

Minnesota Attorney General: Administrative Rules Proceedings

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Version 3
August 20, 2018

ATTORNEY GENERAL

November 16, 1988

~~PEG BUNCH~~ Greg Hawe
Special Assistant
Attorney General

JACQUELYN E. ALBRIGHT
Special Assistant
Attorney General

Drew memo & sent w/Rule to Greg Hawe 11/21/88 AE

6-9715

In the Matter of the Adopted Rule Relating to Securities Offerings

The above-referenced rule has been approved as to its legality by the Attorney General on November 7, 1988.

Enclosed is the agency's copy of the approved rule. This office has already filed two copies with the Secretary of State who will forward one copy to the Revisor of Statutes. The fourth is being retained by this division of the Attorney General's Office for its records.

Also enclosed are any petitions, requests, submission or comments received by the agency and any extra copies of documents which the agency submitted to the Attorney General.

In order for a permanent rule without a hearing to become effective, your agency must publish a notice of adoption in the State Register in accoradance with Minn. Stat. §14.27. An emergency rule becomes effective five working days after approval by the Attorney General; however, the agency must publish a notice in the State Register in accordance with Minn. Stat. §14.34.

If you have any questions in this regard, please contact me.

JAL:rer

Enclosures

cc: Maryanne Hruby
Executive Director
Legislative Commission to Review Administrative Rules

William Brown
Chief Administrative Law Judge
Office of Administrative Hearings

SF-00006-05 (4/86)

STATE OF MINNESOTA

Office Memorandum

DEPARTMENT : ATTORNEY GENERAL

DATE : November 16, 1988

TO : PEG BUNCH
Special Assistant
Attorney General

FROM : JACQUELYN E. ALBRIGHT
Special Assistant
Attorney General

PHONE : 6-9715

SUBJECT : In the Matter of the Adopted Rule Relating to Securities Offerings

The above-referenced rule has been approved as to its legality by the Attorney General on November 7, 1988.

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Legislative Commission to Review
Administrative Rules

William Brown
Chief Administrative Law Judge
Office of Administrative Hearings

RULE REVIEW CHECKLIST
RESUBMITTED RULE

File No. 1523 Docket No. 05.0009.0110

RESUBMISSION DATE 10/31/88
DATE DUE 11/14/88

ADOPTED W/O HEARING X
EMERGENCY RULE _____

APPROVED 11/7/88 - JEA
DISAPPROVED _____
WITHDRAWM _____

REVISOR APPROVED _____
REVISOR DISAPPROVED _____
FILED W/SEC. STATE _____
RETURNED TO AGENCY _____

NO **Does the revision raise significant new legal issues?**

_____ Review date

X Rule as adopted (4 copies)

X Supplemental Findings of Fact, Conclusions & Order Adopting

____ ~~Board's Supplemental Resolution Adopting~~

____ ~~Notice of submission to Attorney General~~

____ ~~Affidavit~~ of Mailing Notice to ~~Attorney General~~

SF-00006-05 (4/86)

DEPARTMENT : ATTORNEY GENERAL

STATE OF MINNESOTA

Office Memorandum

DATE : November 16, 1988

TO : GREG HUWE
Special Assistant
Attorney General

FROM : JACQUELYN E. ALBRIGHT
Special Assistant
Attorney General

PHONE : 6-9715

SUBJECT : In the Matter of the Adopted Rule Relating to Securities Offerings

The above-referenced rule has been approved as to its legality by the Attorney General on November 7, 1988.

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Enclosures

cc: Maryanne Hruby
Executive Director
Legislative Commission to Review
Administrative Rules

William Brown
Chief Administrative Law Judge
Office of Administrative Hearings

Department of Commerce

Adopted Permanent Rules Relating to Securities Offerings

Rules as Adopted

2875.0115 SECURITIES GUARANTEED BY A GOVERNMENTAL UNIT OR INSTRUMENTALITY.

Subpart 1. **Definition of "guaranteed."** For the purpose of Minnesota Statutes, section 80A.15, subdivision 1, paragraph (a), the term "guaranteed," when used with reference to a security issued by the United States, any state, any political subdivision of a state, or any corporate or other instrumentality of one or more of the foregoing, shall include any debt obligation which:

A. is a general obligation of the issuer, to which the issuer has pledged to its full faith and credit (whether or not the issuer has general taxing powers); or

B. the issuer is obligated to repay out of, and only out of, public funds.

Subp. 2. **Definition of "public funds."** For the purposes of this part, "public funds" means:

A. any money derived from:

(1) taxation;

(2) special assessments;

(3) revenues or other service charges derived by the issuer from a public facility or enterprise owned and operated by or on behalf of and under the control of the issuer;

(4) government grants or loans received by the issuer; or

(5) the proceeds of any bond insurance, letter of credit, line of credit, or other credit enhancement device obtained by the issuer; or

B. any other money subject to the control of and appropriation by the governing body of the issuer.

Except with respect to funds identified in item A, subitem

Approved by Revisor

(4) or (5), public funds does not include money received by the issuer from any person other than in the person's capacity as a member of the general public.

2875.0116 NONISSUER TRANSACTIONS INVOLVING PREVIOUSLY EXEMPTED SECURITIES.

Subpart 1. **Scope.** This part applies to any security which was issued and exempt under Minnesota Statutes, section 80A.15, subdivision 1, paragraph (a), prior to July 1, 1987, but which is not exempt under the amended provisions of Minnesota Statutes, section 80A.15, subdivision 1, paragraph (a), which became effective July 1, 1987.

Subp. 2. **Nonissuer transactions.** Any security described in subpart 1, shall be exempt for purposes of nonissuer transactions effected on or after July 1, 1987, provided that the nonissuer transaction does not constitute a public ~~distribution~~ offering.

2875.3500 DIVIDEND AND INTEREST COVERAGE.

Subpart 1. [Unchanged.]

Subp. 2. **Debt securities.**

A. In connection with the offering of debentures, notes, bonds, investment certificates, or similar interest-bearing securities, (other than bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision, or any corporate or other instrumentality of one or more of those entities), whether convertible or not, the cash flow of the issuer, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the securities proposed to be offered to the public.

B. In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any

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by Revisor _____

corporate or other instrumentality of one or more of those entities, except those which are exempt from registration under Minnesota Statutes, section 80A.15 or are rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the cash flow of the user or borrower of the offering proceeds or, if a different entity, the cash flow of the entity obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bonds or securities, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the bonds or securities proposed to be offered to the public. If the bonds or securities proposed to be offered are unconditionally guaranteed, both as to payment of interest and as to the repayment of principal, by an entity other than the user or borrower of the proceeds, then the cash flow of the guarantor shall be used in determining whether the bonds or securities qualify for registration.

C. In connection with the offering of bonds or similar interest-bearing securities issued by the state of Minnesota, its political subdivisions, governmental agencies, or corporate or other instrumentalities, if the cash flow requirements of the previous paragraph are not satisfied, then the application for registration must be accompanied by a financial forecast, examined by an independent certified public accountant who must express an opinion on the forecast. The examination must be made in accordance with the Guide for Prospective Financial Statements as promulgated by the American Institute of Certified Public Accountants, and the financial forecast must attest to the ability of the user or borrower of the offering proceeds or other obligor to generate sufficient

Approved
by Revisor _____

cash flow, computed in accordance with generally accepted accounting principles, exclusive of anticipated extraordinary income, to cover interest on the securities proposed to be offered to the public. Notwithstanding the foregoing, a financial forecast will not be accepted as evidence of the satisfaction of cash flow requirements if the user or borrower of the offering proceeds or other obligor has had a material default during the past three years in any required payment under a lease or any payment of principal, interest, dividend, or sinking fund installments on preferred stock or indebtedness for borrowed money.

Subp. 3. [Unchanged.]

Subp. 4. [See Repealer.]

Subp. 5. [Unchanged.]

2875.3530 DEBT SECURITIES.

Subpart 1. **Indenture.** The indenture or other instrument pursuant to which nonconvertible debt securities are proposed to be issued should normally provide for the following:

A. a sinking fund provision or serial maturity schedule whereby all or a reasonable portion of the issue is to be retired in installment prior to maturity (the deferral of sinking fund payments and the amount of the balloon payment at maturity which will be permitted will depend upon the financial condition and other circumstances of the issuer);

B. to D. [Unchanged.]

Subp. 2. [Unchanged.]

Subp. 3. **Bonds issued by governmental entities.** With respect to bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities other than those which are exempt from registration under Minnesota Statutes, section 80A.15, or are rated in one of the top four <u>letter</u> rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the protective provisions

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by Revisor _____

specified in subpart 1 shall apply to the user or borrower of the offering proceeds, or, if a different entity, the person obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bond or securities.

2875.3531 SECURITY INTEREST.

In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the trustee must be granted, for the benefit of the bondholders or security holders, a mortgage and security interest of first priority in the facility to be constructed, land to be acquired, and other real or personal property to which the offering proceeds will be applied unless:

A. the securities are exempt from registration under Minnesota Statutes, section 80A.15;

B. the securities are rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.; or

C. all of the following conditions are met:

(1) the cash flow requirements of part 2875.3500, subpart 2, item B, are satisfied;

(2) if funds to make principal and interest payments on the bonds or securities arise from appropriations by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the funds are not subject to the risk of nonappropriation; and

(3) if funds to make principal and interest payments on the bonds or securities arise under a lease arrangement, the lease is not subject to termination or nonrenewal prior to the maturity of the bonds or securities.

Approved
by Revisor _____

2875.3532 PROHIBITION; NONRECOURSE LOANS.

No part of the offering proceeds resulting from the sale of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities may be loaned to a person on a nonrecourse basis.

This prohibition does not apply to bonds or similar interest-bearing securities exempt from registration under Minnesota Statutes, section 80A.15 or rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.

2875.3533 SUITABILITY STANDARD.

Except with respect to bonds or similar interest-bearing securities exempt from registration under Minnesota Statutes, section 80A.15 or those rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., purchasers of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of the foregoing, shall have a minimum annual gross income of $30,000 and a net worth of $30,000, or in the alternative, a net worth of $75,000. Net worth is determined exclusive of home, home furnishings, and automobiles.

A purchaser will be considered to meet the standards in this part if the purchaser has certified within the 24-month period immediately preceding the purchase that the standards are satisfied.

REPEALER. Minnesota Rules, part 2875.3500, subpart 4, is repealed.

Approved
by Revisor _____

STATE OF MINNESOTA
DEPARTMENT OF STATE
FILED

NOV 16 1988

Joan Anderson Growe
Secretary of State

9:40 AM

APPROVED AS TO FORM AND LEGALITY

Nov 7 19 88

HUBERT H. HUMPHREY, III
ATTORNEY GENERAL

BY Jacquelyn E. Albright
SPECIAL ASSISTANT ATTORNEY GENERAL

ga

File No. 1523 Docket No. 05.0009, 0110

DATE RECEIVED 10/11/88 ADOPTED W/O HEARING ✓

REVIEW DATE 10/20/88 EMERGENCY RULE _____

DUE DATE 10/25/88 REVISOR APPROVED _____

APPROVED _____ REVISOR DISAPPROVED _____

DISAPPROVED _____ FILED W/SEC. OF STATE _____

WITHDRAWN _____ RETURNED TO AGENCY _____

✓ Rule as adopted (4 copies)

✓ Notice to Solicit Outside Information/Opinion (if applicable)

3/7/88 Date published in State Register
_____ Comments

_____ ~~Petition for Adoption of a Rule (if applicable)~~

✓ ~~Board's Authorizing Resolution~~

_____ ~~Date adopted~~

✓ Proposed Rule

yes Revisor's Certificate

✓ Notice of Intent to Adopt Rule

80A.25(1)
45.023 Statutory Authority
yes Small Business Statement
no Expenditure of public money statement
yes Signature

✓ Statement of Need and Reasonableness (if applicable)

yes Small Business Statement
n/a Fees - § 16A.128

✓ Affidavit of Mailing Notice of Intent to Adopt Rule

7/11/88 Date (30)/25 days before adoption
ok Notice attached
_____ ~~Copy of rule or summary attached~~

✓ Publication in State Register

7/18/88 Date (30)/25 days before adoption

✓ 180-day deadline from:

8/10/88 end of comment period (§ 14.26) (rules without hearing)
_____ ~~effective date of statutory authority (§ 14.29) (emergency rules)~~

_____ ~~Resolution Adopting~~

_____ ~~Date adopted~~

✓ Findings of Fact, Conclusions & Order Adopting

9/29/88 Date

✓ Written requests, submissions or comments (2)

✓ Declaration of attorney

Greg Huwe Name of SAAG representing agency

_____ ~~Notice of Submission to Atty. Gen. (if applicable)~~

_____ ~~Aff. of Mailing Notice to Atty. Gen. (if applicable)~~

Department of Commerce

Proposed Permanent Rules Relating to Securities Offerings

Rules as Proposed

2875.0115 SECURITIES GUARANTEED BY A GOVERNMENTAL UNIT OR INSTRUMENTALITY.

Subpart 1. **Definition of "guaranteed."** For the purpose of Minnesota Statutes, section 80A.15, subdivision 1, paragraph (a), the term "guaranteed," when used with reference to a security issued by the United States, any state, any political subdivision of a state, or any corporate or other instrumentality of one or more of the foregoing, shall include any debt obligation which:

A. is a general obligation of the issuer, to which the issuer has pledged to its full faith and credit (whether or not the issuer has general taxing powers); or

B. the issuer is obligated to repay out of, and only out of, public funds.

Subp. 2. **Definition of "public funds."** For the purposes of this part, "public funds" means:

A. any money derived from:

(1) taxation;

(2) special assessments;

(3) revenues or other service charges derived by the issuer from a public facility or enterprise owned and operated by or on behalf of and under the control of the issuer;

(4) government grants or loans received by the issuer; or

(5) the proceeds of any bond insurance, letter of credit, line of credit, or other credit enhancement device obtained by the issuer; or

B. any other money subject to the control of and appropriation by the governing body of the issuer.

Except with respect to funds identified in item A, subitem

Approved by Revisor

(4) or (5), public funds does not include money received by the issuer from any person other than in the person's capacity as a member of the general public.

2875.0116 NONISSUER TRANSACTIONS INVOLVING PREVIOUSLY EXEMPTED SECURITIES.

Subpart 1. **Scope.** This part applies to any security which was issued and exempt under Minnesota Statutes, section 80A.15, subdivision 1, paragraph (a), prior to July 1, 1987, but which is not exempt under the amended provisions of Minnesota Statutes, section 80A.15, subdivision 1, paragraph (a), which became effective July 1, 1987.

Subp. 2. **Nonissuer transactions.** Any security described in subpart 1, shall be exempt for purposes of nonissuer transactions effected on or after July 1, 1987, provided that the nonissuer transaction does not constitute a public distribution.

2875.3500 DIVIDEND AND INTEREST COVERAGE.

Subpart 1. [Unchanged.]

Subp. 2. **Debt securities.**

A. In connection with the offering of debentures, notes, bonds, investment certificates, or similar interest-bearing securities, (other than bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision, or any corporate or other instrumentality of one or more of those entities), whether convertible or not, the cash flow of the issuer, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the securities proposed to be offered to the public.

B. In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any

Approved by Revisor _____

corporate or other instrumentality of one or more of those entities, except those which are exempt from registration under Minnesota Statutes, section 80A.15 or are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the cash flow of the user or borrower of the offering proceeds or, if a different entity, the cash flow of the entity obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bonds or securities, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the bonds or securities proposed to be offered to the public. If the bonds or securities proposed to be offered are unconditionally guaranteed, both as to payment of interest and as to the repayment of principal, by an entity other than the user or borrower of the proceeds, then the cash flow of the guarantor shall be used in determining whether the bonds or securities qualify for registration.

C. In connection with the offering of bonds or similar interest-bearing securities issued by the state of Minnesota, its political subdivisions, governmental agencies, or corporate or other instrumentalities, if the cash flow requirements of the previous paragraph are not satisfied, then the application for registration must be accompanied by a financial forecast, examined by an independent certified public accountant who must express an opinion on the forecast. The examination must be made in accordance with the Guide for Prospective Financial Statements as promulgated by the American Institute of Certified Public Accountants, and the financial forecast must attest to the ability of the user or borrower of the offering proceeds or other obligor to generate sufficient

Approved
by Revisor _____

cash flow, computed in accordance with generally accepted accounting principles, exclusive of anticipated extraordinary income, to cover interest on the securities proposed to be offered to the public. Notwithstanding the foregoing, a financial forecast will not be accepted as evidence of the satisfaction of cash flow requirements if the user or borrower of the offering proceeds or other obligor has had a material default during the past three years in any required payment under a lease or any payment of principal, interest, dividend, or sinking fund installments on preferred stock or indebtedness for borrowed money.

Subp. 3. [Unchanged.]

Subp. 4. [See Repealer.]

Subp. 5. [Unchanged.]

2875.3530 DEBT SECURITIES.

Subpart 1. **Indenture.** The indenture or other instrument pursuant to which nonconvertible debt securities are proposed to be issued should normally provide for the following:

A. a sinking fund provision or serial maturity schedule whereby all or a reasonable portion of the issue is to be retired in installment prior to maturity (the deferral of sinking fund payments and the amount of the balloon payment at maturity which will be permitted will depend upon the financial condition and other circumstances of the issuer);

B. to D. [Unchanged.]

Subp. 2. [Unchanged.]

Subp. 3. **Bonds issued by governmental entities.** With respect to bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities other than those which are exempt from registration under Minnesota Statutes, section 80A.15, or are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the protective provisions

Approved by Revisor _____

specified in subpart 1 shall apply to the user or borrower of the offering proceeds, or, if a different entity, the person obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bond or securities.

2875.3531 SECURITY INTEREST.

In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the trustee must be granted, for the benefit of the bondholders or security holders, a mortgage and security interest of first priority in the facility to be constructed, land to be acquired, and other real or personal property to which the offering proceeds will be applied unless:

A. the securities are exempt from registration under Minnesota Statutes, section 80A.15;

B. the securities are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.; or

C. all of the following conditions are met:

(1) the cash flow requirements of part 2875.3500, subpart 2, item B, are satisfied;

(2) if funds to make principal and interest payments on the bonds or securities arise from appropriations by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the funds are not subject to the risk of nonappropriation; and

(3) if funds to make principal and interest payments on the bonds or securities arise under a lease arrangement, the lease is not subject to termination or nonrenewal prior to the maturity of the bonds or securities.

2875.3532 PROHIBITION; NONRECOURSE LOANS.

Approved by Revisor _____

No part of the offering proceeds resulting from the sale of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities may be loaned to a person on a nonrecourse basis.

This prohibition does not apply to bonds or similar interest-bearing securities exempt from registration under Minnesota Statutes, section 80A.15 or rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.

2875.3533 SUITABILITY STANDARD.

Except with respect to bonds or similar interest-bearing securities exempt from registration under Minnesota Statutes, section 80A.15 or those rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., purchasers of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of the foregoing, shall have a minimum annual gross income of $30,000 and a net worth of $30,000, or in the alternative, a net worth of $75,000. Net worth is determined exclusive of home, home furnishings, and automobiles.

A purchaser will be considered to meet the standards in this part if the purchaser has certified within the 24-month period immediately preceding the purchase that the standards are satisfied.

REPEALER. Minnesota Rules, part 2875.3500, subpart 4, is repealed.

Approved by Revisor _____

Office of the Revisor of Statutes

Administrative Rules

TITLE: Proposed Permanent Rules Relating to Securities Offerings

AGENCY: Department of Commerce

MINNESOTA RULES: Chapter 2875

The attached rules are approved for publication
in the State Register

Paul M. Marinac
Assistant Deputy Revisor

Withdrawn

Department of Commerce

Adopted Permanent Rules Relating to Securities Offerings

Rules as Adopted

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A. is a general obligation of the issuer, to which the issuer has pledged to its full faith and credit (whether or not the issuer has general taxing powers); or

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Subp. 2. **Definition of "public funds."** For the purposes of this part, "public funds" means:

A. any money derived from:

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(2) special assessments;

(3) revenues or other service charges derived by the issuer from a public facility or enterprise owned and operated by or on behalf of and under the control of the issuer;

(4) government grants or loans received by the issuer; or

(5) the proceeds of any bond insurance, letter of credit, line of credit, or other credit enhancement device obtained by the issuer; or

B. any other money subject to the control of and appropriation by the governing body of the issuer.

Except with respect to funds identified in item A, subitem

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Subp. 2. **Nonissuer transactions.** Any security described in subpart 1, shall be exempt for purposes of nonissuer transactions effected on or after July 1, 1987, provided that the nonissuer transaction does not constitute a public distribution.

2875.3500 DIVIDEND AND INTEREST COVERAGE.

Subpart 1. [Unchanged.]

Subp. 2. **Debt securities.**

A. In connection with the offering of debentures, notes, bonds, investment certificates, or similar interest-bearing securities, (other than bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision, or any corporate or other instrumentality of one or more of those entities), whether convertible or not, the cash flow of the issuer, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the securities proposed to be offered to the public.

B. In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any

Approved
by Revisor _____

corporate or other instrumentality of one or more of those entities, except those which are exempt from registration under Minnesota Statutes, section 80A.15 or are rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the cash flow of the user or borrower of the offering proceeds or, if a different entity, the cash flow of the entity obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bonds or securities, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the bonds or securities proposed to be offered to the public. If the bonds or securities proposed to be offered are unconditionally guaranteed, both as to payment of interest and as to the repayment of principal, by an entity other than the user or borrower of the proceeds, then the cash flow of the guarantor shall be used in determining whether the bonds or securities qualify for registration.

C. In connection with the offering of bonds or similar interest-bearing securities issued by the state of Minnesota, its political subdivisions, governmental agencies, or corporate or other instrumentalities, if the cash flow requirements of the previous paragraph are not satisfied, then the application for registration must be accompanied by a financial forecast, examined by an independent certified public accountant who must express an opinion on the forecast. The examination must be made in accordance with the Guide for Prospective Financial Statements as promulgated by the American Institute of Certified Public Accountants, and the financial forecast must attest to the ability of the user or borrower of the offering proceeds or other obligor to generate sufficient

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cash flow, computed in accordance with generally accepted accounting principles, exclusive of anticipated extraordinary income, to cover interest on the securities proposed to be offered to the public. Notwithstanding the foregoing, a financial forecast will not be accepted as evidence of the satisfaction of cash flow requirements if the user or borrower of the offering proceeds or other obligor has had a material default during the past three years in any required payment under a lease or any payment of principal, interest, dividend, or sinking fund installments on preferred stock or indebtedness for borrowed money.

Subp. 3. [Unchanged.]

Subp. 4. [See Repealer.]

Subp. 5. [Unchanged.]

2875.3530 DEBT SECURITIES.

Subpart 1. **Indenture.** The indenture or other instrument pursuant to which nonconvertible debt securities are proposed to be issued should normally provide for the following:

A. a sinking fund provision or serial maturity schedule whereby all or a reasonable portion of the issue is to be retired in installment prior to maturity (the deferral of sinking fund payments and the amount of the balloon payment at maturity which will be permitted will depend upon the financial condition and other circumstances of the issuer);

B. to D. [Unchanged.]

Subp. 2. [Unchanged.]

