provided that it is 100 percent collateralized by any of the securities listed under paragraphs 1, 2, and 3 of this Exhibit. Care should be taken that withdrawals may be made on demand without loss of interest and without penalty.

5. Money-Market Deposit Accounts

Money-Market Deposit Accounts at depository institutions that may not be insured fully by the FDIC or NCUSIF are permitted provided that the certificates are fully backed by 100 percent collateral consisting of securities listed under paragraphs 1, 2, or 3 of this Exhibit. When accounts exceed the $100,000 insurance limitation, their safety also may depend on the HA's control of the underlying collateral which must consist of clearly identified (not pooled) U.S. Government securities. Possession of the collateral securities and a continuous perfected security interest may be the only sure protection against loss in case of financial institution failure.

6. Municipal Depository Fund

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

7. Super NOW Accounts

Super NOW Accounts have been available and approved for public funds since January, 1983. They offer a relatively high market rate and are fully transactional (have no limitations on the number of checks or transfers). Insurance and collateral requirements are as above for subparagraph 4) Demand and Savings Deposits.

8. Certificates of Deposit

a. Certificates of Deposit are permitted at depository institutions that are insured by an agency of

the Federal Government. Caution must be exercised for certificates exceeding the $100,000 insurance limit or when the term is longer than thirty (30) to ninety (90) days. Although the certificates' rate of return may be attractive for larger amounts and longer terms, U.S. Treasury securities offer superior safety and liquidity for the same amounts and terms. Certificates shall be in the HA's name. In addition, a General Depository Agreement (Exhibit J) must be executed by each financial institution that issues a Certificate of Deposit.

b. Certificate amounts above $100,000 are permitted provided that the excess is 100 percent collateralized by clearly identified (not pooled) U.S. Government securities. Possession of the collateral securities and a continuous perfected security interest may be the only sure protection against loss in case of bank failure.

c. Brokered deposits should be avoided because it is impossible to get $100,000 federal insurance on a number of deposits placed by brokers.

9. Repurchase Agreements (Special Requirements)

Repurchase (repo) agreements for a term not to exceed thirty (30) days may be entered into with Federally insured depository institutions for purchase and sale of securities identified in paragraphs 1, 2 and 3. A repurchase agreement is an agreement negotiated with a bank usually for a short period (1 to 7 days) wherein securities approved for investment are purchased from that bank at a stated price with the bank agreeing to repurchase them on a specified date for a specified amount. The minimum may vary, although it is usually $100,000. There are three main types: (1) fixed term, where both parties are bound to the negotiated time period, (2) demand, where the agreement stays in effect until terminated by either party, and (3) day-to-day, where daily renewal is by mutual consent and 24-hour notice is required for termination. The HA should review existing and future repos for compliance with the following certifications. Prior approval by HUD is not necessary, however, the repos seller depository or its agency must provide a written certification to HUD, Assistant Secretary for Public and Indian Housing (Office of Finance and Budget), the Area Office, and to the HA.

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

b. that the depository owns the underlying Federal securities (approved for repurchase under HUD guidelines) when the repo interest is sold and that the value of the securities is equal to or greater than the amount the HA pays for the repo;

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

d. that the repo agreement and any related documents identify specific Federal securities related to the specific repo purchased by the HA;

e. that the repo interest does not represent any interest in a pool or fund of Federal securities for which registration under the Investment Company Act of 1940 may be required:

f. that the HA will have a continuous perfected security interest in the underlying Federal Securities

under State or Federal law for the full term of the repo (disclosing the method by which perfection has or will be accomplished, i.e., by possession, filing, registration of book-entry securities and/or Federal preemption of State law by Federal regulation);

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

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

10. Sweep Accounts

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

11. Separate Trading of Registered Interest and Principal of Securities

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

12. Mutual Funds (Special Requirements)

A Mutual Fund (Fund) is an investment company that makes investments on behalf of individuals and institutions. The Fund pools the money of the investors and buys various securities that are consistent with the Fund's objective.

a. Mutual Fund Criteria

The Fund shall be organized as a no-load, open-end, diversified management company and its shares shall be registered under the Securities Act of 1933. The Fund shall be under the control of the Securities Exchange Act of 1934, Investment Advisors Act of 1940 and the Investment Company Act of 1940. The investment objective of the Fund shall be to obtain as much income as possible consistent with the preservation, conservation, and stability of capital. The mutual fund objective cannot be changed without the prior approval of fund shareholders.

b. The securities purchased by the Fund shall be on the HUD-approved list of investment securities. The Fund will not engage in options or financial futures. The HA shall limit the amount of funds invested in the Fund to no more than 20 percent of the HA's available investment funds. The Fund shall disclose clearly the basis of earnings and how they are distributed. The HA shall obtain a statement of potential default and risk. The HA's invested funds shall be accessible to the HA daily. It shall be demonstrated that any limitations on withdrawals will not impair the HA's day-to-day cash management needs.

c. The management fee shall be fixed at a reasonable amount. The Fund shall disclose the relationships of the investment advisor, manager, trustee, custodian and transfer agent. The Fund shall clearly state all services (such as wire transfers and check writing privileges) and charges.

d. Investment of the Fund shall be authorized by a Board Resolution. A certified copy of the resolution shall accompany the initial application for the Fund.

e. The Fund (or custodian) and the HA shall sign the General Depository Agreement, HUD-51999 dated June, 1991 (Exhibit J) modified as follows:

1) In the title "(Mutual Fund)" shall be added after General Depository Agreement. Whenever "depository" appears in the text it also refers to "mutual fund."

2) The HA's name and location (including county and city) will be filled in the first clause of the General Depository Agreement. The name, location and the HA's mutual fund account number also will be filled in the first clause. The second clause remains unchanged.

3) The third clause is substituted as follows: "Whereas, under the terms of the Contract the HA shall invest in a mutual fund (herein called the depository) only on the terms set forth hereafter. Mutual fund is defined as an investment company that makes investments on behalf of individuals and institutions. The depository shall be organized as a no-load, open-end, diversified management company and its shares shall be registered under the Securities Exchange Act of 1933. The depository shall be under the control of the Securities Exchange Act of 1934, the Investment Advisers Act of 1940 and the Investment Company Act of 1940. HA shall acquire shares in a mutual fund whose portfolio includes only securities on the HUD-approved list of investment securities."

4) Paragraphs 1, 3, 11 and 12 are deleted.

5) Paragraphs 4 through 6 are modified to read as follows:

a) Paragraph 4: Any shares purchased from HA funds shall be held by the depository in safe-keeping for the HA until sold.
Dividends and distributions on such shares and the proceeds from the sale thereof shall be used to purchase additional shares or remitted directly to the HA.

b) Paragraph 5: The language "from said Accounts" is deleted.

c) Paragraph 6: The language "in respect of the Accounts" is deleted.

d) Paragraphs 7 through 10 are not changed.

e) The additional language can be typed on a separate page, attached and duly executed. The following language shall be added to the bottom of the page: Page number incorporated in and made a part of the General Depository Agreement between the Galveston HA and _____(Depository).