Subp. 3. **Bonds issued by governmental entities.** With respect to bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities other than those which are exempt from registration under Minnesota Statutes, section 80A.15, or are rated in one of the top four <u>letter</u> rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the protective provisions

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specified in subpart 1 shall apply to the user or borrower of the offering proceeds, or, if a different entity, the person obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bond or securities.

2875.3531 SECURITY INTEREST.

In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the trustee must be granted, for the benefit of the bondholders or security holders, a mortgage and security interest of first priority in the facility to be constructed, land to be acquired, and other real or personal property to which the offering proceeds will be applied unless:

A. the securities are exempt from registration under Minnesota Statutes, section 80A.15;

B. the securities are rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.; or

C. all of the following conditions are met:

(1) the cash flow requirements of part 2875.3500, subpart 2, item B, are satisfied;

(2) if funds to make principal and interest payments on the bonds or securities arise from appropriations by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the funds are not subject to the risk of nonappropriation; and

(3) if funds to make principal and interest payments on the bonds or securities arise under a lease arrangement, the lease is not subject to termination or nonrenewal prior to the maturity of the bonds or securities.

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2875.3532 PROHIBITION; NONRECOURSE LOANS.

No part of the offering proceeds resulting from the sale of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities may be loaned to a person on a nonrecourse basis.

This prohibition does not apply to bonds or similar interest-bearing securities exempt from registration under Minnesota Statutes, section 80A.15 or rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.

2875.3533 SUITABILITY STANDARD.

Except with respect to bonds or similar interest-bearing securities exempt from registration under Minnesota Statutes, section 80A.15 or those rated in one of the top four letter rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., purchasers of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of the foregoing, shall have a minimum annual gross income of $30,000 and a net worth of $30,000, or in the alternative, a net worth of $75,000. Net worth is determined exclusive of home, home furnishings, and automobiles.

A purchaser will be considered to meet the standards in this part if the purchaser has certified within the 24-month period immediately preceding the purchase that the standards are satisfied.

REPEALER. Minnesota Rules, part 2875.3500, subpart 4, is repealed.

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Office of the Revisor of Statutes

Administrative Rules

TITLE: Adopted Permanent Rules Relating to Securities Offerings

AGENCY: Department of Commerce

MINNESOTA RULES: Chapter 2875

The attached rules are approved for filing with the Secretary of State

Paul M. Marinac
Assistant Deputy Revisor

State of Minnesota
Department of Commerce

In the Matter of the Proposed Adoption of Rules Relating to Securities Issued by Certain Governmental Entities

Notice of Intent to Adopt Rules Without a Public Hearing

Notice is hereby given that the Department of Commerce intends to adopt the above-entitled rules without a public hearing following the procedures set forth in the Administrative Procedures Act for adopted rules without a public hearing in Minnesota Statutes, section 14.22-14.28. Authority for the adoption of these rules is contained in Minnesota Statutes, Section 45.023 and 80A.25 subd. 1.

All persons have 30 days to submit comments in support of or in opposition to the proposed rule or any part or subpart of the rule. Comment is encouraged. Each comment should identify the portion of the proposed rule addressed, the reason for the comment, and any change proposed. The proposed rules may be modified if the modifications are supported by the data and views submitted to the Department and do not result in a substantial change.

Any person may make a written request for a public hearing within the 30 day comment period. If 25 or more persons submit a written request for a public hearing within the 30 day comment period, a public hearing will be held unless a sufficient number withdraw their request in writing. Any person requesting a hearing should state his or her name and address, and is encouraged to identify the portion of the proposed rule addressed, the reason for the request, and any change proposed. If a public hearing is required, the department will proceed pursuant to Minnesota Statutes, sections 14.13 to 14.20.

Persons who wish to submit comments or a written request for a public hearing should submit them to:

Elizabeth Moran
Acting Deputy Commissioner
Department of Commerce
500 Metro Square Building
St. Paul, MN 55101
(612) 296-6325

A Statement of Need and Reasonableness that describes the need for and reasonableness of each provision of the proposed rule and identifies the data and information relied upon to support the proposed rules has been prepared and is available upon request from Elizabeth Moran.

Pursuant to Minnesota Statutes Section 14.115, subdivision 2, the impact on small business has been considered in the promulgation of the rules. Anyone wishing to present evidence or argument as to the rules' effect on small business may do so. The Department's position regarding the impact of the rules on small business is set forth in the Statement of Need and Reasonableness.

If no hearing is required, upon adoption of the rule, the rule and the required supporting documents will be submitted to the Attorney General for review as to legality and form to the extent the form relates to legality. Any person may request notification of the date of submission to the Attorney General. Persons who wish to be advised of the submission of this material to the Attorney General, or who wish to receive a copy of the adopted rule, must submit the written request to Elizabeth Moran.

Michael A. Hatch
Commissioner of Commerce

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

IN THE MATTER OF THE PROPOSED RULES REGARDING BONDS ISSUED BY GOVERNMENTAL ENTITIES	)))	STATEMENT OF NEED AND REASONABLENESS

STATEMENT OF AUTHORITY

Minnesota Statutes, section 80A.25, subd. 1 provides, in part :

> The commissioner may from time to time make, amend, and rescind such rules... as are necessary to carry out the provisions of sections 80A.01 to 80A.31, including but not limited to rules and forms governing the conduct of business by broker-dealers, agents and investment advisers, registration statements, applications, and reports, and defining any terms... insofar as the definitions are not inconsistent with the provisions of sections 80A.01 to 80A.31.

Additional rulemaking authority pertaining to the proposed rules and amendments is found in Minnesota Statutes, section 45.023.

The Commissioner finds the proposed rules and amendments necessary and appropriate in the public interest or for

the protection of investors and consistent with the purposes fairly intended by the policy and provisions of Minnesota Statutes, section 80A.01 to 80A.31.

FACTS ESTABLISHING NEED AND REASONABLENESS

Background

Minnesota Rules, part 2875.0115 is being proposed to define the term "guaranteed" as that term is contained in Minnesota Statutes, section 80A.15, subdivision 1, clause (a). That section provides an exemption from the securities registration and reporting requirements contained in chapter 80A for the following:

> Any security, including a revenue obligation, guaranteed by the United States, any state, any political subdivision of a state or any corporate or other instrumentality of one or more of the foregoing; but this exemption shall not include any industrial revenue bond.

Prior to 1987 legislative changes, securities issued or guaranteed by one of the above governmental entities qualified for the exemption. In 1987, however, the statute was amended to provide that only securities "guaranteed" by one of the specified governmental entities qualify for

the exemption. Much confusion has subsequently arisen with respect to the definition of "guaranteed" for purposes of this section. Proposed Part 2875.0115 defines the term "guaranteed" to remove existing confusion.

Part 2875.3535 and amendments to Parts 2875.3500 and 2875.3530 are being proposed to provide necessary standards of review to be used in evaluating applications for registration of securities issued by governmental entities. The need for the rules and amendments arose out of changes made during the 1987 legislative session to Minnesota Statutes, section 80A.15, subdivision 1(a) and Minnesota Statutes, section 80A.09, subdivision 1(a).

As noted above, previously, under Minnesota Statutes, section 80A.15, subdivision 1(a), securities issued or guaranteed by specified governmental entities were exempt from the registration and reporting requirements of chapter 80A. Changes made during the 1987 legislative session modified that section to provide that the exemption applied only to securities guaranteed by a govermental entity. Accordingly, securities merely issued but not guaranteed by a governmental entity must be registered under Minnesota Statutes, section 80A.11, thus creating a need for standards to be applied in reviewing applications for registration

of such securities.

Minnesota Statutes, section 80A.09 was also amended during the 1987 legislative session. Prior to the amendment, that section permitted industrial revenue bonds issued by the State of Minnesota, or any of its political subdivisions, municipalities, governmental agencies or instrumentalities to be registered simply by filing a notice with the Department of Commerce. Section 80A.09, subdivision 1(a) was deleted during the legislative session, thus subjecting all applications for registration of industrial revenue bonds to merit review. As existing rules do not address municipal securities, new rules and amendments are necessary.

Finally, it must be noted that the Department is receiving an increasing number of complaints with regard to government bonds, particularly with respect to defaults under those obligations. Therefore, the proposed rules providing merit standards for review of applications for registration of government bonds are intended to provide additional protection to purchasers of such bonds.

Part 2875.0115

Part 2875.0115 defines the term "guaranteed" for purposes

of Minnesota Statutes, section 80A.15, subdivision 1, clause (a), with respect to a security guaranteed by the United States, any state, any political subdivision of a state, or any corporate or other instrumentality of one or moreof the foregoing.

In defining the term "guaranteed", the Department worked with representatives of the public finance industry in Minnesota. The goal of the Department was to define the term in a manner as to ensure that the governmental entity issuing and guaranteeing the security backs the security with its full faith and credit or has adequate funds available or the authority to provide for adequate funds to pay the principal and interest on the bonds. A related consideration was ensuring that the purpose of the debt issuance is a public purpose, recognizing the importance of utilization of the exemption by small municipalities to finance public, not-for-profit projects.

With these considerations in mind, the Department is proposing that the term "guaranteed", with regard to securities issued by governmental entities, include a debt obligation which:

A. is a general obligation of the issuer, to which the

issuer has pledged to its full faith and credit (whether or not the issuer has general taxing powers); or

B. the issuer is obligated to repay out of, and only out of, public funds, which funds are specifically allocated and sufficient to make all principal and interest payments on the obligation.

Public funds are defined in subpart 2 to include funds derived from taxation; special assessments; revenues or other service charges derived by the issuer from a public facility or enterprise owned and operated by or on behalf of and under control of the issuer; government grants or loans received by the issuer; if acceptable to the commissioner, the proceeds of any bond insurance, letter of credit, or other credit enhancement device obtained with respect to the security; or any other money subject to the control of and appropriation by the governing body of the issuer.

General obligations of a governmental entity are included in the definition of "guaranteed" securities because such obligations must be pledged by the full faith and credit of the governmental entity. And, even though the issuer need not have general taxing powers, it is certainly "backing" the obligation to ensure the payment of the debt.

Such backing may take the form of a special tax levy or the application of other funds subject to the control of and by appropriation by the governmental entity.

Obligations which are not general obligations will be deemed to be guaranteed if the governmental entity is obligated to repay the debt out of, and only out of, public funds. The term "public funds" is broadly defined to include funds available to a governmental entity from a variety of sources. Accordingly, if the funds available to the issuer or funds which will be available to the issuer in the future are allocated to pay the principal and interest on the obligation, the obligation will be deemed to be "guaranteed" by the governmental entity.

The only specified exclusion from the definition "public funds" is money received by the issuer from any person other than in the person's capacity as a member of the general public (other than funds identified in Subpart 2, items A(4) or (5)). This exclusion ensures that the governmental entity "guaranteeing" the obligation is not serving merely as a conduit for repayment of funds with the ultimate source of funds for repayment being an unrelated private entity with little or no connection with a public purpose project. The Department has noted many default

problems with such conduit financing. The merit rules which follow are specifically intended to apply to such conduit financing arrangements.

Part 2875.0116

This part provides an exemption from securities registration and reporting requirements for nonissuer transactions involving securities which were exempt under the provisions of Minn. Stat. § 80A.15, subdivision 1(a) prior to July 1, 1987 amendments.

Those former provisions exempted securities, other than industrial revenue bonds, which were issued or guaranteed by certain governmental entities. Many members of the public are presently holding securities which were exempt from registration at the time of purchase as securities issued by a governmental entity. Amendments to the statute which became effective July 1, 1987, limit the exemption to only securities guaranteed by governmental securities. Accordingly such securities held by the public are no longer exempt from registration and cannot be resold without registrationor application of separate exemption.

The rule addresses this situation by providing that the

securities retain their exempt status for purposes of non-issuer transactions, provided that the securities are not sold in a public distribution. Thus, the rule facilitates limited purchases and sales of the securities without requiring holders of small amounts to register the securities. If the securities are to be sold in a public distribution, however, the securities would no longer be deemed to be exempt. This exception addresses the remarketing of an entire or significant portion of a bond issue. In such a case, public investors purchasing the bonds deserve the same protections afforded initial purchases of bonds under the amendments to the statute. Such productions are afforded by applying the following merit standards to new issuances of bonds and to public distributions, i.e. remarketings, of previously exempt securities.

Part 2875.3500

Subpart 2. Amendments to subpart 2 establish standards of review to be applied in reviewing applications for registration of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state or any corporate or other instrumentality of one of those entities. Existing registration rules do not address the offering of securities by these

entities.

The first amendment to subpart 2 amends the current rule to clarify that it does not apply to bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision, or any corporate or other instrumentality of one or more of those entities. While it is apparent from the substance of the rule that it was not intended to apply to securities issued by governmental entities, the clarifying language has been added to remove any confusion. Language has also been added to clarify that the cash flow of an issuer must be sufficient to cover deferred interest on a debt obligation. This is necessary because the cash flow requirements are used to determine the issuer's financial ability to repay the debt. The deferral of interest payments does not mean that the interest need not be covered by the issuer's cash flow because, as is obvious, the interest will have to be paid at some point.

Items B and C of subpart 2 provide specific standards to be applied in reviewing applications for registration of above securities issued by specified governmental entities. The substantive standards apply to all offerings of bonds or similar interest-bearing securities issued by the specified governmental entities except those which are exempt

from registration under Minnesota Statutes, section 80A.15 or those which are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard & Poor's Corporation or Moody's Investor Services, Inc. Exempt securities are excluded from the standards of review because there are typically no filing requirements or minimal requirements with respect to those securities and because the securities are of a nature that the legislature determined that registration and review by the Department is unnecessary or should be minimal. Securities rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard & Poor's Corporation or Moody's Investor Services, Inc. are excluded from application of the proposed rules because those securities are "investment grade" and have been reviewed by an independent rating service which has determined that the likelihood of repayment of the obligation is high.

The proposed merit standards require that the cash flow of the person borrowing the offering proceeds from the governmental entity, the person obligated to make payment of principal and interest on the securities or the person making payments under a lease, sale or loan arrangement, for its last fiscal year prior to the proposed public offering or the average of its last three fiscal years prior

to the public offering, must be sufficient to cover the interest on the securities proposed to be offered to the public. Cash flow must be computed in accordance with generally accepted accounting principles and must exclude extraordinary income.

The same standard is currently applied with respect to debt offerings by commercial entities. The standard provides an indication of whether the person ultimately responsible to repay the debt has the financial ability to do so. A person's most recent fiscal year is perhaps the best indicator of that person's ability to honor future financial obligations. The rules provide an alternative test, i.e. average cash flow of the past three fiscal years, to address persons who may have had a financially difficult prior year, but whose financial performance averaged over the past three years has been strong.

The rules provide that if payment of interest and repayment of principal is unconditionally guaranteed, then the cash flow of the guarantor will be used in determining compliance with the cash flow requirements. Again, because the rules focus on the financial strength of the person ultimately responsible for repayment of the debt, it is appropriate that a guarantor may satisfy the cash flow requirements.

An alternative test is proposed with respect to the offering of bonds or similar interest-bearing securities issued by the State of Minnesota, its political subdivisions, governmental agencies or corporate or other instrumentalities, as those bonds are also filed or reviewed by the Minnesota Department of Energy and Economic Development or other state agency. With regard to the offering of securities by those entities, the application for registration must be accompanied by a financial forecast, examined by an independent certified public accountant in accordance with the Guide for Prospective Financial Statements as promulgated by the American Institute of Certified Public Accountants. The financial forecast must attest to the ability of the user, borrower, or other obligor to generate sufficient cash flow, computed in accordance with generally accepted accounting principles, to cover interest on securities proposed to be offered to the public.

This test permits local start-up ventures which are borrowing bond proceeds to obtain funds from a public offering even though the venture has no financial history from which to determine the adequacy of the venture's cash flow. To ensure that the financial forecast used in determining the adequacy of cash flow has been independently evaluated,

the forecast must be examined by an independent certified public accountant who must express an opinion on the financial statements. The Guide for Prospective Financial Statements is a comprehensive guide including, among other things, the procedure to be followed by certified public accountants when examining financial forecasts. The guide was prepared by the American Institute of Certified Public Accountants, a self-regulatory organization composed of certified public accountants. Through the submission of an independently evaluated financial forecast examined in accordance with the above, and provided that the forecast attests to the adequacy of the cash flow of the borrower to pay interest on the debt, offerings of which the proceeds are loaned to Minnesota ventures with no financial history will be permitted to go forward.

The proposed rules specify, however, that a financial forecast will not be accepted as evidence of satisfaction of cash flow requirements if the user or borrower of the offering proceeds or other obligor has had a material default during the past three years in payment of rentals under a lease or of principal, interest, dividend or sinking fund installments on preferred stock or indebtedness. This exception to the general acceptance of a financial forecast is necessary because an entity with a recent history

of defaulting on financial obligations is more likely to be unable to honor future obligations. Also, this restriction should guard against a Ponzi-type financing where proceeds of a new bond issue are used to repay bondholders from a previous issue and a third issue is offered to repay bondholders from the second issue, and so forth.

Subpart 4. Subpart 4 currently provides that the requirements of Part 2875.3500 do not apply to the offer or sale of securities of a nonprofit or community development issuer. The Department is proposing to delete subpart 4 with respect to the offer or sale of securities by nonprofit or community development issuers. Repeal is proposed because the issuance of securities by nonprofit entities is generally not subject to merit review as those issuers submit applications for registration under Minn. Stat. § 80A.09, which primarily imposes a notice requirement. Therefore, the language with respect to nonprofit organizations is unnecessary. However, the Department believes that the issuance of debt by community development issuers should be subject to the same standards applied to other governmental entities so that purchasers of bonds of community development corporations are afforded the same protections as purchasers of other debt securities. The same protections should be afforded to purchasers of similar securities, particularly

where a community development issuer is engaged in conduit financing. Accordingly, the Department is proposing repeal of subpart 4.

Part 2875.3530

Part 2875.3530 currently provides, among other things, that the indenture pursuant to which nonconvertible debt securities are proposed to be issued should normally include a sinking fund provision; a negative pledge or equal protection clause restricting the creation of liens on the property of the issuer; in certain instances, an appropriate restriction on the creation of other funded debt; and an appropriate restriction on the payment of dividends upon stock of the issuer.

The first proposed amendment provides issuers with an alternative with respect to the inclusion in the indenture of a sinking fund provision. The alternative specified is that of a serial maturity schedule, which is another means of retiring specified portions of an issue prior to maturity. A serial maturity schedule offers the same protections in ensuring that measures are taken prior to maturity to enable an issuer to repay the principal amount of the obligation while providing greater flexibility to an issuer.

The Department is also proposing that an additional subpart be added to Part 2875.3530. This subpart provides that, with respect to debt securities issued by governmental entities, except those which are exempt from registration under Minnesota Statutes, section 80A.15 or rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard & Poor's Corporation or Moody's Investor Services, Inc., the protective provisions specified in subpart 1 apply to the user or borrower of the offering proceeds or other obligor under the bonds. This amendment affords purchasers of bonds issued by governmental entities the same protections currently afforded purchasers of commercial debt instruments through the establishment of indenture provisions noted above.

Part 2875.3531

Part 2875.3531 requires that with respect to certain offerings of debt instruments by specified governmental entities, the trustee must be granted, for the benefit of the bondholders or security holders, a mortgage and/or security interest of first priority in the facility to be constructed, land to be acquired, and/or other real or personal property to which the offering proceeds will be applied.

A mortgage and/or security must be provided if: (i) the cash flow requirements of Part 2875.3500 are satisfied on the basis of a financial forecast, (ii) funds to make principal or interest payments on the bond or securities arise under a lease arrangement where the lease is subject to termination or non-renewal prior to the maturity of the bonds or securities or (iii) funds to make principal and interest payments are subject to the risk of nonappropriation by a governmental entity.

With respect to the above three situations, purchasers of the bonds or securities bear an increased risk that principal and interest payments on the debt obligation may be impaired. Accordingly, in these cases where such increased risk exists, it is imperative for the trustee to be granted a first lien on the property to which the offering proceeds will be applied. In this manner, the trustee will be able to foreclose on the property should the obligor default in payments under the debt obligation.

Part 2875.3532

This part provides that offering proceeds resulting from the sale of bonds issued by certain govermental entities

may not be loaned to a person on a nonrecourse basis. The prohibition does not apply to exempt securities or those rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.

Nonrecourse loans are loans which would bar the trustee from taking action against the borrower if, for example, the borrower defaulted on the loan. Such a limitation is clearly not in the best interests of the bondholders as the bondholders are restricted in such cases to recovering their investment from the liquidation of any property securing the loan. The prohibition in the rule will prevent such loans, thus enabling a trustee to attempt to collect monies for bondholders directly from the borrower of the bond proceeds, thereby increasing the protections afforded bondholders.

Part 2875.3533

Proposed Part 2875.3533 establishes suitability standards with respect to purchasers of debt securities issued by specified governmental entities, except those securities exempt from registration under Minnesota Statutes, section 80A.15 or those rated in one of the top four rating cate-

gories by Standard & Poor's Corporation or Moody's Investor Services, Inc.

The standards require that a purchaser of the above securities have a minimum annual gross income of $30,000 and a net worth of $30,000, or in the alternative, a net worth of $75,000. Net worth is determined exclusive of home, home furnishings and automobiles.

Suitability standards are proposed with respect to the purchase of the above securities because of the relative lack of transferability of the securities and because of the significant degree of risk involved in the purchase of the securities due to the frequently uncertain cash flow of the person responsible for the repayment of the obligation. Similar suitability requirements are currently applied with regard to purchasers of limited partnership interests where similar risks are present. Accordingly, the Department is proposing the suitability standards in an effort to ensure that purchasers of debt obligations of governmental entities have a certain degree of financial sophistication so that they are able to understand the financial risks associated with the investment.

Subpart 2 of the proposed rule provides that a purchaser

will be deemed to meet the above suitability standards if the purchaser has certified within the twenty-four month period preceding the purchase that he or she satisfies the standards. This provision is being proposed to make application of the rule by underwriters more workable.

Small Business Considerations

Minnesota Statutes, section 14.115 requires that the impact of proposed rules on small business be considered in the rulemaking process.

Subdivision 2 of that section specifies a number of methods for reducing the impact of the rules. The Department has considered these methods in the preparation of the rules.

Clause (a) of subdivision 2 requires the consideration of less stringent compliance or reporting requirements for small businesses. Less stringent compliance standards were considered with respect to Minnesota small businesses, which are often the recipients of proceeds from municipal bond offerings. The less stringent compliance standards set forth in Part 2875.3500 permit a Minnesota small business to project cash flow sufficient to pay interest on the debt rather than requiring those businesses to have histor-

ical cash flow. In this manner, start-up ventures will still be able to obtain funds through municipal financing without relaxing investor protection.

Clause (b) requires the consideration of the establishment of less stringent schedules or deadlines for compliance or reporting requirements for small business. Because of the nature of the proposed rules and amendments, no less stringent schedules or deadlines for compliance or reporting requirements for small businesses were established. The proposals pertain to the offering of securities by certain governmental entities and the recipients of the proceeds. There are no reporting requirements. The only compliance requirements pertain to small businesses which, in the future, will receive bond offering proceeds. At the present time, it is unlikely that any of those small businesses have even been identified. Therefore, because the proposals require compliance only by small businesses which will receive benefits from future bond offerings and because there are no schedules or deadlines for compliance, no less stringent schedules or deadlines were established for small businesses.

Clause (c) of subdivison 2 requires the consideration of the consolidation or simplification of compliance or report-

ing requirements for small businesses. Again, no reporting requirements are imposed by the proposed rules and amendments. With respect to compliance with the rules, Part 2875.3500 was simplified with respect to compliance by small businesses in Minnesota. Further simplification of the requirements would likely decrease investor protection to an unacceptable level, contrary to statutory objectives.

Clause (d) is not applicable to this rule as performance, design or operational standards are not involved.

Exemption of small businesses under clause (c) is not feasible and would be contrary to statutory objectives of investor protection.

The Department fully considered small businesses as it developed the proposals. The proposed rules and amendments are intended to impose as light a regulatory burden as possible while still protecting investors to ensure that the activities regulated by the proposals could be undertaken by small as well as large organizations.

In the Matter of the Proposed Rules
Relating to Securities Issued by Certain
Governmental Entities

STATE OF MINNESOTA)
) ss
COUNTY OF RAMSEY)

AFFIDAVIT OF
MAILING

Jane Schaub, being first duly sworn, deposes and says:

I hereby certify that the list of persons, associations, and other interested groups who have requested, pursuant to Minnesota Statutes, section 14.14, subd. 1a, that their names be placed on file with and maintained by the Department of Commerce for the purpose of receiving notice of the proposed adoption of rules is accurate and complete as of 12:00 P.M. this 11th day of July 1988.

That on the 11th day of July 1988, at the City of St. Paul, County of Ramsey, State of Minnesota, the attached Notice of Intent to Adopt Rules Without a Public Hearing was served by depositing in the State of Minnesota Central Mail System for United States mailing at said City of St. Paul, a copy properly prepared with first-class postage prepaid, on all persons and associations who have requested that their names be placed on file with the Minnesota Department of Commerce for the purpose of receiving notice of the proposed adoption of rules by the department.

Jane Schaub

Subscribed and sworn to before me
this 11th day of July 1988.

Richard G. Gomsrud
Notary Public

RICHARD G. GOMSRUD
NOTARY PUBLIC—MINNESOTA
RAMSEY COUNTY
My Comm. Expires June 7, 1993

State of Minnesota

STATE REGISTER

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Department of Commerce

Proposed Permanent Rules Relating to Securities Offerings

Notice of Intent to Adopt Rules Without a Public Hearing

Notice is hereby given that the Department of Commerce intends to adopt the above-entitled rules without a public hearing following the procedures set forth in the Administrative Procedures Act for adopted rules without a public hearing in *Minnesota Statutes*, section 14.22-14.28. Authority for the adoption of these rules is contained in *Minnesota Statutes*, Section 45.023 and 80A.25 subd. 1.

All persons have 30 days to submit comments in support of or in opposition to the proposed rule or any part or subpart of the rule. Comment is encouraged. Each comment should identify the portion of the proposed rule addressed, the reason for the comment, and any change proposed. The proposed rules may be modified if the modifications are supported by the data and views submitted to the Department and do not result in a substantial change.

Any person may make a written request for a public hearing within the 30 day comment period. If 25 or more persons submit a written request for a public hearing within the 30 day comment period, a public hearing will be held unless a sufficient number withdraw their request in writing. Any person requesting a hearing should state his or her name and address, and is encouraged to identify the portion of the proposed rule addressed, the reason for the request, and any change proposed. If a public hearing is required, the department will proceed pursuant to *Minnesota Statutes*, sections 14.13 to 14.20.

Persons who wish to submit comments or a written request for a public hearing should submit them to:

Elizabeth Moran
Acting Deputy Commissioner
Department of Commerce
500 Metro Square Building
St. Paul, MN 55101
(612) 296-6325

A Statement of Need and Reasonableness that describes the need for and reasonableness of each provision of the proposed rule and identifies the data and information relied upon to support the proposed rules has been prepared and is available upon request from Elizabeth Moran.

Pursuant to *Minnesota Statutes* Section 14.115, subdivision 2, the impact on small business has been considered in the promulgation of the rules. Anyone wishing to present evidence or argument as to the rules' effect on small business may do so. The Department's position regarding the impact of the rules on small business is set forth in the Statement of Need and Reasonableness.

If no hearing is required, upon adoption of the rule, the rule and the required supporting documents will be submitted to the Attorney General for review as to legality and form to the extent the form relates to legality. Any person may request notification of the date of submission to the Attorney General. Persons who wish to be advised of the submission of this material to the Attorney General, or who wish to receive a copy of the adopted rule, must submit the written request to Elizabeth Moran.

Michael A. Hatch
Commissioner of Commerce

Rules as Proposed

2875.0115 SECURITIES GUARANTEED BY A GOVERNMENTAL UNIT OR INSTRUMENTALITY.

Subpart 1. **Definition of "guaranteed."** For the purpose of *Minnesota Statutes*, section 80A.15, subdivision 1, paragraph (a), the term "guaranteed," when used with reference to a security issued by the United States, any state, any political subdivision of a state, or any corporate or other instrumentality of one or more of the foregoing, shall include any debt obligation which:

A. is a general obligation of the issuer, to which the issuer has pledged to its full faith and credit (whether or not the issuer has general taxing powers); or

B. the issuer is obligated to repay out of, and only out of, public funds.

KEY: PROPOSED RULES SECTION — Underlining indicates additions to existing rule language. ~~Strike outs~~ indicate deletions from existing rule language. If a proposed rule is totally new, it is designated "all new material." ADOPTED RULES SECTION — Underlining indicates additions to proposed rule language. ~~Strike outs~~ indicate deletions from proposed rule language.

Subp. 2. **Definition of "public funds."** For the purposes of this part, "public funds" means:

A. any money derived from:

(1) taxation;

(2) special assessments;

(3) revenues or other service charges derived by the issuer from a public facility or enterprise owned and operated by or on behalf of and under the control of the issuer;

(4) government grants or loans received by the issuer; or

(5) the proceeds of any bond insurance, letter of credit, line of credit, or other credit enhancement device obtained by the issuer; or

B. any other money subject to the control of and appropriation by the governing body of the issuer.

Except with respect to funds identified in item A, subitem (4) or (5), public funds does not include money received by the issuer from any person other than in the person's capacity as a member of the general public.

2875.0116 NONISSUER TRANSACTIONS INVOLVING PREVIOUSLY EXEMPTED SECURITIES.

Subpart 1. **Scope.** This part applies to any security which was issued and exempt under *Minnesota Statutes*, section 80A.15, subdivision 1, paragraph (a), prior to July 1, 1987, but which is not exempt under the amended provisions of *Minnesota Statutes*, section 80A.15, subdivision 1, paragraph (a), which became effective July 1, 1987.

Subp. 2. **Nonissuer transactions.** Any security described in subpart 1, shall be exempt for purposes of nonissuer transactions effected on or after July 1, 1987, provided that the nonissuer transaction does not constitute a public distribution.

2875.3500 DIVIDEND AND INTEREST COVERAGE.

Subpart 1. [Unchanged.]

Subp. 2. **Debt securities.**

A. In connection with the offering of debentures, notes, bonds, investment certificates, or similar interest-bearing securities, (other than bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision, or any corporate or other instrumentality of one or more of those entities), whether convertible or not, the cash flow of the issuer, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the securities proposed to be offered to the public.

B. In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, except those which are exempt from registration under *Minnesota Statutes*, section 80A.15 or are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the cash flow of the user or borrower of the offering proceeds or, if a different entity, the cash flow of the entity obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bonds or securities, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the bonds or securities proposed to be offered to the public. If the bonds or securities proposed to be offered are unconditionally guaranteed, both as to payment of interest and as to the repayment of principal, by an entity other than the user or borrower of the proceeds, then the cash flow of the guarantor shall be used in determining whether the bonds or securities qualify for registration.

C. In connection with the offering of bonds or similar interest-bearing securities issued by the state of Minnesota, its political subdivisions, governmental agencies, or corporate or other instrumentalities, if the cash flow requirements of the previous paragraph are not satisfied, then the application for registration must be accompanied by a financial forecast, examined by an independent certified public accountant who must express an opinion on the forecast. The examination must be made in accordance with the Guide for Prospective Financial Statements as promulgated by the American Institute of Certified Public Accountants, and the financial forecast must attest to the ability of the user or borrower of the offering proceeds or other obligor to generate sufficient cash flow, computed in accordance with generally accepted accounting principles, exclusive of anticipated extraordinary income, to cover interest on the securities proposed to be offered to the public. Notwithstanding the foregoing, a financial forecast will not be accepted as evidence of the satisfaction of cash flow requirements if the user or borrower of the offering proceeds or other obligor has had a material default during the past three years in any required payment under a lease or any payment of principal, interest, dividend, or sinking fund installments on preferred stock or indebtedness for borrowed money.

Subp. 3. [Unchanged.]

Subp. 4. [See Repealer.]

Subp. 5. [Unchanged.]

2875.3530 DEBT SECURITIES.

Subpart 1. **Indenture.** The indenture or other instrument pursuant to which nonconvertible debt securities are proposed to be issued should normally provide for the following:

A. a sinking fund provision or serial maturity schedule whereby all or a reasonable portion of the issue is to be retired in installment prior to maturity (the deferral of sinking fund payments and the amount of the balloon payment at maturity which will be permitted will depend upon the financial condition and other circumstances of the issuer);

B. to D. [Unchanged.]

Subp. 2. [Unchanged.]

Subp. 3. **Bonds issued by governmental entities.** With respect to bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities other than those which are exempt from registration under *Minnesota Statutes*, section 80A.15, or are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc., the protective provisions specified in subpart 1 shall apply to the user or borrower of the offering proceeds, or, if a different entity, the person obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bond or securities.

2875.3531 SECURITY INTEREST.

In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the trustee must be granted, for the benefit of the bondholders or security holders, a mortgage and security interest of first priority in the facility to be constructed, land to be acquired, and other real or personal property to which the offering proceeds will be applied unless:

A. the securities are exempt from registration under *Minnesota Statutes*, section 80A.15;

B. the securities are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.; or

C. all of the following conditions are met:

(1) the cash flow requirements of part 2875.3500, subpart 2, item B, are satisfied;

(2) if funds to make principal and interest payments on the bonds or securities arise from appropriations by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, the funds are not subject to the risk of nonappropriation; and

(3) if funds to make principal and interest payments on the bonds or securities arise under a lease arrangement, the lease is not subject to termination or nonrenewal prior to the maturity of the bonds or securities.

2875.3532 PROHIBITION; NONRECOURSE LOANS.

No part of the offering proceeds resulting from the sale of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities may be loaned to a person on a nonrecourse basis.

This prohibition does not apply to bonds or similar interest-bearing securities exempt from registration under *Minnesota Statutes*, section 80A.15 or rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc.

2875.3533 SUITABILITY STANDARD.

Except with respect to bonds or similar interest-bearing securities exempt from registration under *Minnesota Statutes*, section 80A.15 or those rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation,

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or Moody's Investor Services, Inc., purchasers of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of the foregoing, shall have a minimum annual gross income of $30,000 and a net worth of $30,000, or in the alternative, a net worth of $75,000. Net worth is determined exclusive of home, home furnishings, and automobiles.

A purchaser will be considered to meet the standards in this part if the purchaser has certified within the 24-month period immediately preceding the purchase that the standards are satisfied.

REPEALER. *Minnesota Rules,* part 2875.3500, subpart 4, is repealed.

Department of Labor and Industry

Occupational Safety and Health Division

Proposed Revisions to the Occupational Safety and Health Standards

Request for Comments

Notice is hereby given that the Department of Labor and Industry, Occupational Safety and Health Division (Minnesota OSHA) proposes to adopt the following revisions to the Minnesota Occupational Safety and Health Standards, as authorized under *Minnesota Statutes,* § 182.655 (1986) amending the Occupational Safety and Health Standards that have already been proposed and adopted by the federal Occupational Safety and Health Administration (Federal OSHA).

Complete copies of the specific revisions are available by writing: Occupational Safety and Health Division, Department of Labor and Industry, 443 Lafayette Road, St. Paul, Minnesota 55101; or by calling (612) 297-3254.

Interested persons are hereby afforded a period of 30 days to submit written data or comments on the described standards. Any interested person may file with the Commissioner written objections to the proposed standards stating the grounds for those objections. Such person may request a public hearing on those objections.

Ray Bohn, Commissioner
Department of Labor and Industry

Standards as Proposed

5205.0010 ADOPTION OF FEDERAL OCCUPATIONAL SAFETY AND HEALTH STANDARDS BY REFERENCE. The Minnesota Department of Labor and Industry, Occupational Safety and Health standards and rules are amended by incorporating and adopting by reference, and thereby making a part thereof, Title 29 of the *Code of Federal Regulations* as follows:

Part 1910: Occupational Safety and Health Standards as published in Volume 43, No. 206 of the *Federal Register* on October 24, 1978 and corrected in Volume 43, No. 216 on November 7, 1978 which incorporates changes, additions, deletions, and corrections made up to November 7, 1978; and subsequent changes made prior to ~~April 1, 1988~~ June 30, 1988:

Federal Register, Vol. 53, No. 66, dated April 6, 1988; "Occupational Exposure to Ethylene Oxide (1910.1047).

Federal Register, Vol. 53, No. 70, dated April 12, 1988; "Safety Testing or Certification of Certain Workplace Equipment and Materials; Deletion of Specific Testing Laboratory Names; Definition of Nationally Recognized Testing Laboratory; Determination of Eligible Testing Organizations (1910.7)."

Federal Register, Vol. 53, No. 96, dated May 18, 1988; "Grain Handling Facilities; Notice of Approval of Information Collection Requirements by OMB and Corrections to Appendices as published on December 31, 1987 (1910.272).

Part 1926: Construction Safety and Health Regulations as published in Part VII, Volume 44, No. 29 of the *Federal Register* on February 9, 1979, which incorporates changes, additions, deletions and corrections made up to October 17, 1978, and includes General Industry Occupational Safety and Health Standards (29 CFR Part 1910) which have been identified as applicable to construction work; and subsequent changes made prior to ~~April 1, 1988~~ June 20, 1988: *Federal Register,* Vol. 53, No. 116, dated June 16, 1988; "Concrete and Masonry Construction Safety Standards (1926.700-1926.706)."

Summary of Standards: The following summary of the proposed standards is very brief; persons interested in reviewing any of these standards in their entirety may obtain a copy as noted above.

A) "Occupational Exposure to Ethylene Oxide—1910.1047." On April 6, 1988, Federal OSHA amended its existing standard regulating occupational exposure to ethylene oxide, 29 CFR 1910.1047, by adopting an excursion limit for ethylene oxide (EtO) of 5 parts of EtO per million parts of air (5 ppm) averaged over a sampling period of 15 minutes. The existing standard, adopted by Federal OSHA and Minnesota OSHA in 1984, requires employers to limit exposure to one part EtO per million parts of air (1 ppm)

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
ST. PAUL 55101

OFFICE OF THE COMMISSIONER

500 METRO SQUARE BUILDING
ST. PAUL, MN 55101

September 23, 1988

Thomas M. Strand
Vice President, Legislation
Minnesota Institute of Public Finance, Inc.
Dougherty, Dawkins, Strand & Yost, Inc.
100 South Fifth Street
Suite 2300
Minneapolis, Minnesota 55402

Re: Proposed Rules Relating to Municipal Securities

Dear Mr. Strand:

We have received your letter dated August 16, 1988 with respect to the proposed rules relating to municipal securities. I will address your comments in the manner in which they were presented in your letter.

1. Proposed Part 2875.0116, subp. 2.

You stated in your letter that the qualification contained in this exemption that a nonissuer transaction not constitute a public distribution is unnecessary. You first argued that the qualification is unworkable because the term "public distribution" is not defined. While this is true, the Securities Act of 1933 exempts from registration requirement transactions not involving a "public offering". Abundant case law defines the term "public offering" and we believe that that case law would serve to define the term "public distribution" as well.

You further indicated that the condition is unnecessary because the proposed exemption is already limited to nonissuer transactions. We are well aware of that limitation, but that requirement does not address the remarketing of bonds as is covered by the proposed rules.

Finally, you indicated that the condition is inconsistent with two secondary trading exemptions contained in Minn. Stat. § 80A.15, subd. 2(h) and subd. 2(g). It must be noted that the proposed rule has nothing to do with those sections. Rather, the rule interprets Minn. Stat. § 80A.15, subd. 1(a). If the legislature's intent was to provide an unqualified nonissuer exception with respect to securities outstanding at the time

it amended § 80A.15, subd. 1(a), we assume that the legislature would have provided such an exception.

2. Investment Grade Rating Classification

We intend to clarify existing proposals to state that designations "-" and "+" do not establish separate rating categories when following a letter grade.

3. Bank Letters of Credit

Interpretation of Minn. Stat. § 80A.15, subd. 1 (c) is outside the scope of the proposed rules.

4. Proposed Part 2875.3500, subp. B

With respect to the cash flow test, you requested that the rules be amended to state that securities backed by a letter of credit or insurance policy constitute "guaranteed" securities.

As you are probably aware, the terms of insurance policies and letters of credit significantly vary from one case to another. The terms of a policy or letter of credit in a given case would have to be reviewed in order to determine whether that specific document guarantees to bondholders payment of principal and interest. Accordingly, because the protection afforded investors by a letter of credit varies or insurance policy with the terms of the document itself, letters of credit and insurance policies are not categorically considered to be guarantees. Rather, the terms of each letter of credit and policy are reviewed to determine whether principal and interest payments are, in fact, "guaranteed".

With regard to the preparation of financial statements by a bank which issues a letter of credit which in fact, constitutes a "guarantee"), the Financial Examinations Division of this Department has advised me that banks routinely prepare financial statements in accordance with generally accepted accounting procedures for internal purposes. Accordingly, it is not unreasonable to require that banks submit those statements for determining compliance with the proposed rules.

5. Proposed Part 2875.3532

With regard to your proposal to except from the prohibition against non-recourse loans offerings backed by

bank letters of or credit insurance, it must first be noted that the purpose of the prohibition is to provide bondholders with the remedy of bringing an action against a borrower of loan proceeds if the borrower defaults in its payments under the bonds. Bondholders should be afforded every legal remedy in order to be made "whole" upon a default by a borrower. If a credit enhancement device is drawn upon and bondholders recover their investment, there would be no damages for them to claim against the borrower of offering proceeds. On the other hand, if draws under a credit enhancement device are insufficient to provide bondholders their principal and expected return or if the issuer of the credit enhancement device is financially unable to honor its commitment, bondholders should not be foreclosed from bringing a legal action against the defaulting borrower. Accordingly, we believe that any changes to the proposed rule would weaken investor protection.

6. Proposed Part 2875.3533

For the reasons discussed in the Statement of Need and Reasonableness, suitability standards are necessary for the protection of investors, and the Department declines to remove those standards from its proposal. Regarding standards imposed by other regulatory agencies, none provide as specific of standards as those contained in the proposed rules. Further, current suitability standards imposed by other agencies are clearly inadequate, as the Department has received numerous complaints in recent years from individuals for whom an investment in municipal bonds was unsuitable.

Sincerely,

MICHAEL A. HATCH
Commissioner

By:

KRISTINE L. EIDEN
Deputy Commissioner
(612) 296-6325

KLE:cc

Department of Commerce

Notice to Solicit Outside Opinion Regarding Proposed Rules Regarding Debt Securities Issued or Guaranteed by Government Unit or Instrumentality Including the Impact of the Rules on Small Business

Notice is hereby given that the Department of Commerce is seeking information or opinions from persons outside the agency in preparing to promulgate new rules and amend current rules regarding debt securities issued or guaranteed by governmental units or instrumentalities and other entities. Promulgation of these rules is authorized by *Minnesota Statutes*, 80A.25 and 45.023.

Outside opinion is also being solicited as to how these rules will affect small businesses as defined by *Minnesota Statutes*, § 14.115, subdivision 1.

The Department of Commerce requests information and comments concerning the subject matter of these rules. Interested or affected persons or groups may submit statements of information or comment orally or in writing to

Kristine L. Eiden, Deputy Commissioner
Department of Commerce
500 Metro Square Building
St. Paul, Minnesota 55101
(612) 296-6325

Oral statements will be received during regular business hours over the telephone at (612) 296-6325.

All statements of information and comment shall be accepted until April 1, 1988. Any written material received by the Department of Commerce shall become part of the record in the event that the rules are promulgated.

Michael A. Hatch
Commissioner of Commerce

Department of Health

Office of Health Systems Development

Notice of Intent to Solicit Outside Opinions Concerning a Request for a Waiver of HMO Statutes and Rules by Group Health, Inc.

Notice is hereby given that the Department of Health is seeking opinions and comments pertaining to a request by Group Health, Inc. for a waiver of HMO statutes and rules regarding elimination of prescription drug benefits for members enrolled in Group Health Seniors who receive their primary health care services at private clinics which are affiliated with Group Health, Inc. Such waivers are authorized for demonstration projects by *Minnesota Statutes*, § 62D.30.

The request submitted by Group Health, Inc. is available for inspection during normal business hours at the following location:

Alternative Delivery Systems
Room 456
Minnesota Department of Health
Minneapolis, Minnesota 55440
(612) 623-5365

Comments on the request must be received by March 18, 1988.

Department of Health

Office of Health Systems Development

Notice of Intent to Solicit Outside Opinions Concerning a Request for a Waiver of HMO Statutes and Rules by NWNL Health Network, Inc.

Notice is hereby given that the Department of Health is seeking opinions and comments pertaining to a request by NWNL Health Network, Inc. (formerly Senior Health Plan) for a waiver of HMO statutes and rules regarding an extension of their present pharmacy

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Proposed Adoption of the Rules of the State Department of Commerce Governing Securities Offerings

FINDINGS OF FACT, CONCLUSIONS, AND ORDER ADOPTING RULE WITHOUT PUBLIC HEARING

Notice of the Department of Commerce's intent to adopt the above-entitled rule was published in the State Register on July 18, 1988 and was sent by United States mail to all persons on the list maintained by the agency pursuant to Minnesota Statutes, sections 14.14, subdivision 1a and 14.22 on July 11, 1988. The statement of need and reasonableness was prepared before the notice of intent to adopt a rule without a public hearing was mailed to all persons on the rulemaking mailing list and published in the State Register and was available to the public.

All persons were give the opportunity to submit comment on the rule for 30 days after notice of proposed rulemaking. No requests for a public hearing on the rule was received by the agency.

Based on the comments and evidence in the record before the agency, I find the following:

Changes were made clarifying that the references to rating categories established by certain rating agencies refer to letter ratings categories. The changes are insubstantial in that they merely clarify the Department's original intent and do not alter the substance of the proposed rules.

The above-captioned rule is needed and reasonable.

NOW, THEREFORE, IT IS ORDERED that the rule identified as Proposed Rules Regarding Debt Securities Issued or Guaranteed by Government Unit or Instrumentality are adopted this 29th day of September, 1988, pursuant to authority vested in Minnesota States, section 80A.25, subd. 1 and section 45.023.

MICHAEL A. HATCH
Commissioner of Commerce

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Proposed Adoption of the Rules of the State Department of Commerce Governing Securities Offerings	ORDER OF WITHDRAWAL OF RULES; SUPPLEMENTAL FINDINGS OF FACT, CONCLUSIONS, AND ORDER ADOPTING RULE WITHOUT PUBLIC HEARING

The Department of Commerce hereby withdraws from review by the attorney general the above-entitled rules as adopted in the Findings of Fact, Conclusions, and Order Adopting Rule Without a Public Hearing, dated September 29, 1988 (the "Original Order").

The Department of Commerce hereby resubmits the above-entitled rules to the attorney general. No persons requested notice of submission of the rule pursuant to Minnesota Statutes, section 14.26 or 14.32.

Based on the comments and evidence in the record before, I find the following:

In addition to the changes discussed in the Original Order, changes were made with respect to proposed Minnesota Rules, part 2875.0116. The term contained in the rules as originally proposed "public distribution" was changed to "public offering" at the recommendation of the Attorney General's Office. By containing the term "public offering", the proposed rules follow the terminology of federal securities laws and uniformity in the interpretation of such terms will be enhanced. This change is insubstantial in that it merely changes terminology in the proposed rules and does not affect the scope or substance of the proposals.

The above-captioned rules are needed and reasonable.

NOW, THEREFORE, IT IS ORDERED that the rules identified as Proposed Rules Regarding Debt Securities Issued or Guaranteed by Government Unit or Instrumentality are adopted this 25th day of October, 1988, pursuant to authority vested in me pursuant to Minnesota Statutes, section 80A.25, subd. 1 and section 45.023.

MICHAEL A. HATCH
Commissioner of Commerce

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Proposed Adoption of the Rules of the State Department of Commerce Governing Securities Offerings	ORDER OF WITHDRAWAL OF RULES; SUPPLEMENTAL FINDINGS OF FACT, CONCLUSIONS, AND ORDER ADOPTING RULE WITHOUT PUBLIC HEARING

The Department of Commerce hereby withdraws from review by the attorney general the above-entitled rules as adopted in the Findings of Fact, Conclusions, and Order Adopting Rule Without a Public Hearing, dated September 29, 1988 (the "Original Order").

The Department of Commerce hereby resubmits the above-entitled rules to the attorney general. No persons requested notice of submission of the rule pursuant to Minnesota Statutes, section 14.26 or 14.32.

Based on the comments and evidence in the record before, I find the following:

In addition to the changes discussed in the Original Order, changes were made with respect to proposed Minnesota Rules, part 2875.0116. The term contained in the rules as originally proposed "public distribution" was changed to "public offering" at the recommendation of the Attorney General's Office. By containing the term "public offering", the proposed rules follow the terminology of federal securities laws and uniformity in the interpretation of such terms will be enhanced. This change is insubstantial in that it merely changes terminology in the proposed rules and does not affect the scope or substance of the proposals.

The above-captioned rules are needed and reasonable.

NOW, THEREFORE, IT IS ORDERED that the rules identified as Proposed Rules Regarding Debt Securities Issued or Guaranteed by Government Unit or Instrumentality are adopted this 25th day of October, 1988, pursuant to authority vested in me pursuant to Minnesota Statutes, section 80A.25, subd. 1 and section 45.023.

MICHAEL A. HATCH
Commissioner of Commerce

FBS Capital Markets Group
Member First Bank System

P.O. Box A-1674
Minneapolis, Minnesota 55480
612 370-4151

August 17, 1988

Ms. Elizabeth Moran
Acting Deputy Commissioner
Department of Commerce
500 Metro Square Building
St. Paul, MN 55101

Department of Commerce

Dear Ms. Moran:

These comments are submitted on behalf of FBS Capital Markets Group, a division of First Bank National Association, regarding the Proposed Permanent Rules Relating to Securities Offerings which were published in the State Register July 18, 1988. FBS Capital Markets Group is both an underwriter and dealer in municipal bonds.

Let me begin by saying that we appreciate the extent to which the Department of Commerce has worked with members of the public finance community in formulating these rules and, in general, we support the Proposed Rules. However, we are seeking clarification on the proposed language relating to investment categories. In addition, we have concerns regarding the proposed rules dealing with nonissuer transactions (Part 2875.0116), nonrecourse loans (Part 2875.3532), and the suitability standard (Part 2875.3533).

1. Part 2875.0116, Subpart 2

   This subpart limits the proposed secondary trading exemption for governmental securities issued and exempt prior to July 1, 1987, by stating that the security shall be exempt for purposes of nonissuer transactions provided that the "nonissuer transaction does not constitute a public distribution."

   Such a limitation has never been applied to nonissuer transactions, and we do not believe that such a limitation enhances the protection of investors in governmental securities. Furthermore, the term "public distribution" is not defined in Minnesota Statutes 80A.

2. Part 2875.3532

   This part would prohibit the proceeds of an offering from being loaned to a person on a nonrecourse basis. While we can understand the Department's interest in limiting this type of activity, this prohibition fails to recognize those offerings which are enhanced by the use of surety bonds or

(2. Part 2875.3532)

bank letters of credit. In such cases, although the proceeds are loaned on a nonrecourse bases, full payment of the principal and interest are guaranteed by the surety bond or letter of credit. We urge you to reconsider the prohibition on these types of financings because many of the projects financed are for lower income housing.

3. Part 2875.3533

This part establishes a suitability standard for governmental offerings. It is our opinion that this standard does little to enhance the protection of investors, but will be costly and time-consuming for broker-dealers to administer. We ask the Department of Commerce to delete this part from the Proposed Rules.

4. Rating Categories

In Part 2875.3530, the proposed rules refer to "one of the top four rating categories by Fitch investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc." A similar reference also is made in Parts 2875.3531, 2875.3532, and 2875.3533.

It is our assumption that "rating categories" refer to categories such as AAA, AA, A, and B, and that variations of these ratings, such as AAA- or A+, would not constitute separate categories. We request that the Department of Commerce clarify the intent of the Proposed Rules.

We appreciate the opportunity to comment on the Proposed Rules and would be happy to meet with you to discuss our comments further. Should you have any questions or require additional clarification of our position, please contact Allan Vagstad at 343-1397 or the undersigned at 343-1515.

Very truly yours,

James P. Curtis
Director of Compliance

JPC/lmm
08-17MOR

Minnesota Institute of Public Finance, Inc.

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August 16, 1988

AUG 16 1988
Department of Commerce

Ms. Elizabeth Moran
Acting Deputy Commissioner
Department of Commerce
500 Metro Square Building
Seventh and Robert Streets
St. Paul, Minnesota 55101

Re: Proposed Rules Parts 2875.0115 et seq.

Dear Ms. Moran:

The purpose of this letter is to comment upon the Proposed Rules Parts 2875.0115 et seq. published in the State Register on Monday, July 18, 1988 (pages 119 - 122). Generally, we support the Proposed Rules and what the Department of Commerce is attempting to accomplish in terms of increased investor protection. The purpose of our comments is to make the Department aware of our concerns and to request that the Proposed Rules be modified to reflect these comments. We believe that our proposals will not adversely affect investor protection and are conceptually consistent with the Proposed Rules.

1. Proposed Rule Part 2875.0116, subpart 2. This part provides a secondary trading exemption for governmental securities which were issued and exempt from securities registration prior to July 1, 1987. This proposed exemption is limited by the proviso that "the nonissuer transaction does not constitute a public distribution." We believe that this limitation should be deleted because it is unnecessary and, in fact, defeats the whole purpose of the proposed exemption for the following reasons:

a. The proviso is unworkable because the term "public distribution" is not defined in M.S.A. Chapter 80A, the existing Rules Part 2875 or the Proposed Rules. No one can rely upon an unknown when civil liability for rescission and damages is at stake.

b. The proviso is unnecessary because the proposed exemption is already limited to nonissuer transactions which are defined in M.S.A. § 80A.14(14) to mean "not directly or indirectly for the benefit of the issuer or an affiliate of the issuer."

c. The proviso is inconsistent with M.S.A. Chapter 80A because the two existing secondary trading exemptions (M.S.A. § 80A.15(2)(b) and 80A.15(2)(q)) use the nonissuer concept by itself without the additional limitation that there be no public distribution. In both instances the Minnesota Legislature clearly determined that the nonissuer standard was sufficient to protect the public interest in connection with secondary trading of corporate securities and Minnesota issued industrial revenue bonds. We do not believe it is appropriate to go beyond the Legislature's intent in the case of governmental securities when the nonissuer standard has been sufficient for other types of securities.

Accordingly, we respectfully request that the Department delete the "public distribution" proviso in its entirety.

2. Investment Grade Rating Clarification. Throughout the Proposed Rules, reference is made to debt obligations "rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services, Inc. . . ." We assume that the reference to the top four rating categories is irrespective of any "+" or "-" designation for a particular rating category. For instance, the top four rating categories established by S & P for long-term debt obligations are AAA, AA, A and BBB; thus, a rating of AAA+, AAA or AAA- should all fall within one rating category. Any other result would be unduly restrictive, inconsistent with the securities market's understanding of what a rating category is and unnecessary for investor protection.

Accordingly, we respectfully request the Department adopt the following provision to clarify the intent of the Proposed Rules:

"For purposes of Part 2875, a 'rating category' established by Fitch Investors Service, Inc., Standard and Poor's Corporation or Moody's Investor Services,

Inc. includes '+' or '-' designations or other variations that occur within that rating category."

3. Bank Letters of Credit. We understand that the staff has informally interpreted M.S.A. § 80A.15(1)(c) in such a manner that irrevocable bank letters of credit that fully cover payment of interest and repayment of principal are not considered guarantees for purposes of that section. We believe that this interpretation is clearly incorrect in light of the realities of an irrevocable bank letter of credit and the position of the Securities and Exchange Commission.

Although not technically a "guarantee" under the banking laws because it is a separate obligation of the issuing bank and independent of the underlying transaction it enhances, an irrevocable bank letter of credit is the undeniable obligation of the issuing bank. The SEC has consistently taken the position that an irrevocable bank letter of credit is the functional equivalent of a guarantee which entitles the underlying securities to an exemption from registration as securities guaranteed by a bank.

Accordingly, we respectfully request the Department to adopt a new rule or publish an interpretative opinion consistent with the economic realities of an irrevocable bank letter of credit and with the SEC's position. If the Department does so, our comments in paragraph 4 below should be considered as applying only to insurance policies and similar instruments.

4. Proposed Rule Part 2875.3500, subpart B. The last sentence of this subpart permits the cash flow of a guarantor to be considered for purposes of meeting the cash flow test. We agree with the concept because that is the reality of the market--investors look at the best credit backing a debt obligation when they decide whether to buy. This is the reason that many offerings obtain the benefit of a credit enhancement device such as bond insurance or a letter of credit. However, bond insurance policies and letters of credit are not technically "unconditional guarantees" even though they are the functional equivalents of guarantees because the credit of the insurance company or letter of credit issuer is pledged to payment of the debt obligations. Both the market and the rating agencies (i.e., S & P, Moody's and Fitch's) consider insurance policies and letters of credit to be guarantees from a credit standpoint.

Accordingly, we respectfully request the Department adopt the following provision to treat insurance policies, letters of credit and similar instruments as unconditional guarantees for the sole purpose of meeting the cash flow test of Part 2875.3500:

> "For purposes of Part 2875.3500, the words 'unconditionally guaranteed' include bonds or securities which are covered, both as to payment of interest and as to the repayment of principal, by a letter of credit, insurance policy or similar instrument which represents a general obligation of the person issuing the letter of credit, insurance policy or similar instrument and "guarantor" means the person issuing the letter of credit, insurance policy or similar instrument."

Furthermore, we note that financial and other regulated institutions are required to prepare financial statements in accordance with the requirements prescribed by the regulating governmental agencies. Ordinarily, the governmental regulatory requirements do not provide for financial statements audited in accordance with GAAP. We respectfully request that for purposes of Part 2875.3500, subpart B, the Department should make it clear that in the case of financial and other regulated institutions, the cash flow test will be determined in accordance with the accounting principles established by the regulating governmental agency.

5. Proposed Rule Part 2875.3532. This part prohibits financings where the offering proceeds are loaned to a person on a nonrecourse basis. We understand the Department's concerns in this area, but we believe that the prohibition should not extend to financings which are in the public interest and which are secured by credit enhancement devices like letters of credit and insurance policies. For instance, if the offering proceeds are used to make a nonrecourse loan to the user of a project being financed and the user obtains a letter of credit to secure full payment of principal and interest, the financing really is not nonrecourse because from the point of view of the investor the issuer of the letter of credit is fully at risk. In such a situation, the Department would apply the cash flow test of Part 2875.3500 to assure that the issuer of the letter of credit has sufficient cash flow to be entitled to registration.

Accordingly, we respectfully request the Department adopt the following provision:

> "This prohibition does not apply to bonds or similar interest-bearing securities which are covered, both as to payment of interest and as to the repayment of principal, by a letter of credit, insurance policy or similar instrument which represents a general obligation of the person issuing the letter of credit, insurance policy or similar instrument."

6. Proposed Rule Part 2875.3533. This part imposes a suitability standard on sales of governmental securities. We believe it is unnecessary for the protection of investors because both the Municipal Securities Rulemaking Board and the NASD have established long-standing suitability standards (copies attached) which are more protective than this proposal because a broker-dealer must take into consideration the purchaser's total situation on a case-by-case basis so that the unique circumstances of the investor are considered. As you are aware, both the NASD and MSRB as self-regulatory agencies under the Securities Exchange Act of 1934 have the power to fine, censure or even suspend the broker-dealer licenses of their members who fail to comply with these suitability standards.

Furthermore, this proposal is much less comprehensive than the MSRB's and NASD's suitability standards and could actually mislead a purchaser into believing that a particular security is suitable for him just because he meets the tests. In addition, compliance with this part by broker-dealers will be both costly and time-consuming for little apparent gain from an investor's standpoint.

Accordingly, we respectfully request the Department delete this part in its entirety.

The Institute is deeply committed to Minnesota public finance as shown by the attached statement of our purpose and membership. We want to take this opportunity to offer our assistance to the Department and are available to further explain the comments contained in this letter at your convenience.

We would appreciate it if you would direct your questions to me at 341-6018 or in writing c/o Dougherty, Dawkins, Strand & Yost Incorporated, 100 South Fifth Street, Suite 2300, Minneapolis, Minnesota 55402.

Very truly yours,

Thomas M. Strand

Thomas M. Strand
Vice President, Legislation

Minnesota Institute of Public Finance, Inc.

President
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The Minnesota Institute of Public Finance, Inc. is a non-profit organization comprised of municipal bond broker/dealers, dealer banks, financial consultants and law firms. The Institute is operated for the purpose of promoting its members common business interests related to the marketing of securities issued or guaranteed by the State of Minnesota and its political subdivisions and instrumentalities.

The current membership of MIPFI includes the following firms:

Allison Williams Company, Inc.
American National Bank & Trust Company
Craig Hallum, Inc.
Cronin & Company, Inc.
Dain Bosworth, Inc.
Dean Witter Reynolds, Inc.
Dorsey & Whitney
Dougherty, Dawkins, Strand & Yost, Inc.
Drake & Rogeshke
Ehlers & Associates, Inc.
Evensen Dodge, Inc.
Faegre & Benson
First Bank System Capital Markets
Juran & Moody, Inc.
John Kinnard & Co., Inc.
Leonard Street & Deinard
Marcotte Hume & Associates, Inc.
Marquette Bank
Miller & Schroeder Financial
Miller Securities, Inc.
Moore Juran & Company, Inc.
Norwest Investments
Piper Jaffray & Hopwood, Inc.
Public Financial Systems
Springsted, Inc.
Winthrop & Weinstine

Recommendations to Customers

Sec. 2. In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

● ● ● *Policy of the Board of Governors*

Fair Dealing With Customers

Implicit in all member and registered representative relationships with customers and others is the fundamental responsibility for fair dealing. Sales efforts must therefore be undertaken only on a basis that can be judged as being within the ethical standards of the Association's rules, with particular emphasis on the requirement to deal fairly with the public.

This does not mean that legitimate sales efforts in the securities business are to be discouraged by requirements which do not take into account the variety of circumstances which can enter into the member-customer relationship. It does mean, however, that sales efforts must be judged on the basis of whether they can be reasonably said to represent fair treatment for the persons to whom the sales efforts are directed, rather than on the argument that they result in profits to customers.

District Business Conduct Committees and the Board of Governors have interpreted the Rules of Fair Practice, taken disciplinary action and imposed penalties in many situations where members' sales efforts have exceeded the reasonable grounds of fair dealing.

Some practices that have resulted in disciplinary action and that clearly violate this responsibility for fair dealing are set forth below, as a guide to members:

Recommending Speculative Low-priced Securities

1. Recommending speculative low-priced securities to customers without knowledge of or attempt to obtain information concerning the customers' other securities holdings, their financial situation and other necessary data. The principle here is that this practice, by its very nature, involves a high probability that the recommendation will not be suitable for at least some of the persons solicited. This has particular application to high pressure telephone sales campaigns.

Excessive Trading Activity

2. Excessive activity in a customer's account, often referred to as "churning" or "overtrading." There are no specific standards to measure excessiveness of activity in customer accounts because this must be related to the objectives and financial situation of the customer involved.

Trading in Mutual Fund Shares

3. Trading in mutual fund shares, particularly on a short-term basis. It is clear that normally these securities are not proper trading vehicles and such activity on its face may raise the question of rule violation.

Fraudulent Activity

4. Numerous instances of fraudulent conduct have been acted upon by the Association and have resulted in penalties against members. Among some of these activities are:

Fair Dealing With Customers

● ● ● *Policy of the Board of Governors*

Fictitious Accounts

(a) Establishment of fictitious accounts in order to execute transactions which otherwise would be prohibited, such as the purchase of hot issues, or to disguise transactions which are against firm policy.

Discretionary Accounts

(b) Transactions in discretionary accounts in excess of or without actual authority from customers.

Unauthorized Transactions

(c) Causing the execution of transactions which are unauthorized by customers or the sending of confirmations in order to cause customers to accept transactions not actually agreed upon.

Misuse of Customers' Funds or Securities

(d) Unauthorized use or borrowing of customers' funds or securities.

In addition, other fraudulent activities, such as forgery, non-disclosure or misstatement of material facts, manipulations and various deceptions, have been found in violation of Association rules. These same activities are also subject to the civil and criminal laws and sanctions of Federal and State Governments.

Recommending Purchases Beyond Customer Capability

5. Recommending the purchase of securities or the continuing purchase of securities in amounts which are inconsistent with the reasonable expectation that the customer has the financial ability to meet such a commitment.

While most members are fully aware of the fairness required in dealing with customers, it is anticipated that these enumerated practices, which are not all inclusive, will be of future assistance in the training and education of new personnel.

The Securities and Exchange Commission has also recognized that brokers and dealers have an obligation of fair dealing in actions under the general anti-fraud provisions of the Federal securities laws. The Commission bases this obligation on the principle that when a securities dealer opens his business he is, in effect, representing that he will deal fairly with the public. Certain of the Commission's cases on fair dealing involve practices not covered in the foregoing illustrations. Usually, any breach of the obligation of fair dealing as determined by the Commission under the anti-fraud provisions of the securities laws could be considered a violation of the Association's Rules of Fair Practice.

Suitability of Recommendations and Transactions; Discretionary Accounts

Rule G-19. (a) *Account Information.* Each broker, dealer and municipal securities dealer shall obtain at or before the completion of a transaction in municipal securities with or for the account of a customer a record of the information required by rule G-8(a)(xi).

(b) *Knowledge of Customer.* Each broker, dealer or municipal securities dealer at or before recommending the purchase, sale or exchange of a municipal security to a customer shall have knowledge or shall inquire about the customer's financial background, tax status, and investment objectives and any other similar information.

(c) *Suitability of Recommendations.* No broker, dealer or municipal securities dealer shall recommend the purchase, sale or exchange of a municipal security to a customer unless such broker, dealer or municipal securities dealer, after reasonable inquiry,

(i) has reasonable grounds based upon information available from the issuer of the security or otherwise for recommending a purchase, sale or other transaction in the security; and

(ii)(A) has reasonable grounds to believe and does believe that the recommendation is suitable for such customer in light of the customer's financial background, tax status, and investment objectives and any other similar information concerning the customer known by such broker, dealer or municipal securities dealer, or

(B) has no reasonable grounds to believe and does not believe that the recommendation is unsuitable for such customer if all of such information is not furnished or known.

Notwithstanding the foregoing, if a broker, dealer or municipal securities dealer determines that a transaction in municipal securities or in specific municipal securities would not be suitable for a customer and so informs such customer, the broker, dealer or municipal securities dealer may thereafter respond to the customer's requests for investment advice concerning municipal securities generally or such specific securities and may execute transactions at the direction of the customer.

(d) *Discretionary Accounts.* No broker, dealer or municipal securities dealer shall effect a transaction in municipal securities with or for a discretionary account

(i) except to the extent clearly permitted by the prior written authorization of the customer and accepted in writing by a municipal securities principal or municipal securities sales principal on behalf of the broker, dealer or municipal securities dealer; and

(ii) unless the broker, dealer or municipal securities dealer first determines that the transaction is suitable for the customer as set forth in paragraphs (c)(i) and (c)(ii)(A) of this rule or unless the transaction is specifically authorized by the customer.

(e) *Churning.* No broker, dealer or municipal securities dealer shall recommend transactions in municipal securities to a customer, or effect such transactions or cause such transactions to be effected for a discretionary account, that are excessive in size or frequency in view of information known to such broker, dealer or municipal securities dealer concerning the customer's financial background, tax status, and investment objectives.

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August 16, 1988

[By Messenger]

AUG 16 1988
Department of Commerce

Ms. Elizabeth Moran
Acting Deputy Commissioner
Department of Commerce
500 Metro Square Building
St. Paul, MN 55101

RE: Proposed Permanent Rules Relating to Securities Offerings

Dear Ms. Moran:

This letter is submitted on behalf of Piper, Jaffray & Hopwood Incorporated to comment on certain aspects of the Proposed Permanent Rules Relating to Securities Offerings as published in the State Register on July 18, 1988. It is respectfully requested that the Proposed Rules be modified to (a) clarify the status of letters of credit issued by banks as being guarantees within the meaning of 2875.3500, Subpart 2B and the appropriate financial information necessary to demonstrate compliance with the cash flow requirement of that subpart, (b) permit HUD approved feasibility reports to satisfy the feasibility standards of 2875.3500, Subpart 2C in the case of FHA insurance programs, (c) provide an exception for bank letters of credit and FHA insurance to the prohibition in 2875.3532 against nonrecourse loans, (d) provide a limited exception to the first mortgage requirement to accommodate FHA insurance, (e) modify 2875.3500 to exempt the securities described in Subpart 2A as well as those described in subpart 2B if they meet the rating requirements of proposed Subpart 2B, and (f) permit the cash flow requirements of 2875.3500, Subpart 2, to be met by pledges of asset-backed securities.

A. Bank Letters of Credit Generally.

As a preliminary matter, our comments relating to irrevocable bank letters of credit are necessary only because

of informal staff interpretations that, notwithstanding the exemption for securities guaranteed by banks set forth in Minnesota Statutes, Section 80A.15, Subd. 1(c), debt securities supported as to principal and interest by irrevocable bank letters of credit are required to be registered. We believe that interpretation is erroneous.

A letter of credit is a written undertaking to pay money. It represents a separate and independent obligation of the issuer to the beneficiary without regard to the terms of the underlying transaction. The legal relationships of the parties are governed by Article 5 of the Uniform Commercial Code and, when expressly made applicable, the Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce Publication 400.

In the industrial revenue bond context, letters of credit are commonly used when the bond issuer (or borrower of the proceeds) lacks sufficient creditworthiness to market the bonds at an acceptable interest rate. The borrower then commonly arranges for a bank to issue an irrevocable letter of credit to the trustee for the holders of the bonds in the amount of principal and the current portion of interest due on the bonds. These letters of credit are subject to regulatory lending limits which restrict the amount which a bank may loan to any single borrower. If the letter of credit is a "standby" letter of credit, the bank is obligated to pay the bond trustee upon notification that the borrower has defaulted under the underlying obligation. If the letter of credit is a "direct pay" letter of credit, the bank is obligated to make payment of principal and interest when due. In either case the bank's obligation is an independent obligation running to the bond trustee entirely separate from the borrower's obligation to the bond trustee and the borrower's reimbursement obligation to the bank. Purchasers of bonds supported by bank letters of credit are typically relying solely on the credit of the bank and not on the credit of the borrower or other security.

Although a letter of credit is technically not a "guarantee" for purposes of banking laws because it is a separate obligation independent of the underlying transaction, the Staff of the Securities and Exchange Commission has consistently taken the position that a bank letter of credit is the functional equivalent of a guarantee by the bank within the meaning of Section 3(a)(2) of the Securities Act of 1933. Therefore, debt instruments supported by bank letters of credit are securities "issued or guaranteed by any bank" exempt from registration under Section 3(a)(2). See, e.g., Martin Homes, Inc. (available March 28, 1983); Merrill Lynch, Pierce, Fenner & Smith, Inc. (available May 3, 1982); The Chase Manhattan Bank, N.A. (available February 1, 1982); The Great Atlantic & Pacific Tea Co., Inc. (available July 2, 1981); Frontier Gas

Storage Co. (available January 5, 1981). This interpretation was reiterated and extended to cover letters of credit issued by regulated domestic branches of foreign banks in SEC Interpretive Release Nos. 33-6661/3902038, effective September 26, 1986.

Debt instruments supported by bank letters of credit are also exempt from registration under most state securities laws. That this should also be true in Minnesota seems clear from Minnesota Statutes, Section 80A.15, Subd. 1(c), which exempts from registration "any security issued by and representing an interest in or debt of, or guaranteed by, any bank ...".

Chapter 80A is of course derived from the Uniform Securities Act (1956 as amended) and Section 80A.15, Subd. 1(c) is virtually identical to Section 402(a)(3) of the Uniform Act. While the official comment to the Uniform Act does not specifically refer to letters of credit, it does indicate that the provision is applicable where, as the case in a letter of credit transaction, there is a claim against the assets of the bank. The official comments to the 1985 Revision of the Uniform Securities Act are specific that letters of credit were intended to be covered by the language. Under Minnesota Statutes, Section 80A.31, the Minnesota provision is required to be construed "to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretive of sections 80A.01 to 80A.31 with related federal regulations". For these reasons, we believe the best course to follow is to issue an interpretive letter (for we would be happy to make a formal request) or otherwise rule that bonds supported as to principal and interest by irrevocable bank letters of credit are exempt from registration. Aside from being the proper interpretation, it would obviate the need to deal with certain issues discussed below.

B. Determination of Bank Cash Flow.

Even if debt securities supported by bank letters of credit are not "guaranteed" by a bank so as to be exempt under Section 80A.15, Subd. 1(c), we presume they are "guaranteed" within the meaning of the last sentence of Subpart 2B so that the cash flow of a letter of credit bank must be used to determine whether the cash flow requirement is satisfied.

This raises the issue of how a bank is to comply with the requirement that the cash flow be computed in accordance with generally accepted accounting principles. Banks are required to publish financial information in accordance with government regulatory requirements and do not ordinarily provide audited financial information in accordance with generally accepted accounting principles. For example, Norwest Bank Minnesota, N.A. and a number of other large banks publish

financial information only in the form required by federal regulatory authorities. Accordingly, we believe the cash flow for banks should be determined by reference to lines 1 (interest income), 2 (interest expense), 3 (net interest income), 5 (noninterest income), 6 (gains and losses on securities) and 7 (noninterest expense) which banks are required to file quarterly with regulatory agencies. One possibility is to add the following sentence to Subpart 2B: "In the case of bank letters of credit, cash flow shall be determined based on regulatory accounting and consist of net income (other than provisions for loan and lease losses and provision for allocated transfer risk) before taxes and extraordinary items and other adjustments." A better solution would be to exempt banks from the cash flow requirement entirely. After all, the basic purpose of a banking regulation (including the lending limit rule) is to assure that banks are managed in a way which assures that cash will be available to meet current demands.

C. Projects Involving FHA Insured and Coinsured Loans.

A number of worthwhile housing projects are financed through bond proceeds used to make loans insured or coinsured by the Federal Housing Administration. Purchasers of these Bonds rely primarily on the FHA insurance as the ultimate source of repayment. Enclosed herewith is a description of the FHA mortgage insurance program. As you will see, the feasibility analysis of projects obtaining mortgage insurance under the program must be approved by the Department of Housing and Urban Development. Where FHA insurance is the ultimate source of repayment and the feasibility has been reviewed to HUD's satisfaction, there is no need for a separate independent review by an independent certified public accountant. Accordingly, we request that the following phrase to be added at the end of the first sentence of 2875.3500, Subpart 2C: "or, in the case of mortgage loans insured or coinsured by the Federal Housing Administration, an underwriting analysis prepared by the Department of Housing and Urban Development or, in the case of a coinsured loan, an FHA approved coinsuring lender". Also the next sentence should be preceded by the words "Except in the case of FHA insured or coinsured mortgage loans."

D. Exception to Prohibition Against Non-recourse Loans for Certain Bank Letters of Credit and FHA Insurance.

Proposed Rule 2875.3532 prohibits public offerings of securities which involve non-recourse loans. Non-recourse loans are the standard method of financing real estate developments involving limited partnerships. The nonrecourse feature is driven by federal tax laws which would limit the tax benefits to limited partners if the loan were on a recourse basis. While we understand that there have been a number of substantial defaults involving projects with nonrecourse loans,

we are not aware of any defaults where the principal and interest was supported by an irrevocable letter of credit issued by a major bank or by FHA mortgage insurance.

Bonds and other securities supported by bank letters of credit are in fact a relatively safe and attractive investment. Further, as explained above, such bonds are not non-recourse as to the letter of credit bank. The bondholders have a direct claim against the assets of the bank even though the underlying loan to the ultimate borrower may be on a nonrecourse basis. The same is true for loans insured by the FHA. There is no substantial reason from a securities regulation standpoint to prevent the public offering of bonds to finance non-recourse real estate projects where the investors have direct recourse to a substantial bank or recourse to FHA insurance.

In connection with our proposal to exempt bank letters of credit from the nonrecourse loan prohibition, it may be appropriate to limit the exemption to banks of a certain size. As of March 31, 1988, for example, we believe Norwest Bank Minnesota, Marquette Bank and American National Bank and Trust Company respectively reported equity capital of $400 million, $93 million and $38 million. We believe $25 million would be an appropriate limit.

Accordingly, we suggest that the following phrase be added to the end of 2875.3532: "or to bonds or similar interest-bearing securities supported by irrevocable letters of credit issued by banks having equity capital in excess of $25 million or involving mortgage loans insured or coinsured by the Federal Housing Administration."

E. <u>First Mortgage Requirement</u>.

Proposed Rule Part 2875.3531 generally requires that the trustee of a bond issue be the holder of a first mortgage in the property constructed or acquired with the offering proceeds. We believe this requirement to be more restrictive than necessary with respect to certain mortgage loans guaranteed or coinsured by the FHA.

24 CFR Part 251.106, entitled "Assignment of and participation in coinsured mortgages", provides the conditions under which an interest in a coinsured mortgage may be transferred by the originating FHA approved coinsuring mortgage banker to others. Under the terms of a coinsured mortgage, FHA guarantees approximately 85% of the coinsured mortgage. A revenue bond issue by a governmental entity where the proceeds are to be loaned to a private developer to construct a multifamily housing project and where the loan is to be

coinsured by FHA constitutes a "transfer" of the coinsured loan within the meaning of the regulation from the coinsuring mortgage banker to the bondholders. Section 251.106(b)(1) of this regulation requires that the coinsuring mortgage banker be named as mortgagee in the mortgage.

Similarly, where an FHA insured or coinsured loan is to be used to back a certificate guaranteed by the Government National Mortgage Association ("GNMA") which in turn is to be used to secure bonds issued by a governmental entity, the mortgage must be assigned to GNMA as a condition of receiving GNMA's full guarantee. Section 16-8 of the GNMA I Mortgage-Backed Securities Guide requires an assignment of the mortgage to GNMA.

These two peculiarities of FHA insured loans would be best addressed by adding a new exception to Part 2875.3531 as paragraph D excepting securities which are fully secured by securities guaranteed by GNMA or mortgage loans coinsured by FHA and a coinsuring lender.

F. Rating Exemption from Cash Flow Requirements.

We understand that current Department practice is not to require compliance with Minnesota Rules Part 2875.3500 Subpart 2 where the securities to be issued are rated in one of the top four letter categories by a nationally recognized rating agency. This practice is in fact reflected in the prosed amendments to Minnesota Rules, Part 2875.3500 Subpart 2B by exempting rated securities issued by certain governmental entities from the cash flow requirements of paragraph B of Subpart 2. This exemption should be moved from paragraph B and included as a new separate paragraph of Subpart 2 so that all rated debt securities would be exempt from this part. Attached to this letter is suggested language to accomplish this change.

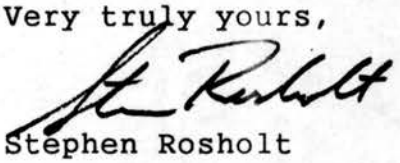
G. Cash Flow of Asset-Backed Securities.

Another area of concern with respect to Subpart 2 of Part 2875.3500 is the applicability of paragraph A to asset-backed debt securities such as collateralized mortgage obligations and pass-through certificates. Existing Subpart 2, which becomes paragraph A of Subpart 2 in the proposed rules, contemplates the issuance of debt securities by operating companies where debt service on the securities is to be paid from normal company operations. This rule did not and does not adequately regulate the issuance of securities by limited purpose finance companies which use specific assets with identifiable cash flow to pay principal and interest on the securities offered to the public. These offerings might take the form of pass-through certificates, where investors are offered an undivided interest in a pool of loans (which may be

mortgage loans, loans secured by equipment or unsecured loans such as credit card receivables) or the form of bonds which are collateralized by such a pool of loans. In each instance, it is the underlying pool of loans or receivables which provide the cash flow to pay amounts due under the pass-through certificates or the collateralized bonds. The holders of these types of instruments typically have no recourse to the issuer of the securities other than to the specific pool of loans pledged to the securities the investor has purchased. These limited purpose finance companies often issue many successive issues of these securities with each separate issue payable solely out of the cash flow from the pool of assets pledged to such issue. We believe that this concern would be best addressed by exempting asset-backed securities from paragraph A of Subpart 2 and adding a new paragraph D which would require that the expected cash flow of the pool of loans or other assets pledged to a particular issue of securities be sufficient to pay principal and interest on such securities when due. We have prepared and are enclosing suggested language to accomplish these changes.

Please let me know if you would like any further explanation of the points raised in this letter.

Very truly yours,



Stephen Rosholt

SR:lkl
3094g

2875.3500 DIVIDEND AND INTEREST COVERAGE.

Subpart 1. [Unchanged.]

Subp. 2. Debt securities.

A. In connection with the offering of debentures, notes, bonds, investment certificates, or similar interest-bearing securities, (other than bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision, or any corporate or other instrumentality of one or more of those entities and other than asset-backed securities such as pass-through certificates and collateralized mortgage obligations), whether convertible or not, the cash flow of the issuer, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the securities proposed to be offered to the public.

B. In connection with the offering of bonds or similar interest-bearing securities issued by the United States, any state, any political subdivision of any state, or any corporate or other instrumentality of one or more of those entities, ~~except those which are exempt from registration under Minnesota Statutes, section 80A.15 or are rated in one of the top four rating categories by Fitch Investors Service, Inc., Standard and Poor's Corporation, or Moody's Investor Services Inc.~~, the cash flow of the user or borrower of the offering proceeds or, if a different entity, the cash flow of the entity obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan, or guarantee arrangement sufficient to make principal and interest payments on the bonds or securities, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be

sufficient to cover the interest, including that which is deferred and not paid, on the bonds or securities proposed to be offered to the public. If the bonds or securities proposed to be offered are unconditionally quaranteed, both as to payment of interest and as to the repayment of principal, by an entity other than the user or borrower of the proceeds, then the cash flow of the quarantor shall be used in determining whether the bonds or securities qualify for registration.

C. In connection with the offering of bonds or similar interest-bearing securities issued by the state of Minnesota, its political subdivisions, governmental agencies, or corporate or other instrumentalities, if the cash flow requirements of the previous paragraph are not satisfied, then the application for registration must be accompanied by a financial forecast, examined by an independent certified public accountant who must express an opinion on the forecast. The examination must be made in accordance with the Guide for Prospective Financial Statements as promulgated by the American Institute of Certified Public Accountants, and the financial forecast must attest to the ability of the user or borrower of the proceeds or other obligor to generate sufficient cash flow, computed in accordance with the generally accepted accounting principles, exclusive of anticipated extraordinary income, to cover interest on the securities proposed to be offered to the public. Notwithstanding the foregoing, a financial forecast will not be accepted as evidence of the satisfaction of cash flow requirements if the user or borrower of the offering proceeds or other obligor has had a material default during the past three years in any required payment under a lease or any payment of principal, interest, dividend, or sinking fund installments on preferred stock or indebtedness for borrowed money.

D. In connection with the offering of asset-backed securities such as pass-through certificates and collateralized mortgage obligations the cash flow of the pool of loans or other assets pledged or backing such securities, established to the satisfaction of the Department, shall be sufficient to cover the interest, including that which is deferred and not paid, on the securities proposed to be offered to the public.

E. This part shall not apply to any security exempt from registration under Minnesota Statutes, Section 80A.15 or rated in one of the four highest letter rating categories by Fitch Investors Service, Inc., Standard & Poor's Corporation or Moody's Investors Service, Inc.

Subp. 3. [Unchanged.]

Subp. 4. [See Repealer.]

Subp. 5. [Unchanged.]

FHA MORTGAGE INSURANCE

The Federal Housing Administration was created in 1934 pursuant to the National Housing Act of 1934 to provide a system of mutual mortgage insurance, to exert a stabilizing influence on the mortgage market and to encourage improvement in housing standards. FHA has operated as an organizational unit within the Department of Housing and Urban Development of the United States since 1965. The following is a general description of the FHA mortgage insurance program administered under Section 221(d)(4) of the National Housing Act of 1934, as amended (the "National Housing Act"), and the regulations promulgated thereunder (the "FHA Regulations"). This description is qualified in its entirety by reference to the National Housing Act and the FHA Regulations, and should not be construed as a full statement thereof.

General

To be eligible for insurance under Section 221(d)(4), a mortgage must (1) have been made by an FHA-approved mortgagee; (2) be secured by property which conforms to certain FHA-specified location criteria, has located thereon a dwelling conforming to certain other FHA-specified criteria, and meets the requirements of all applicable state and local laws, ordinances and regulations; (3) involve a principal obligation not to exceed certain specific amounts per dwelling unit; and (4) contain other terms and conditions as are prescribed by FHA.

Insurance benefits are payable in cash, unless the mortgagee files a written request with FHA to receive such benefit payments in FHA debentures, upon the fulfillment of certain procedural requirements. The payment of insurance benefits will generally be in an amount equal to the unpaid principal balance of the loan plus accrued interest, subject to the exceptions and deductions specified below.

Mortgage Insurance Processing

Under FHA's mortgage insurance program, the development sponsor submits an application to FHA for the issuance of a site appraisal and market analysis letter with respect to the project (the "SAMA letter"). The issuance of a SAMA letter by FHA usually indicates a determination of initial acceptability of the development site and recognition of a specific market need for the development. Upon receipt of the SAMA letter, the development sponsor and the mortgagee submit

an application for the issuance of a conditional commitment for mortgage insurance along with preliminary working drawings for the project, although FHA will, under certain circumstances, permit the sponsor and mortgagee to submit an application for a firm commitment for mortgage insurance in lieu of an application for a conditional commitment. The issuance by FHA of the conditional commitment for mortgage insurance usually indicates HUD's conditional approval of, among other things, the estimated cost of the development, the "as is" value of the development site, estimates of operating expenses and taxes, financial and credit capacity information concerning the development sponsor or the development owner, and the proposed amount of the mortgage.

Upon receipt of the conditional commitment for mortgage insurance, the mortgagee submits a application for the issuance of a firm commitment for mortgage insurance, which application includes, among other things, final working drawings and specifications, the contractor's trade payment breakdown which consists of a schedule of costs of material and labor, a management agreement and a property survey. The firm commitment for mortgage insurance evidences FHA's approval of the mortgagee's application for insurance, and establishes the terms and conditions upon which the mortgage will be insured. Under the FHA mortgage insurance program, the firm commitment for mortgage insurance may provide for insurance of advances (as in the case of the Mortgage Loan) or insurance upon completion of construction of a development.

The firm commitment requires the owner to pay, during the construction period, an annual insurance premium equal to 1/2 of 1% of the full anticipated principal amount of the loan. Following the construction period, the firm commitment requires the owner to pay an insurance premium to FHA in an amount equal to 1/2 of 1% of the outstanding principal balance of the mortgage loan, which fee is collected by the mortgagee on a monthly basis for payment to FHA annually. FHA will impose a late charge on the mortgagee in the event it fails to pay the FHA insurance premium in a timely manner, which charge may not be imposed on the owner.

Initial Closing and Construction

Mortgage. After receipt of the firm commitment for mortgage insurance, the owner of the development proceeds to an initial closing of the loan. At the initial closing, the owner executes an FHA form of mortgage note evidencing the loan, an FHA form of mortgage securing the mortgage note and other documents and certifications required by FHA. At the initial closing, FHA initially endorses the mortgage note for

insurance, and moneys are advanced by the mortgagee to provide for the initial costs of the development, including a portion of land acquisition and financing fees.

The standard form FHA mortgage note is a nonrecourse obligation since the maker is not personally liable for the payment of the principal thereof and interest thereon. The face amount of the mortgage note is approved by FHA and is endorsed for insurance by FHA at the initial closing of the mortgage loan. The amount of the mortgage insurance is increased from time to time during the construction period as FHA-approved advances are made by the mortgagee to the mortgagor. The mortgage note has a stated maturity date after commencement of amortization, which is scheduled to occur on a date determined by FHA and set out in the firm commitment.

To secure the payment of the debt evidenced by the mortgage note, the owner of the development grants, for the benefit of the payee under the mortgage note, a lien on or a security interest in the development site together with all buildings, improvements and fixtures to be constructed on the site and all articles of personal property of the owner located on the site (collectively, the "mortgaged property"), and, in addition, pledges to the mortgagee all rents, profits and income to be derived from the mortgaged property. Until final payment of the indebtedness, the owner agrees not to sell, encumber or alienate the mortgaged property in any way without the consent of the secured party and FHA.

Payments of interest only on the outstanding principal amount of the mortgage loan are made monthly commencing on the first day of the month immediately following the month in which initial endorsement occurs, and on the first day of each month prior to the month in which commencement of amortization is scheduled to occur (as set out in the FHA firm commitment), or such extension of the date for commencement of amortization as may be agreed upon by FHA, the owner and the mortgagee. Thereafter, monthly payments of principal and interest are made until maturity.

Building Loan Agreement. Construction of the project is required to proceed in accordance with the FHA form building loan agreement executed by the owner and the mortgagee. During construction of the project, an architect and FHA inspector make inspections to insure on-site conformity with approved plans and specifications. Construction progress is monitored and requests for further advances are submitted to FHA for approval. From each approved advance an amount is withheld until final completion and final inspection by FHA, provided that under certain conditions FHA may permit a reduction in such retainage.

The standard form FHA building loan agreement requires, among other things, that the development be completed in accordance with plans and specifications approved by FHA; that any changes in the plans and specifications may be effected only with the prior written approval of the mortgagee and FHA, and under such conditions as either the mortgagee or FHA may establish; that advances for construction are to be made only for work completed and accepted by FHA, together with the value of materials and equipment not incorporated in the work but delivered to and suitably stored at the development site; and that all advances will be subject to prior approval of the mortgagee and FHA.

Assurance of Completion. Pursuant to FHA regulations, the mortgagee must require the owner and general contractor for the project to execute a standard form FHA construction contract. Under the contract, the general contractor agrees to complete the construction of the development in accordance with the plans and specifications approved by FHA. To assure completion of construction, the general contractor is required to provide either payment and performance bonds in amounts approved by FHA and the mortgagee or to enter into a completion assurance agreement with the mortgagee secured, as required by FHA, by a deposit of cash or an unconditional, irrevocable letter of credit in favor of the mortgagee.

Final Closing and Final Endorsement

As dwelling units are completed with respect to the development, the owner begins marketing and rent-up of those dwelling units. When a development is completed a cut-off date is established for cost certification of the development. Final closing consists of a review and approval by FHA of the total cost of the development, certified by an independent certified public accountant, and of operating income and expenses through the cut-off date. FHA reviews the final closing documents and the mortgage note is finally endorsed for insurance before the final construction disbursement is made. The development owner is required to make monthly payments for reserves and escrows under the FHA forms of regulatory agreement and mortgage.

Collection of Insurance Benefits

Failure to make any payment due under the mortgage, and failure to perform any other covenant under the mortgage where the mortgagee accelerates the indebtedness, constitute defaults under the FHA insurance program. Before any default matures into an event upon which a claim for insurance benefits may be filed, the mortgagee must allow the mortgagor a 30-day

"grace period" within which to correct such default. If the default continues at the end of the grace period, the mortgagee becomes entitled to receive insurance benefits from FHA (the "entitlement date"), provided that the procedural steps outlined below are carried out.

Within 30 days after the entitlement date, the mortgagee must notify HUD in writing of the default and within 45 days of the entitlement date (the "election date"), the mortgagee must file a written notice with FHA of (1) its intention to file a claim for insurance benefits; and (2) its election to either (a) assign certain specified documents to FHA, or (b) acquire title to and convey the project to FHA. The Trustee has covenanted in the Indenture that, in the event of the occurrence of default with respect to the development which is not cured within the grace period, the assignment option will be elected. Mortgage insurance benefits are subject to a 1% reduction upon assignment rather than foreclosure of the mortgage. If the mortgagee elects the assignment option, upon receipt of documentation from HUD it must file an application for insurance benefits, complete the HUD documentation, and, upon approval from HUD, assign to FHA the credit and security instruments (the "assignment date"). In addition, the mortgagee must (1) notify FHA of the assignment and recordation of mortgage; (2) warrant as to the real property that (a) no act or omission of the mortgagee has impaired the validity or priority of the mortgage, (b) the mortgage is prior to all mechanics' liens filed of record subsequent to the recording of the mortgage, regardless of whether such liens attached prior to the recording date, (c) the mortgage is prior to all liens and encumbrances which may have attached, or defects which may have arisen, subsequent to recording, except for liens and other matters approved by FHA, (d) the amount stated in the instrument of assignment is actually due under the mortgage, and that there are no offsets or counterclaims against such, and (e) it has good right to assign the mortgage; and (3) warrant as to the personal property that (a) no act or omission of the mortgagee has impaired the validity or priority of the lien created by the security instruments, (b) the mortgagee has good right to assign the security instruments, and (c) the security instruments are a first lien on the items covered, except for liens and other matters approved by FHA.

Within 45 days of the assignment date (the "delivery date"), the mortgagee must deliver to FHA (a) an assignment of claims of the mortgagee against the mortgagor or others arising out of the mortgage transaction; (2) all policies of title or other insurance, or surety bonds or other guaranties, including evidence satisfactory to FHA that the effective date of the

original title insurance coverage has been extended to include the assignment of the mortgage to FHA; (3) all records, ledger cards, documents, books, papers and accounts relating to the mortgage transaction; (4) all property of the mortgagor held by the mortgagee or to which it is entitled (other than those cash items which are permitted to be retained by the mortgagee); and (5) any additional information or data which FHA may require. At the option of FHA, the mortgagee may also be required to deliver (1) any balance of the mortgage loan not advanced to the mortgagor; (2) any cash held by the mortgagee or its agents, or to which it is entitled, including deposits made to the account of the mortgagor, and which have not been applied to reduce the principal amount of the mortgage indebtedness; (3) all funds held by the mortgagee for the account of the mortgagor pursuant to any other agreement; and (4) the amount of any undrawn balance under a letter of credit used in lieu of a cash deposit.

If the mortgagee fails to make a timely election, or fails to deliver the assigned documents in a timely manner, FHA will not pay interest from the date such election or assignment should have been made to the date of insurance settlement, unless FHA has agreed to extend such period with interest.

The mortgagee is required to furnish FHA with a title policy which names FHA as the insured party and which assures FHA that the mortgage loan to be assigned constitutes a first lien on the mortgaged premises, subject only to such exceptions as shall have been previously approved by FHA. The mortgagee will be required to remove any intervening liens and to obtain an updated endorsement within the 45 day period during which documents are required to be submitted. FHA will deduct the amount of any liens which have priority over the mortgage lien from the mortgagee's FHA insurance claims.

Tax liens against the property which have priority over the lien of the mortgage must be paid by the mortgagee. Although the mortgagee will be reimbursed for funds it advances to pay real estate taxes on the mortgaged property, failure to pay taxes when due may result in a penalty which will not be reimbursed by FHA in connection with the insurance claim.

The mortgagee is required to inspect the mortgaged property at least annually and to advise FHA of its recommendations for actions necessary to protect or maintain the property and to maintain adequate hazard insurance coverage. Failure to maintain adequate coverage is grounds for termination of the FHA insurance contract, unless FHA has been timely notified of the unavailability of coverage. Losses

occurring as a result of a failure to properly insure the mortgaged property will be deducted from the mortgage insurance claim.

In certain circumstances the mortgagee is permitted to transfer some or all of its interests in the mortgage. The transfer, pledge or assignment of a mortgage in a manner which is not in compliance with FHA requirements is grounds for termination of the FHA insurance. Prior to final endorsement by FHA, the mortgage note may be assigned only to another FHA-approved mortgagee with the approval of FHA. Subsequent to final endorsement, the mortgage loan may be assigned to another FHA-approved mortgagee after notice to FHA on a prescribed form.

Although the mortgagee will be reimbursed for advances properly made for taxes, insurance premiums and preservation of the property, such reimbursement may not fully compensate the mortgagee for the making of such advances since the mortgagee will be paid only debenture interest on such advances from the date of default. FHA will reimburse the mortgagee for funds advanced to maintain or preserve the mortgaged property if the approval of FHA is received prior to the time such funds are advanced.

FHA is required to pay insurance benefits in cash, unless debentures are requested. The Trustee has covenanted in the Indenture that, in the event of the payment of FHA mortgage insurance benefits with respect to the development, cash payment of insurance benefits will be requested. FHA must pay interest to the mortgagee on cash benefits from the entitlement date to the date of the insurance settlement at the FHA "debenture rate" in effect on the date of the firm commitment for mortgage insurance or the date of initial endorsement, whichever is higher, except that if the mortgagee has failed to timely give the required notice to FHA, only interest from the date that such notice is actually given until the date of the insurance settlement will be paid.

In the case of a monetary default, the date of default is deemed to be the expiration of the 30-day grace period, after the date on which payment originally should have been received. Since interest is paid one month in arrears in FHA mortgage transactions, FHA will not, in the event of a claim for insurance benefits, reimburse for interest which accrued during the 30-day grace period. FHA will reimburse, in such event, only for interest at the debenture rate commencing on the date of default.

FHA is required to pay benefits in an amount equal to (1) the sum of (a) the unpaid principal amount of the mortgage on the date of default, (b) the amount of all payments made by

the Mortgagee for taxes, special assessments and water rates constituting liens prior to the mortgage, insurance on the project, and mortgage insurance premiums after default, (c) an allowance for reasonable payments made by the mortgagee, with FHA approval, for the completion and preservation of the project, and (d) provided the mortgagee has given timely notice to FHA, an amount equal to the debenture interest which would have been earned on cash benefits had they been paid on default; less (2) the sum of (a) any amount received by the mortgagee on account of the mortgage after the date of default, (b) any net income received by the mortgagee from the project, (c) the sum of certain cash items retained by the mortgagee, and (d) an amount equal to 1% of the mortgage funds advanced to the mortgagor and not repaid as of the date of default.

FHA is not required by law or contract to pay insurance claims within any specified time period, but typically pays a portion of an insurance claim prior to the delivery of required documents, including the mortgage note and the mortgage. If the claim is made in connection with a mortgage loan which has not yet been finally endorsed, FHA will usually, but is not obligated to, pay 70% of the outstanding principal balance of the loan promptly after the filing of an assignment of the mortgage loan to FHA, provided the pertinent data is submitted to FHA in a timely manner. In the case of the mortgage loan which has been finally endorsed, FHA will usually, but is not obligated to, pay 90% of the outstanding principal balance promptly after the filing of an assignment of the mortgage loan to FHA, provided the pertinent data is submitted to FHA in a timely manner. Any remaining balances are paid to the mortgagee after FHA has received final financial data, legal clearance has been obtained and all necessary documents have been delivered to FHA in acceptable form.

The mortgagee is responsible for all deposits made for the account of the owner of the development under its control and FHA will deduct from any insurance claim all such amounts. Where deposits made for the account of the owner of the development are held in the form of a letter of credit, the insured party under certain circumstances must convert the letter of credit to cash as needed. FHA, which does not review or approve letters of credit, generally views a letter of credit as its cash equivalent. Therefore, FHA mortgage insurance benefits may be reduced by the amount of any letter of credit deposited for the account of the owner of the development and held by or for the benefit of the mortgagee, even if the mortgagee fails or is unable to convert such letter of credit prior to its expiration. The mortgagee is required, in certain cases, to receive the approval of FHA prior to the release of deposits under its control. Failure to properly

protect deposits may result in a deduction from the insurance claim in an amount equal to any deposits FHA asserts have been improperly maintained. Since the Letters of Credit to be deposited in the Mortgage Reserve Fund are required to be issued for the account of a party other than the owner of the Project, there should not be any basis for FHA to reduce FHA mortgage insurance benefits by the amount of such Letters of Credit.

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August 16, 1988

AUG 16 1988
Department of Commerce

[By Messenger]

Ms. Kris Eiden
Deputy Commissioner
Department of Commerce
500 Metro Square Building
St. Paul, MN 55101

RE: Impact of Proposed Securities Offerings Rules on Minnesota Small Business Development Loan Program of Minnesota Agricultural and Economic Development Board

Dear Ms. Eiden:

The following comments relate to the potential impact of Proposed Rule 2875.3500, Subpart 2B, on the Minnesota Small Business Development Loan Program conducted by the Minnesota Agricultural and Economic Development Board. We represent Dougherty, Dawkins, Strand & Yost Incorporated and Piper, Jaffray & Hopwood Incorporated as underwriters of bonds issued by the Board under this Program.

Proposed Rule 2875.3500, Subpart 2B, would require that the users or borrowers of the proceeds of bonds issued by the Board under its Small Business Development Loan Program meet certain cash flow requirements as a condition to registration of the bonds. The substance of the proposed rule is generally consistant with the standards being followed by the Board in issuing Bonds under the Program. However, we have been informally advised by your staff that, in order to demonstrate compliance with the proposed rule, it will now be necessary that the users or borrowers of the proceeds of the Board's bonds prepare and submit audited financial statements. In the past, the Commissioner has accepted the audited financial statements of the Board as satisfying applicable requirements for registration of the Board's bonds and has not

required audited financial statements of borrowers under the Program. We do not believe staff's preliminary informal interpretation is warranted under the proposed rule and existing rules relating to financial statements. However, if you think that interpretation would be required, we believe the rules should be modified in a way which allows the Program to continue. Accordingly, we respectfully request that either (a) an interpretive letter be issued confirming our opinion that audited financial statements of the borrowers under the Program are not required to demonstrate compliance with the proposed rule, or (b) that the proposed rule be modified to provide an appropriate exemption for borrowers under the Program.

The Minnesota Small Business Development Loan Program was instituted by the Minnesota Energy and Economic Development Authority for the purpose of making economic development loans to small businesses for land, buildings and other capital improvements. Operation of the Program was transferred to the Minnesota Agricultural and Economic Development Board in 1987. The Program is administered pursuant to rules promulgated specifically for the Program as Parts 8300.3020 to 8300.3024 and general rules for financial assistance set forth in Parts 8300.0100 to 8300.3013.

Borrowers under the Program must qualify as a "small business" within the meaning of regulations of the United States Small Business Administration. Loans may be made only for capital improvements and generally may not exceed 80% of the authorized project costs. In addition, the loans must generally be secured by collateral having a value equal to the principal amount of the loan. Applicants under the Program are required to furnish financial statements, which need not be audited, for the previous three years and to make certain projections. Under guidelines approved for the Program, each applicant must demonstrate a capacity to meet loan repayments based on past and projected performance.

Loans to borrowers under the program are financed by bonds issued by the Board. The Board presently has 18 outstanding unrated bond issues aggregating more than $17 million. These bonds are all payable primarily from a common debt service account derived from the monthly loan repayments by borrowers under the Program. No borrower is presently more than 30 days in arrears in loan repayments. The bonds are additionally secured by debt service reserves derived from bond proceeds or borrower contributions presently aggregating more than $2 million and a guaranty fund consisting of funds appropriated by the Legislature and earnings thereon which currently exceeds $9.8 million. Accordingly, the Program has the capacity to absorb substantial defaults by individual borrowers.

Bonds issued by the Board are registered with the Commissioner. The most recent offering was registered in June of 1988. The filing was accompanied by the most recent audited financial statement of the Board and an unaudited financial statement of the borrower of the proceeds of that issue. Because of the common debt service account for all Bonds issued under the Program, the loan repayments by any particular borrower represent only a small portion of the debt service payable with respect to any series of bonds. Further, the bonds are sold on the financial strength of the Board's guaranty fund and not on the financial strength of any borrowers. For these reasons the Commissioner has required only that the financial statements of the Board be audited and has not required audited financial statements of borrowers.

The Board believes its Program serves an important governmental purpose in assisting expansion of small businesses in the State of Minnesota. Continued success of the Program is dependent on the ability to obtain low cost long-term fixed-rate financing which is available in the public securities markets. This is possible only with the help of the guaranty fund and by keeping bond issuance costs relatively low. If the small business under the Program are required to provide audited financial statements in order to participate, this would add substantial costs to the Program and limit participation to only a few of the otherwise eligible applicants. For further information about the Program, please contact David Mocol, Executive Director, Minnesota Agricultural and Economic Development Board.

Proposed rule 2875.3500, Subpart 2B, provides in part that "the cash flow of the entity obligated to make payment of principal and interest on the bonds or securities or obligated to make payments under a lease, sale, loan or guaranty arrangement sufficient to make principal and interest payments on the bonds or securities, computed in accordance with generally accepted accounting principles, exclusive of extraordinary income, for its last fiscal year prior to the public offering, or the average of its last three fiscal years prior to the public offering, shall be sufficient to cover the interest, including that which is deferred and not paid, on the bonds or securities proposed to be offered to the public". The proposed rule does not require the submission of a financial statement to demonstrate compliance with the proposed rule.

Existing rules applicable to financial statements and setting forth the audit requirements are set forth in Part 2875.0950 and Part 2875.0960. Part 2875.0950 applies to "financial statements required by these rules or by any official form". Part 2875.0960 applies "[w]henever in these rules financial statements of an issuer or other person are required by a particular part or form without further

description ...". Since Proposed Rule 2875.3500, Subpart 2B, does not require a financial statement, we do not believe Parts 2875.0950 and 2875.0960 are applicable.

As a matter of practice we had expected to satisfy the requirements of Proposed Rule 2875.3500, Subpart 2B, by asking borrowers to prepare a cash flow statement as part of the financial statements which the Board presently requires under the Program and to certify that the cash flow was computed in accordance with generally accepted accounting principles. We then expected to submit the cash flow computation along with a computation of interest payments under the proposed loan to the Commissioner as part of the registration application to demonstrate compliance with the Proposed Rule. The Board has not expected that borrowers under the Program would henceforth be required to go to the expense of an audit for the sole purpose of demonstrating compliance with the rule.

If you do not agree that borrower audits are not required under the Proposed Rule when read in conjunction with Parts 2875.0950 and 2875.0960, we request that the Proposed Rule be modified. This could be accomplished by making any of the following modifications to Proposed Rule 2875.3500, Subpart 2B:

1. Add the words "and except for bonds issued by the Minnesota Agricultural and Economic Development Board pursuant to its Minnesota Small Business Development Loan Program described in Parts 8300.3020 to 8300.3024," after "Moody's Investor Services, Inc." in 2875.3500, Subpart 2B.

2. Add the following sentence at the end of 2875.3500, Subpart 2B: "Financial statements of Borrowers or other users of bond proceeds under the Small Business Development Loan Program of the Minnesota Agricultural and Economic Development Board described in Parts 8300.3020 to 8300.3024 submitted to demonstrate compliance with the foregoing cash flow requirements need not be audited."

3. Add as Subpart 2D: "In the case of bonds offered by the Minnesota Agricultural and Economic Development Board for its Small Business Development Loan Program described in Parts 8300.3020 to 8300.3024, compliance with paragraphs B or C may be demonstrated without audited financial statements with respect to cash flow and without an examination by an independent certified public accountant with respect to a financial forecast."

Of the foregoing alternatives, the first is preferable in that it would permit the Board to continue to evaluate borrowers in accordance with its existing rules and guidelines. It is submitted that these practices are adequate in

the context of small business loans under the Program. The second alternative is limited to the cash flow rule and would solve the most serious difficulty with the proposed rule since the Board has generally not made loans to start-up businesses. The third alternative would allow the Board to consider all applicants meeting the substance of the proposed rule without placing additional burdens on small businesses.

As the foregoing comments indicate, we believe Proposed Rule 2875.3500, Subpart 2 may have a substantial, and we think unintended, adverse impact on small business. Accordingly, consistant with Minnesota Statutes, 14.115, Subd. 2, we respectfully request that you consider appropriate means of permitting the Program to continue to function as an aid to small business without the burden of additional audit requirements.

If you would like additional information about the Program, we, together with representatives of the Board, would appreciate an opportunity to meet with you or your staff to discuss this further.

Very truly yours,

Stephen Rosholt

SR:lkl
cc: Mr. David Mocol
Mr. William Kuretsky
Mr. Thomas Strand
Mr. Thomas Peterson
Mr. Steve Yanish
Mr. Bruce Bonjour

3090g

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
ST. PAUL 55101

OFFICE OF THE COMMISSIONER

500 METRO SQUARE BUILDING
ST. PAUL, MN 55101

September 23, 1988

Stephen Rosholt
Faegre & Benson
2300 Multifoods Tower
33 South Sixth Street
Minneapolis, Minnesota 55402-3694

Re: Proposed Rules Relating to Municipal Securities

Dear Mr. Rosholt:

We have reviewed your letter dated August 16, 1988 containing comments with respect to the potential impact of proposed Minn. Rules, part 2875.3500, subp. 2B as it relates to bonds issued by the Minnesota Agricultural and Economic Development Board (the "Board") through the Minnesota Small Business Development Loan Program (the "Program").

Your comments relate to the application of Parts 2875.0950-.0960 to bonds issued by the Board under the Program. You stated that because proposed Part 2875.3500, subp. 2B does not specifically refer to a financial statement, you do not believe Parts 2875.0950-.0960 are applicable.

We disagree. Proposed part 2875.3500, subp. 2B requires financial statements in that, as a condition of registration, the cash flow of a borrower must be sufficient to pay interest on the bonds proposed to be offered to the public. Additionally, the proposed rule requires that cash flow be determined in accordance with generally accepted accounting principles. Accordingly, financial statements of a borrower must be submitted in order to determine compliance with these standards, and the requirements set forth in Minn. Rules, Parts 2875.0950-.0960 apply.

You requested that Proposed Part 2875.3500, subp. 2B be modified if Parts 2875.0950-.0960 apply to bonds issued by the Board. You specifically proposed that the Board be excepted from providing audited financial statements as required by Parts 2875.0950-.0960 in connection with the offering of bonds under the Program.

You indicated that bonds issued by the Board are payable primarily from a common debt service account derived from the monthly loan repayments by borrowers under the Program, and that because of this source of repayment, audited financial statements of an individual borrower should not be

required. Upon receipt of your letter, I had requested that you provide to me a copy of an official statement describing an offering by the Board so that I could review the financial structure of such offerings. Apparently, you were unable to locate such a document as I have not received it to date.

Because of the lack of supporting documentation indicating the need for amendment of the proposed rules, we do not intend to make the changes requested in your letter. Further, your proposed changes are unnecessary in light of the fact Minn. Rules, Part 2875.0990 grants the Commissioner the authority to waive the requirements of Parts 2875.0950-.0960 as he considers appropriate under the circumstances of a particular case. Accordingly, if an offering conducted by the Board is structured in such a manner as to render unnecessary the submission to investors of audited financial information about the borrower of the offering proceeds, the Commissioner could, in his discretion, waive the requirements of Parts 2875.0950-.0960.

Sincerely,

MICHAEL A. HATCH
Commissioner

By:

KRISTINE L. EIDEN
Deputy Commissioner
(612) 296-6325

KLE:cc

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STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
ST. PAUL 55101

OFFICE OF THE COMMISSIONER

500 METRO SQUARE BUILDING
ST. PAUL, MN 55101

September 21, 1988

Stephen Rosholt
Faegre & Benson
2300 Multifoods Tower
33 South Sixth Street
Minneapolis, Minnesota 55402-3694

Re: Proposed Rules Relating to Municipal Securities

Dear Mr. Rosholt:

I have received your letter dated August 16, 1988 with respect to the proposed rules pertaining to municipal securities. I will address your comments in the manner in which they were presented in your letter.

With respect to whether bank letters constitute "guarantees" for purposes of Minn. Stat. § 80A.15, subd. 1(c) that issue is outside the scope of the proposed rules.

The second item discussed in your letter pertains to the consideration of whether securities backed by bank letters of credit constitute "guaranteed" securities for proposes of proposed Part 2875.3500, subp. 2B. As you are probably aware, the terms of a letter of credit significantly vary from one case to another. The terms of a letter of credit in a given case would have to be reviewed in order to determine whether that specific letter of credit guarantees to bondholders payment of principal and interest. Accordingly, because the protection afforded investors by a letter of credit varies with the terms of the letter itself, letters of credit are not categorically considered to be guarantees. Rather, the terms of each letter of credit are reviewed to determine whether principal and interest payments are, in fact, "guaranteed".

With respect to the preparation of bank financial statements, the Financial Examination Division of this Department has advised me that banks routinely prepare financial statements in accordance with generally accepted accounting procedures for internal purposes. Accordingly, it is not unreasonable to require the submission of those statements for determining compliance with the proposed rules.

An additional item discussed in your letter is the possibility of excepting from the requirement of a financial forecast prepared by an independent certified public accountant,

offerings relating to housing projects financed through bond proceeds insured or coinsured by the Federal Housing Administration. The basis for your request is your representation that a feasibility analysis of projects must be submitted to HUD with regard to such projects.

We do not believe that such a feasibility analysis is an adequate substitute for a financial forecast prepared by an independent certified public accountant. An independent certified public accountant is required to follow recognized accounting procedures in preparing such a forecast, thereby protecting, to a certain degree, the integrity of the assumptions made with respect to the project. This is particularily important in light of the fact that a forecast is submitted in cases where a borrower does not have sufficient historical cash flow to make interest payments on the bonds proposed to be offered. For these reasons, we do not believe that it is in the best interest of bondholders to provide the exception you have requested.

With regard to your proposal to except from the prohibition against non-recourse loans offerings backed by bank letters of credit and FHA insurance, it must first be noted that the purpose of the prohibition is to provide bondholders with the remedy of bringing an action against a borrower of loan proceeds if the borrower defaults in its payments under the bonds. Bondholders should be afforded every legal remedy in order to be made "whole" upon a default by a borrower. If a credit enhancement device is drawn upon and bondholders recover their investment, there would be no damages for them to claim against the borrower of offering proceeds. On the other hand, if draws under a credit enhancement device are insufficient to provide bondholders their principal and expected return or the issuer of the credit enhancement device is financially unable to honor its commitment, bondholders should not be foreclosed from bringing a legal action against the defaulting borrower. Accordingly, we believe that any changes to the proposed rule in this area would weaken investor protection. Neither will we except from the prohibition projects backed by FHA insurance because, among other reasons, that insurance may be cancelled by FHA on various grounds prior to the maturity of bonds previously issued.

You further proposed that securities which are fully secured by securities guaranteed by GNMA or mortgage loans coinsured by FHA and a coinsuring lender be excepted from the requirement that trustees be granted a first mortgage and security interest in project property.

With respect to FHA insured and coinsured projects, it is possible for a trustee to be granted a lien on project property without violating federal requirements. We understand that prior approval may be required to be obtained from HUD prior to a trustee exercising its foreclosure rights under a lien, but that HUD requirements do not prohibit the existence of a lien. Further, as previously noted, FHA insurance may be cancelled during the term of the bonds. For these reasons, we do not believe an exception is in the best interest of bondholders.

Regarding assignment of a mortgage to the Government National Mortgage Association where a FHA insured or coinsured loan is to be used to back a certificate guaranteed by GNMA, I discussed that situation with you several weeks ago. You indicated at that time that you were not aware of any such offering with respect to industrial development bonds. Accordingly, there appears to be no reason to amend the rules to address this situation. If offerings of this type develop in the future, we will consider amending the rules.

Regarding commercial debt requirements and cash flow of asset-backed securities, those areas are outside the scope of the proposed rules which pertain only to municipal securities.

If you have further comments or questions, please contact me.

Sincerely,

MICHAEL A. HATCH
Commissioner

By:

KRISTINE L. EIDEN
Deputy Commissioner
(612) 296-6325

KLE:cc

KE

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE
ST. PAUL 55101

OFFICE OF THE COMMISSIONER

500 METRO SQUARE BUILDING
ST. PAUL, MN 55101

September 23, 1988

James P. Curtis
Director of Compliance
FBS Capital Markets Group
P.O. Box A-1674
Minneapolis, Minnesota 55480

Re: Proposed Rules Pertaining to Municipal Securities

Dear Mr. Curtis:

I have reviewed your letter to Elizabeth Moran dated August 17, 1988 with respect to the proposed rules pertaining to municipal bonds. I will address your comments in the manner in which they were presented in your letter.

1. With respect to Part 2875.0116, subp. 2, you stated that you believe that limiting the exception contained in that Part to nonissuer transactions which do not constitute public distributions is unnecessary.

   We disagree. As you are aware, in 1987 the legislature amended the exemption contained in Minn. Stat. § 80A.15, subd. 1(a), restricting the exemption to securities "guaranteed" by various governmental entities rather than securities "issued or guaranteed" by governmental entities. The proposed rule addresses securities issued prior to the change in the law to allow small holders of the securities to sell their holdings without being burdened by the requirement that they register the securities. The rule was not intended to allow for public offerings of such securities by, for example, institutional investors. Purchasers of bonds in public distributions by an institutional investor should be afforded the same protections as purchasers of bonds in public distributions by a municipality. Accordingly, we believe that the limitation contained in Part 2875.0116, subp. 2 is necessary.

   With respect to your comment that the term "public distribution" is not defined, the Securities and Exchange Act of 1933 exempts transactions not involving a "public offering". Abundant case law defines the term "public offering", and we believe that that case law would serve to define the term "public distribution" as well.

2. With respect to the limitation involving nonrecourse loans, the prohibition is intended to provide bondholders

with the remedy of bringing an action against the borrower of loan proceeds if the borrower defaults in its payments under the bonds. Bondholders should be afforded every legal remedy in order to be made "whole" upon a default by a borrower. If a credit enhancement device is drawn upon and bondholders recover their investment, there would be no damages for them to claim against the borrower of offering proceeds. On the other hand, if draws under a credit enhancement device are insufficient to provide bondholders their principal and expected return or if the issuer of the credit enhancement device is financially unable to honor its commitment, bondholders should not be foreclosed from bringing a legal action against the defaulting borrower.

Accordingly, we believe that any changes to the proposed rule would weaken investor protection.

3. For reasons discussed on the Statement of Need and Reasonableness, suitability standards are necessary. Further, the proposed rule has been drafted in such a way as to impose upon broker-dealers as little a burden as possible.

4. With regard to rating categories, we intend to clarify the proposed rules to indicate that variations of rating designated by "-" or "+" do not constitute separate rating categories.

Sincerely,

MICHAEL A. HATCH
Commissioner

By:

Kristine L Eiden

KRISTINE L. EIDEN
Deputy Commissioner
(612) 296-6325

KLE:cc

FAEGRE & BENSON

2300 MULTIFOODS TOWER
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303/592-5690
TELECOPIER 592-5693

September 8, 1988

State of Minnesota
SEP 8 1988
Department of Commerce

Ms. Kris Eiden
Deputy Commissioner
Department of Commerce
500 Metro Square Building
St. Paul, MN 55101

RE: Comments on Proposed Rules

Dear Ms. Eiden:

In response to your inquiry I am enclosing two offering documents which may be of interest.

One involves a typical FHA insured mortgage loan for a Maplewood housing project. The mortgage in this case is a nonrecourse first mortgage on the property being financed.

The other involves conventional financing with GNMA Mortgage Passthrough Certificates. I have been unable to find an example of a similar transaction involving municipal financing, but the structure in the municipal context would be substantially the same. Under this program the Servicer, rather than the holders of the GNMA securities, holds the mortgages. In case of a default by the Servicer, GNMA may step into the shoes of the Servicer. The holders of the GNMA securities, although having a beneficial interest in the mortgage, do not technically have a first mortgage on the property financed. In the municipal financing context, the bond trustee would hold the GNMA securities, while the Servicer would be the mortgagee.

We believe it should be sufficient that the bondholders have a beneficial interest in an FHA co-insured first mortgage and that the bonds need not be directly secured by a first mortgage.

Very truly yours,

Stephen Rosholt

SR:lkl
Enclosure
3243g

In the opinion of Briggs and Morgan, Professional Association, Minneapolis and Saint Paul, Minnesota, Bond Counsel, according to existing Minnesota and Federal laws, regulations, rulings and judicial decisions, as of their date of issuance, except as discussed under "TAX EXEMPTION AND OTHER TAX CONSIDERATIONS" herein, the Bonds bear interest which is not includable in gross income for purposes of federal income taxation and is not includable, to the same extent, in taxable net income of individuals, estates or trusts for purposes of State of Minnesota income taxation, but is subject to the State of Minnesota franchise tax imposed on corporations and financial institutions. Interest on the Bonds is not subject to the federal alternative minimum tax for individuals, but is subject to the federal alternative minimum tax for corporations. See "TAX EXEMPTION AND OTHER TAX CONSIDERATIONS" herein for a further discussion of certain tax consequences of owning the Bonds.

$5,565,000*
CITY OF MAPLEWOOD, MINNESOTA
Multifamily Mortgage Revenue Refunding Bonds (Beaver Creek Apartments Project–FHA Insured Mortgage Loan), Series 1988

Dated: August 1, 1988
Final Maturity Date: August 1, 2028*

Due: February 1 and August 1, as shown below
First Fixed Purchase Date: August 1, 1998

The Bonds are special limited obligations of the City of Maplewood, Minnesota (the "Issuer"). Debt service on the Bonds is secured by, and payable solely from, the Mortgage Loan (and insurance proceeds relating thereto), including the payments and prepayments of principal and interest thereon and amounts on deposit in the various reserve and other funds and accounts and investment income therefrom. The Bonds do not constitute a general or moral obligation of the United States of America, or any department or agency thereof (including the United States Department of Housing and Urban Development), the Issuer, Ramsey County, the State of Minnesota or any other political subdivision thereof, within the meaning of any constitutional or statutory provision, nor a charge against its general credit or taxing power.

The Bonds are being issued as fully registered Bonds in denominations of $5,000 each and any integral multiple thereof. Principal or purchase price of, premium, if any, and interest on the Bonds will be payable at the principal corporate trust office of First Trust National Association, Saint Paul, Minnesota, as Trustee and Paying Agent (the "Trustee"), and interest on the Bonds (payable February 1 and August 1, commencing February 1, 1989) will be payable by check or draft mailed to the registered owners thereof.

The Bonds are subject to mandatory purchase by the Partnership described below on August 1, 1998, or if such date is not a Business Day, the next succeeding Business Day (the "First Fixed Purchase Date"), unless the registered holder has affirmatively elected to retain its Bond from and after the First Fixed Purchase Date. The purchase price to be paid on the First Fixed Purchase Date is the principal amount of the Bonds tendered or deemed tendered for purchase on, plus accrued interest to, the First Fixed Purchase Date. Failure of the Partnership to purchase the Bonds on the First Fixed Purchase Date does *not* constitute a default under the Mortgage Loan and the Partnership's purchase obligation is *not* insured by FHA. See "RISK FACTORS" and "THE BONDS — Mandatory Purchase on First Fixed Purchase Date" herein.

The Bonds will be subject to redemption and prepayment prior to their maturities as more fully described under the heading "THE BONDS — Redemption of the Bonds Prior to Maturity" in this Official Statement.

The Bonds are being issued pursuant to an Indenture of Trust (the "Indenture") dated as of August 1, 1988 between the Issuer and the Trustee to provide money to refund and redeem in part certain outstanding bonds of Issuer issued on December 27, 1985 (the "1985 Bonds") to finance the acquisition, construction and installation of the Project described below. Proceeds of the 1985 Bonds will be transferred in part to funds established under the Indenture and used to fund a mortgage loan made to Beaver Creek Apartments Limited Partnership (the "Partnership") to be insured by the Federal Housing Administration ("FHA") of the United States Department of Housing and Urban Development pursuant to Section 221(d)(4) of the National Housing Act of 1934, as amended, to finance the acquisition, construction and installation of a 120-unit multifamily housing development (the "Project") located within the corporate limits of the Issuer to be owned and operated by the Partnership, all as more fully described under the heading "INTRODUCTORY STATEMENT" contained in this Official Statement.

The Bonds mature, are subject to purchase on, and bear annual interest rates to, the First Fixed Purchase Date as follows:

MATURITY SCHEDULE*
$220,000 Serial Bonds

Maturity Date	Amount	Interest Rate	Maturity Date	Amount	Interest Rate
August 1, 1990	$10,000	%	February 1, 1995	$15,000	%
February 1, 1991	10,000		August 1, 1995	15,000	
August 1, 1991	10,000		February 1, 1996	15,000	
February 1, 1992	10,000		August 1, 1996	15,000	
August 1, 1992	10,000		February 1, 1997	15,000	
February 1, 1993	10,000		August 1, 1997	15,000	
August 1, 1993	10,000		February 1, 1998	15,000	
February 1, 1994	10,000		August 1, 1998	20,000	
August 1, 1994	15,000				

$5,345,000 at % on August 1, 2028 (to be purchased on August 1, 1998)
Price: 100% plus accrued interest

The exclusion of interest on the Bonds from gross income for purposes of federal income taxation is dependent upon continuing compliance by the Partnership with certain requirements and tax covenants pertaining to use and operation of the Project which are contained in a Declaration of Restrictive Covenants dated as of December 1, 1985, amended and restated as of August 1, 1988 (the "Declaration") and executed by the Partnership. See "RENTAL HOUSING REQUIREMENTS" and "TAX EXEMPTION" herein.

The Bonds are offered, when, as and if, accepted by the Underwriter, subject to prior sale, to withdrawal or modification of the offer without notice, and subject to the opinion as to the validity and tax exemption of the Bonds by Briggs and Morgan, Professional Association, Minneapolis and Saint Paul, Minnesota, Bond Counsel, and certain other conditions. The Underwriter is represented in this transaction by Dorsey & Whitney, Minneapolis, Minnesota. It is expected that delivery of the Bonds will be made on or about August , 1988 (the "Closing Date") in Minneapolis, Minnesota, against payment therefor.

Subject to prevailing market conditions, the Underwriter may, but is not obligated to, effect secondary market trading in the Bonds, subject to applicable securities laws. The Underwriter is not obligated to repurchase any Bonds at the request of the holder thereof. There can be no assurance that a secondary market will develop. For information with respect to the Underwriter, see the caption "UNDERWRITING" herein.

Piper, Jaffray & Hopwood
Incorporated

The date of this Official Statement is , 1988

*Preliminary; subject to change.

This Preliminary Official Statement and the information contained herein are subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the Official Statement is delivered in final form. Under no circumstances shall this Preliminary Official Statement constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

No dealer, broker, salesman or any other person has been authorized by the Issuer, the Partnership or th Underwriter to give any information or to make any representations other than those contained in this Officia Statement, and if given or made, such information or representations must not be relied upon as having bee authorized by any of the foregoing. This Official Statement does not constitute an offer to sell or the solicitatio of any offer to buy any of the securities offered hereby in any state to any person to whom it is unlawful t make such offer, solicitation or sale in such state. Except where otherwise indicated, this Official Statemen speaks as of the date hereof. The information set forth herein has been obtained from the Partnership an other sources which are believed to be reliable, but is not guaranteed as to accuracy or completeness, and it i not to be construed as a representation by the Underwriter or the Issuer. Neither the delivery of this Officia Statement nor any sale hereunder shall under any circumstances create any implication that there has been n change in the affairs of the Partnership, the General Partner, the Issuer or the Project since the date hereo

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IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATIO OF THE PERSON OR ENTITY CREATING THE SECURITIES AND THE TERMS OF THE OFFERIN INCLUDING THE MERITS AND RISKS INVOLVED. THE BONDS HAVE NOT BEEN REGISTERED WI THE SECURITIES AND EXCHANGE COMMISSION BY REASON OF THE PROVISIONS OF SECTIC 3(a)(2) OF THE SECURITIES ACT OF 1933, AS AMENDED. THE REGISTRATION OR QUALIFICATION (THESE SECURITIES IN ACCORDANCE WITH APPLICABLE PROVISIONS OF SECURITIES LAWS (THE JURISDICTIONS IN WHICH THESE SECURITIES HAVE BEEN REGISTERED OR QUALIFIED AN THE EXEMPTION FROM REGISTRATION OR QUALIFICATION IN OTHER JURISDICTIONS SHALL NC BE REGARDED AS A RECOMMENDATION THEREOF. NEITHER THESE JURISDICTIONS NOR ANY (THEIR AGENCIES HAVE PASSED UPON THE MERITS OF THE SECURITIES OR THE ACCURACY (COMPLETENESS OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY M/ BE A CRIMINAL OFFENSE.

IN CONNECTION WITH THE OFFER AND SALE OF THE BONDS, THE UNDERWRITER MAY AT I OPTION OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKI PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPI MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

$5,565,000*
City of Maplewood, Minnesota
Multifamily Mortgage Revenue Refunding Bonds
(Beaver Creek Apartments Project-FHA Insured Mortgage Loan),
Series 1988

INTRODUCTORY STATEMENT

The following is a brief introduction about matters discussed elsewhere in this Official Statement and is qualified in its entirety by such further discussion in this Official Statement and by the text of the actual documents described or referred to in this Official Statement.

GENERAL

The City of Maplewood, Minnesota (the "Issuer") is issuing its Multifamily Mortgage Revenue Refunding Bonds, (Beaver Creek Apartments Project-FHA Insured Mortgage Loan), Series 1988 (the "Bonds"), in the aggregate principal amount of $5,565,000* under an Indenture of Trust, dated as of August 1, 1988 (the "Indenture"), between the Issuer and First Trust National Association, Saint Paul, Minnesota (the "Trustee"). The Issuer will use the proceeds of the Bonds to refund and redeem in part the Issuer's $8,500,000 Variable Rate Demand Purchase Multifamily Mortgage Revenue Bonds, Series 1985 (Beaver Creek Apartments Limited Partnership Project) (the "1985 Bonds") on or about the date of delivery of the Bonds. The 1985 Bonds were originally issued on December 27, 1985 to acquire and construct the Project described below. Upon redemption of the 1985 Bonds, $5,565,000* of the proceeds of the 1985 Bonds, together with interest earnings on the proceeds of the 1985 Bonds, will be transferred in part to the Reserve Fund and in part to the Construction Fund established in connection with the Bonds. The balance of the proceeds of the 1985 Bonds will be used to redeem 1985 Bonds. Proceeds credited to the Reserve Fund and Construction Fund will be lent to Beaver Creek Apartments Limited Partnership, a Minnesota limited partnership (the "Partnership") pursuant to a Loan Agreement dated as of August 1, 1988 (the "Loan Agreement"), between the Issuer and the Partnership, to make a mortgage loan (the "Mortgage Loan") to acquire land for, and construct, install and equip thereon, a 120-unit multifamily housing development located within the corporate limits of the Issuer (the "Project"), as more fully described in this Official Statement under the heading "THE PROJECT." The Mortgage Loan

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* Preliminary; subject to change.

will be evidenced by a nonrecourse mortgage note (the "Mortgage Note") and secured by a mortgage (the "Mortgage") on the real property and improvements constituting the Project. The Mortgage Loan will be insured by the Federal Housing Administration ("FHA"), an organizational unit within the United States Department of Housing and Urban Development ("HUD"), pursuant to the provisions of Section 221(d)(4) of the National Housing Act of 1934, as amended. See Appendix B, "FHA Mortgage Insurance." In addition, a portion of the Transferred Proceeds will be used to fund a debt service reserve fund (the "Reserve Fund") in the amount of $300,000*, which is approximately two-thirds of the maximum annual debt service on the Bonds to and including August 1, 1998 (the "First Fixed Purchase Date").

The Mortgage Loan is expected to be initially endorsed for advances by FHA in the amount of $5,265,000*, and will require monthly payments of interest only on the outstanding amount of the Mortgage Loan advanced to the Partnership at the interest rate of 8.50%* per annum through February 1, 1990.* Thereafter, the Mortgage Loan will bear interest at the rate of 7.75% per annum and will require the payment of 462 monthly payments of principal and interest, commencing March 1, 1990,* each in the amount of approximately $35,625.* The scheduled payments due under the Loan Agreement, including investment earnings on funds held under the Indenture, are expected to be sufficient, together with cash deposited by the Partnership at closing and held by the Trustee, in the aggregate, to pay in full the principal of and interest on the Bonds as the same become due. See "SECURITY FOR THE BONDS." Under certain circumstances, as more fully described herein, in order to provide sufficient money to make timely payments of principal of and interest on the Bonds, or to pay the redemption price of all or a portion of the Bonds upon the redemption thereof, the Trustee is required to apply the proceeds of one or more Letters of Credit to be deposited with the Trustee and cash and Permitted Investments, if any, held by the Trustee for such purpose. See "THE INDENTURE--Reserve Fund" and "THE INDENTURE--Mortgage Reserve Fund."

It is expected that the Mortgage Loan will be serviced by Glaser Financial Group, Inc. (the "Mortgage Servicer") pursuant to a servicing agreement entered into between the Trustee and the Mortgage Servicer. See "THE INDENTURE--Servicing of the Loan." Certain terms used in this Official Statement, unless otherwise defined herein, are defined in Appendix A hereto.

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* Preliminary; subject to change.

RISK FACTORS

Prospective purchasers of the Bonds should carefully consider all possible factors which may affect the security for the Bonds. The following are some, although not all, of the possible factors which should be considered prior to purchase of the Bonds:

1. Failure to Remarket or Refinance on a Fixed Purchase Date.

The Partnership expects that the source for the payment of the purchase price of Bonds on any Fixed Purchase Date will be the proceeds of a remarketing of the Bonds or other refinancing or sale of the Project. No assurance can be given, however, that the Bonds will be able to be remarketed or otherwise refinanced or the Project sold in contemplation of the First Fixed Purchase Date at all, or in any event, at rates which are feasible. Since the Mortgage Loan will bear interest at a fixed rate of 7.75% for its entire term (after commencement of amortization), the Reset Rate at which the Bonds must be remarketed on the First Fixed Purchase Date must be equal to or lower than the rate in effect immediately prior to the First Fixed Purchase Date, or some other source of funds must be found; otherwise, payments on the Mortgage Loan would be insufficient to pay principal of and interest on the Bonds. The Partnership has no obligation to provide additional funds from other sources to pay the purchase price of the Bonds. Thus, if interest rates are generally higher than present rates, it is unlikely that the Bonds will be purchased from remarketing proceeds on the First Fixed Purchase Date, but if rates are generally lower it is more likely that the purchase price will be paid from remarketing proceeds.

Although the Partnership has agreed to purchase the Bonds tendered or deemed tendered on the First Fixed Purchase Date and failure to do so constitutes a default under the Loan Agreement and the Indenture, such failure does not constitute a default under the Mortgage Loan. Therefore, upon a failure of the Partnership to purchase such Bonds, the Trustee may not assign the Mortgage Loan to FHA for mortgage insurance benefits. The Trustee may exercise its remedy of foreclosure of the Mortgage, but in order to do so the Trustee must first elect to terminate and cancel the FHA insurance. An election to cancel the FHA mortgage insurance requires the consent of the Holders of 100% of the Outstanding Bonds, unless the Trustee determines that the proceeds of sale or other disposition of the Project will provide sufficient amounts to pay 100% of the principal of the Outstanding Bonds and accrued interest thereon upon acceleration of maturity, in which case

no Bondholder consent is required. **Potential purchasers of Bonds must not look to the FHA insurance as a source for payment of the purchase price of the Bonds on the First Fixed Purchase Date.**

If the Bonds are not purchased on a Fixed Purchase Date, the owners thereof will continue to hold their Bonds and will be entitled to payment of principal and interest thereon in accordance with their terms. Neither the Partnership nor the Remarketing Agent has undertaken any obligation to remarket the Bonds other than in contemplation of a Fixed Purchase Date.

To secure the Partnership's obligation to purchase Bonds tendered or deemed tendered for purchase on the First Fixed Purchase Date, Knights Group and the limited partners of the Partnership have pledged and granted a security interest in their respective interests in the Partnership to the Trustee, as tender agent and on behalf of owners tendering Bonds for purchase on the First Fixed Purchase Date. Although the Trustee might be entitled to realize upon such security if the purchase price of the Bonds were not paid on the First Fixed Purchase Date, no assurance can be given or representation made whether such remedy would, in fact, be exercised by the Trustee without Bondholder direction and indemnification, or whether the exercise of any such remedies would, in fact, result in recovery of amounts sufficient to pay the purchase price or redemption price, as applicable, of the Bonds.

2. Redemption of Bonds Prior to Maturity. There are a number of circumstances under which all or a portion of the Bonds may be redeemed prior to their stated maturity. See "THE BONDS--Redemption Prior to Maturity." These circumstances include, but are not limited to: (a) a portion of the funds on deposit in the Construction Fund is not used to make eligible advances under the Mortgage Loan; (b) exercise by HUD of its right to override the prepayment lock-out and penalty provisions of the Mortgage Note under certain circumstances following a default thereunder; and (c) failure of the Partnership to make scheduled payments of principal and interest on the Loan.

3. Nonrecourse Obligations. The Mortgage Note will be a nonrecourse obligation of the Partnership, and none of its partners will have any personal liability to repay the Mortgage Note or to perform any other obligations of the Partnership under the Mortgage. In addition, the Partnership's obligations under the Loan Agreement, the Declaration and the Regulatory Agreement will be nonrecourse obligations. Failure of the Partnership to fully comply with the provisions of the Declaration could result in substantial economic loss to the

owners of the Bonds. The assets of the Partnership available to discharge any resulting liability to the owners of the Bonds will be inadequate to fully reimburse the owners of the Bonds for all economic loss suffered by such owners. See Paragraph 5 ("Loss of Tax Exemption") below.

4. FHA Mortgage Insurance Benefits. As more fully discussed in Appendix B, "FHA Mortgage Insurance," the failure to maintain adequate casualty insurance on the Project may result in the loss of FHA mortgage insurance benefits in the event of damage to or destruction of the Project. Mortgage insurance benefits also may be lost for failure to pay required mortgage insurance premiums to FHA and failure of the Trustee as mortgagee to provide FHA with required notices. The Servicing Agreement requires the Mortgage Servicer to supervise the Partnership with regard to the payment of casualty and mortgage insurance premiums and to provide FHA with required notices. Failure by the Mortgage Servicer to perform such duties may result in the loss of the FHA mortgage insurance or a reduction of the amount of mortgage insurance benefits. Furthermore, any claim filed by the Trustee for mortgage insurance benefits may be subject to delays in processing and payment, and such delays would affect the timing of distributions of mortgage insurance proceeds to the Bondholders.

The amount of the Mortgage Loan ($5,265,000*) is less than the aggregate principal amount of the Bonds ($5,565,000*), and the maximum benefits payable under the FHA Insurance are correspondingly less than the amount that would be needed to pay principal of and accrued interest on the Bonds upon maturity or redemption of the Bonds. In order to provide additional funds to pay principal of and interest on the Bonds, the Reserve Fund will be funded with approximately $300,000* of transferred proceeds of the 1985 Bonds, and the Partnership has agreed to provide additional cash and/or Letters of Credit in the aggregate amount of approximately $100,000* (to be held by the Trustee in the Mortgage Reserve Fund). See information under "SECURITY FOR THE BONDS--Reserve Fund" and "SECURITY FOR THE BONDS--Mortgage Reserve Fund" herein.

5. Loss of Tax Exemption. The Declaration and Regulatory Agreement require that the Project be maintained for a limited period as a residential rental housing project within the meaning of Section 103(b)(4)(A) of the Internal Revenue Code of 1954, as amended (the "1954 Code") and the Treasury Regulations thereunder (the "Regulations"), and that 20% of the units in the Project be held available for occupancy by

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* Preliminary; subject to change.

low-or-moderate-income persons, within the meaning of Section 103(b)(4)(A) of the 1954 Code, for a limited period. See "RENTAL HOUSING RESTRICTIONS" and "TAX EXEMPTION AND OTHER TAX CONSIDERATIONS" herein. The Declaration further requires that the entire Project be offered for rental to the general public, prohibits rentals on a transient basis, and imposes other restrictions on the operation of the Project. Furthermore, under the FHA Regulatory Agreement, operation of the Project is subject to certain requirements imposed by FHA. If the Project fails to comply with the provisions of Section 103(b)(4)(A) of the 1954 Code as required under the Declaration, and noncompliance is not corrected within a reasonable time (not less than 60 days after such noncompliance is discovered or, if earlier, the date on which such noncompliance would have been discovered with the use of reasonable diligence), the Regulations provide that interest on the Bonds will become taxable as of their date of issuance.

The failure of the Project to comply with the provisions of Section 103(b)(4)(A) of the 1954 Code or applicable provisions of the Internal Revenue Code of 1986, as amended (the "Code") does not constitute a default under the Mortgage Loan, and the Trustee, as a result of such noncompliance, may not assign the Mortgage Loan to FHA for mortgage insurance benefits. As long as the Mortgage Loan is insured by FHA, the Trustee is not entitled to declare a default under the Mortgage Loan, to foreclose its interest in the Project or to assign the Mortgage Loan to FHA for mortgage insurance benefits in the event of such noncompliance. The Trustee covenants in the Indenture to enforce the provisions of the Declaration for the benefit of the Bondholders; however, the remedies available to the Issuer and the Trustee are severely limited by the requirements of FHA. See "THE INDENTURE--Remedies." In the event interest on the Bonds should become includable in gross income for purposes of federal income taxation, the Bonds are not subject to early redemption or acceleration by reason thereof, and neither the Issuer, the State nor any political subdivision thereof will have any liability for any loss, cost, damage, addition to tax or other expense suffered or incurred by the owner of any Bonds. To the extent the Partnership is obligated to take, or to refrain from taking, any action that may affect the tax-exempt status of interest on the Bonds, the liability of the Partnership is limited as described herein.

If the Trustee exercises its remedies under the Partner Payment and Security Agreements or takes possession of the Project under the Mortgage or otherwise becomes a "substantial user" of the Project, the interest on the Bonds may become includable in gross income for federal income tax

purposes (and in taxable net income for Minnesota income tax purposes), during the period the Trustee is treated as owning or using the Project on behalf of the Bondholders for federal income tax purposes.

6. Conflicts of Interest. Affiliates or related entities of the General Partner are acting as counsel to the Partnership, agent for the title insurance company insuring title to the Project and as subcontractors in connection with construction of the Project. See information under "THE PARTNERSHIP AND GENERAL PARTNER" and "LEGAL MATTERS" herein. In addition, both The Phalen Bank and Summit National Bank, which are expected to issue the Letters of Credit, are owned or controlled by C. E. Von Feldt, one of the partners of the General Partner.

7. Bankruptcy Risk. Bankruptcy proceedings and equity principles may require disgorgement of amounts paid by the Partnership or the General Partner to the Trustee under the Loan Agreement within a specified period (generally 90 days) preceding an event of bankruptcy, and may also delay or otherwise adversely affect enforcement of Bondholders' rights in the property pledged as security for the Bonds.

THE BONDS

Original Terms

The Bonds are being issued in the aggregate principal amount of $5,565,000* and are dated and will bear interest from August 1, 1988. The Bonds have been issued only in fully registered form in denominations of $5,000 or any whole multiple of $5,000. The principal of the Bonds (including principal paid as a result of the prepayment or redemption of the Bonds) will be paid upon presentation of the Bonds at the principal corporate trust office of the Trustee, as Paying Agent, or any successor Paying Agent and Trustee. Prior to the First Fixed Purchase Date, the Bonds will mature in accordance with the Maturity Table set forth on the cover page of this Official Statement and will bear interest at the respective rates per annum set forth on such cover page. Interest shall accrue from and including the nominal date of the Bonds, August 1, 1988, and shall be paid by check or draft mailed to the registered holder or, upon written request of a registered holder of at least $1,000,000 principal amount of Bonds (or, if less, the total principal amount of Bonds Outstanding), by wire transfer.

* Preliminary; subject to change.

The Bonds will be subject to redemption upon the terms and conditions described under the heading "THE BONDS--Redemption Prior to Maturity," herein.

Interest Rate On and After the First Fixed Purchase Date

On and after the First Fixed Purchase Date, the Bonds will bear interest at a rate or rates determined by the Remarketing Agent in the manner provided in the Indenture and described herein. Prior to the First Fixed Purchase Date, the Remarketing Agent, having due regard to prevailing financial market conditions, is to determine the rate or rates for the Bonds which, if borne by the Bonds would, in its judgment, be the interest rate(s), but would not exceed the interest rate(s), which would result in the market value of the Bonds on the First Fixed Purchase Date being 100% of the principal amount thereof, and the interest rate(s) so determined is or are to be effective for the Bonds commencing on the First Fixed Purchase Date until the earlier of the Final Maturity Date or the next succeeding Fixed Purchase Date. The Remarketing Agent is to announce the interest rate(s) so determined (the "Reset Rate") by notice to the Partnership, the Issuer, the Servicer and the Trustee at least 15 calendar days prior to the First Fixed Purchase Date. In the event the Remarketing Agent is unable to determine the Reset Rate on or in contemplation of any Fixed Purchase Date, the rate in effect immediately preceding such Fixed Purchase Date shall continue until a new Reset Rate is determined by the Remarketing Agent.

Purchase of Bonds on the First Fixed Purchase Date

Mandatory Purchase by the Partnership

On the First Fixed Purchase Date, the Bonds are required to be purchased by the Trustee on behalf of the Partnership at a price equal to their principal amount, plus accrued interest to the First Fixed Purchase Date, subject to the right of any Bondholder to direct that his Bond(s) not be so purchased. As described herein under the caption "Interest Rate On and After the First Fixed Purchase Date" above, the interest rate on the Bonds will change on the First Fixed Purchase Date and as so changed will remain in effect until the earlier of the Final Maturity Date or the next succeeding Fixed Purchase Date.

At least 30 calendar days prior to the First Fixed Purchase Date, the Trustee is to mail to each registered holder of a Bond, notice of the purchase thereof, together with the estimated interest rate to be borne by the Bonds and certain information prepared by the Partnership regarding the

Partnership, the Project and the terms of, and security for, the Bonds after the First Fixed Purchase Date, a form of direction to be executed by any Holder exercising his option to retain ownership of his Bond(s), and the procedure for informing the Bondholders of the actual interest rate or rates to be borne by the Bonds from and after the First Fixed Purchase Date. Unless a Bondholder directs the Trustee in writing on or before the seventh (7th) calendar day following the date the Trustee gives the foregoing notice that his Bond(s) not be purchased, such Bondholder will be deemed to have tendered his Bond(s) to the Trustee for purchase on the First Fixed Purchase Date, and is required to deliver such Bond(s) to the Trustee on or before the First Fixed Purchase Date. The Trustee shall hold all such Bonds in trust pending the purchase thereof by the Partnership.

Prior to the First Fixed Purchase Date, the Partnership intends to engage the Remarketing Agent to use its best efforts to remarket the Bonds on behalf of the Company. On the First Fixed Purchase Date, the Partnership is required to deposit with the Trustee funds sufficient to purchase all Bonds which are tendered (or deemed to be tendered) for purchase or to redeem all Bonds that are not purchased or retained. Failure by the Partnership to deposit such funds with the Trustee shall constitute an Event of Default under the Indenture and the Loan Agreement, but shall not constitute a default under the Mortgage Loan. See "THE INDENTURE--Events of Default" herein. See also "RISK FACTORS--Failure to Remarket or Refinance on a Fixed Purchase Date" herein.

Right to Direct that a Bond not be Purchased

A registered holder of a Bond may direct the Trustee that such Bond is not to be purchased on the First Fixed Purchase Date. Such direction must be given in writing, on a form which will be sent by the Trustee to each Bondholder, along with the notice described above, on or before the seventh (7th) calendar day following the date the Trustee gives the notice described above. Any such direction will be irrevocable and must be accompanied by the Bond which is the subject of that direction, in order for the registration of ownership thereof to be confirmed by the Trustee. The Trustee will confirm such registration and return a new Bond to the holder on the First Fixed Purchase Date.

Any Bond with respect to which the Trustee has not received direction that such Bond not be purchased will be deemed to be tendered by the holder of the Bond for purchase on the First Fixed Purchase Date. From and after the First Fixed Purchase Date, the person who is named on such Bond as the

registered holder thereof will no longer be deemed to be the registered holder and will no longer be regarded as the owner thereof or entitled to any further interest thereon, but will be entitled only to receive the purchase price plus accrued interest to the First Fixed Purchase Date deposited with the Trustee. From and after the First Fixed Purchase Date, the Partnership, or its assigns, shall be deemed to be the owner of all Bonds which are tendered, or deemed to be tendered, on the First Fixed Purchase Date. In the event the holder of a Bond which is deemed to be tendered on a First Fixed Purchase Date does not surrender such Bond for purchase on that date, the Trustee will authenticate and deliver to the Partnership a new Bond in substitution therefor.

Redemption Prior to Maturity

Except as otherwise hereinafter provided, the Bonds are subject to redemption and prepayment at the principal amount thereof plus accrued interest to the redemption date as follows:

Excess Loan Proceeds. The Bonds shall be redeemed in part, without premium, on the next succeeding Interest Payment Date for which timely notice of call can be given after receipt by the Trustee of a Partnership certificate pursuant to the Loan Agreement directing the Trustee to apply as partial prepayment of the Loan amounts which represent excess Transferred Proceeds in the Construction Fund (including earnings thereon) not applied or not to be applied to the payment of Costs of the Project.

Damage, Destruction or Condemnation. The Bonds shall be redeemed, in whole or in part, without premium, on the next succeeding Interest Payment Date for which timely notice of call can be given after the Trustee has received a prepayment by the Partnership, in whole or in part, of the Loan to the extent Net Proceeds of any insurance or condemnation award are not utilized to repair, replace or reconstruct the damaged, destroyed or condemned Project, or portion thereof, as provided in the Loan Agreement and the Mortgage.

Calamity Redemption. In the event of (A) damage to or destruction of the Project or any part thereof or condemnation of the Project or any part thereof to the extent provided in the termination provisions of the Loan Agreement and to the extent a corresponding prepayment results under the Mortgage Note, or in the event of any changes in the Constitution or laws of the United States of America or the State of Minnesota as provided in the Loan Agreement and (B) termination of the Loan Agreement upon the occurrence of one of those events as provided in the Loan Agreement, all Bonds shall be redeemed by

the Issuer, in whole but not in part, on the then next succeeding Interest Payment Date for which timely notice of call can be given, without any premium.

Scheduled Mandatory Redemption. The Bonds maturing in 2028 are subject to scheduled mandatory redemption by lot on each February 1 and August 1 after the First Fixed Purchase Date as provided in the Indenture.

Reduction of Mortgage Note at Completion. If, upon final endorsement of the Mortgage Loan for FHA Insurance, the maximum principal amount of the Mortgage Note and the Mortgage has been reduced below the amount initially endorsed for FHA Insurance, the Trustee will use available monies in the Construction Fund to redeem Bonds on the earliest practicable date for which proper notice of redemption can be given, without premium, in a principal amount equal, or as nearly as practicable, to the amount of such reduction.

FHA Insurance Benefits. If insurance benefits are payable by FHA to the Trustee, the Trustee shall redeem the Bonds to the extent of available monies and without premium on the earliest practicable date for which proper notice of redemption may be given.

Acceleration. In addition to the foregoing, the Bonds may be subject to acceleration and prepayment upon the occurrence of certain events of default and the commencement of foreclosure or other remedial proceedings under the Mortgage, or the entering into of an agreement with the Partnership in lieu of taking any such remedial action, as more fully set forth in the Indenture.

Prepayment of Mortgage Loan. Notwithstanding any prohibition and/or penalty otherwise required by the Mortgage Note, the Mortgage Loan may be prepaid in whole or in part, without prepayment penalty, if HUD determines that: (i) the Partnership has defaulted and HUD has received notice of such default; (ii) the Project has been experiencing a net income deficiency (not caused solely by management inadequacy or lack of owner interest) of such magnitude that the Partnership is currently unable to make required payments on the Mortgage Loan, pay all Project operating expenses and fund all required HUD reserves; (iii) there is a reasonable likelihood that the Partnership can arrange to refinance the defaulted loan at a lower interest rate or otherwise reduce debt service through partial prepayment; and (iv) such refinancing or partial prepayment is necessary to restore the Project to a financially viable condition and to avoid an insurance claim. Upon any such prepayment, the Bonds shall be redeemed in a principal

amount equal to the principal amount of the Mortgage Loan so prepaid, on the earliest practicable date for which proper notice of redemption can be given.

Optional Redemption. Bonds maturing on or after February 1, 1995 are subject to redemption and prepayment, upon request by the Partnership to the Trustee, on August 1, 1994 and on any Interest Payment Date thereafter, in whole or in part, and if in part, by lot within each maturity selected by the Trustee, at their principal amount plus accrued interest and a premium, expressed as a percentage of the principal amount, set forth below:

Date	Premium
August 1, 1994 and February 1, 1995	2%
August 1, 1995 and February 1, 1996	1%
August 1, 1996 and thereafter	without premium

General Bond Terms

Registered Bonds. Each Bond will be registered in the name of the owner of such Bond upon the books and records of the Trustee, as Bond Registrar, maintained for that purpose. Bonds of one denomination may be exchanged for one or more Bonds of a different authorized denomination, and may be transferred and assigned to others, in either case, upon presentation of such Bonds to the Trustee (together with a proper assignment form or authorization for exchange form, as the case may be in form and with guarantee of signature reasonably satisfactory to the Trustee, duly executed by the Holder or its duly authorized attorney), and the payment of a sum sufficient to pay any tax or other governmental charge payable in connection with such transfer, assignment or exchange.

Limited Obligations. The Bonds are a special, limited obligation of the Issuer, payable solely from the sources set forth in the Indenture. See the information under the heading "SECURITY FOR THE BONDS" herein. In no case will the general revenues (including tax revenues) of the Issuer be used to pay the principal of, premium, if any, interest on, or the purchase price of, the Bonds. The Bonds do not constitute a general or moral obligation of the Issuer within the meaning of any constitutional or statutory provision, nor a charge against its general credit or taxing power.

Notice of Redemption. Notice of redemption shall be mailed by certified or registered mail (or by regular mail if published notice is also given) not less than 30 days prior to

the redemption date by the Trustee to the Paying Agent and the Holders of Bonds to be redeemed. If and to the extent that the laws of the State of Minnesota at the time of redemption require that publication is necessary to properly redeem obligations, notice of redemption shall also be published at least once at least 15 days prior to the date fixed for redemption in the Wall Street Journal and in a daily or weekly financial journal or newspaper of general circulation in Minneapolis and Saint Paul, Minnesota, and in New York, New York. Published notice, if given, shall, however, be effective without such mailed notice and no defect in or failure to give mailed notice shall affect the validity of the proceedings for redemption of any Bond. Such notice shall state the provisions of the Indenture pursuant to which the Bonds are being called for redemption, the redemption date, the principal amount of each Bond to be redeemed, the redemption price, the place where they shall be presented for redemption and that interest will cease to accrue after the redemption date; and, unless all Outstanding Bonds are to be redeemed, each such notice shall refer to the Bonds to be redeemed by their numbers and maturities. On or before the date fixed for redemption, funds sufficient to redeem such Bonds, including accrued interest thereon to the redemption date and any premium, shall be deposited with the Paying Agent. The Bonds thus called shall not, on or after the specified redemption date, bear any interest and, except for the purpose of payment, shall not be entitled to the lien of the Indenture or the benefits of the Loan Agreement.

Selection by Trustee of Bonds To Be Redeemed. If less than all of the Bonds are to be redeemed by operation of the provisions for mandatory or optional redemption, the Trustee, prior to giving notice of redemption, shall assign to each Bond then Outstanding a distinctive number for each $5,000 of the principal amount of such Bond. The Trustee shall then select by lot, using such method of selection as it shall deem proper in its discretion, from the numbers so assigned to such Bonds, as many numbers as, at $5,000 for each number, shall equal the principal amount of such Bonds to be redeemed. The Bonds to be redeemed shall be the Bonds to which were assigned numbers so selected. However, only so much of the principal amount of each such Bond of a denomination of more than $5,000 shall be redeemed as shall equal $5,000 for each number assigned to it and so selected. If a Bond may be redeemed only in part, it shall be surrendered to the Trustee (with, if the Issuer or the Trustee so requires, a written instrument of transfer in form satisfactory to the Issuer and the Trustee duly executed by the Holder thereof or his attorney duly authorized in writing) and the Issuer shall execute and the Trustee shall authenticate and deliver to the Holder of such Bond, without service charge, a

new Bond or Bonds of the same series, of any authorized denomination or denominations, as requested by such Holder, having the same stated maturity and interest rate of any authorized denomination in aggregate principal amount equal to and in exchange for the unredeemed portion of the principal of the Bond so surrendered.

No Additional Bonds

After delivery of the initial issue of Bonds, no additional bonds may be issued which are secured by the Indenture or Related Documents.

SECURITY FOR THE BONDS

General

The Bonds are special limited obligations of the Issuer payable solely from the revenues and assets pledged therefor pursuant to the Indenture. Under the Indenture the Bonds are secured by an assignment and pledge of (i) the Issuer's rights and interests in the Loan Agreement (except for certain rights to indemnification and payment of expenses), and under the Regulatory Agreement and Declaration and all other sums required to be deposited in trust accounts under the Indenture, (ii) the earnings derived from the investment of the foregoing sums, and (iii) all property mortgaged, pledged and assigned under the Mortgage and other Collateral Security Documents, all proceeds of FHA Insurance and any other property which may become subject to the lien of the Indenture. See Appendix B, "FHA Mortgage Insurance."

The Bonds and the interest thereon are special limited obligations of the Issuer and do not constitute or give rise to an indebtedness, pecuniary liability, general or moral obligation or a pledge of the faith or loan of credit of the United States of America or any department or agency thereof (including HUD), the State of Minnesota, any political subdivision of the State of Minnesota or the Issuer within the meaning of any constitutional or statutory debt limitation provisions. Neither the United States of America, the State of Minnesota nor any political subdivision thereof nor the Issuer shall be obligated to pay the principal of the Bonds, the interest thereon, the purchase price thereof, or other costs incident thereto except from the sources referred to in the preceding paragraph. Neither the faith and credit nor the taxing power of the Issuer, the State of Minnesota or any political subdivision thereof or the United States of America

is pledged to the payment of the principal of the Bonds, the interest thereon, the purchase price thereof, or other costs incident thereto.

Mortgage

Under the Mortgage, the Partnership, as mortgagor, will grant to the Trustee, as mortgagee, a mortgage lien on and security interest in the Project, to secure its obligations under the Mortgage Loan. The Trustee's remedies under the Mortgage are subject to HUD consent as long as the FHA Insurance is in force, and such remedies may not be exercised unless and until HUD consent is obtained or the FHA Insurance is cancelled.

Reserve Fund

The Indenture establishes the Reserve Fund, which is required to be funded from Transferred Proceeds, and thereafter maintained, in an amount equal to the Reserve Requirement.

Amounts on deposit in the Reserve Fund are required to be applied by the Trustee only in the event that (a) the Mortgage Loan has been assigned to FHA for collection of FHA mortgage insurance benefits, or (b) the Partnership has failed to make a payment under the Loan Agreement, and then only if, and to the extent, that proceeds of a draw under the Letters of Credit deposited in the Mortgage Reserve Fund pursuant to the Loan Agreement have not yet been received, or (c) the Trustee has elected to terminate the FHA Insurance and pursue its remedy of foreclosure of the Mortgage Loan. In any such case, amounts credited to the Reserve Fund are required to be applied, to the extent necessary, to provide sufficient funds to pay the principal and interest due on the Bonds on any Interest Payment Date or redemption date, or the purchase price of the Bonds on the First Fixed Purchase Date, but only after the application of amounts available therefor in the Mortgage Reserve Fund (including the proceeds of any Letters of Credit).

Mortgage Reserve Fund

The Indenture establishes the Mortgage Reserve Fund which is required to be funded and maintained with cash and/or Letters of Credit in an amount equal to the Mortgage Reserve Fund Requirement. The issuers of the Letters of Credit are expected to be The Phalen Bank and/or Summit National Bank. As of December 31, 1987, The Phalen Bank had combined capital and surplus of approximately $1,270,000 and Summit National Bank had combined capital and surplus of approximately $1,110,000. For a description of the requirements applicable to such

Letters of Credit, see the definition of the term "Letter of Credit" in Appendix A. Under certain circumstances, the Trustee is required to apply amounts held in the Mortgage Reserve Fund, including the proceeds of one or more Letters of Credit held by the Trustee therein, to provide sufficient funds to pay the principal and interest due on the Bonds at maturity or upon the redemption thereof. See "THE INDENTURE--Mortgage Reserve Fund."

ESTIMATED SOURCES AND USES OF FUNDS*

Refunding Sources of Funds

Proceeds of Bonds	$ 5,565,000
Escrowed Proceeds of 1985 Bonds	8,500,000
Investment Earnings on Escrowed Proceeds	220,000
Partnership Contribution of Cash and Letters of Credit	570,000
	$14,855,000

Application of Funds

Redemption of 1985 Bonds	$ 8,500,000
Transferred Proceeds of 1985 Bonds to Indenture	5,785,000
Partnership Cash Contributed to Indenture	570,000
	$14,855,000

Application of Transferred Proceeds of 1985 Bonds

Mortgage Loan	$5,265,000
Reserve Fund	300,000
Mortgage Reserve Fund	100,000
Other Project Costs	790,000
TOTAL	$6,455,000

THE PARTNERSHIP AND THE GENERAL PARTNER

Beaver Creek Apartments Limited Partnership is a limited partnership organized under the laws of the State of Minnesota. The general partner of the Partnership is Knights Group, a Minnesota general partnership (the "General Partner") whose partners currently are Kenneth D. Gervais, Gregory A. Schmit, Gary Mulcahy, Ray Lemmons, Chad Lemmons, Thomas Kelley

* Preliminary; subject to change.

and C.E. VonFeldt (the "General Partners"). The Partnership was formed solely for the purpose of constructing, owning and operating the Project. The General Partner was formed solely for the purpose of acting as General Partner in the Partnership. Neither the Partnership nor the General Partner has any operating history, and it is not currently expected that either the Partnership or the General Partner will have any significant assets other than the Project. The Partnership will rely solely on the General Partner for the management of the Partnership and the Project. Mr. Gervais is currently acting as managing partner of the General Partner, but receives no compensation from the Partnership for such services.

THE PROJECT

The Project will comprise a 120-unit apartment project to be constructed at the intersection of Ferndale and Ivy Streets in Maplewood, Minnesota. The Project site is served by Century Avenue two blocks to the east which is a major north/south artery and has direct access to Highway 36 to the north and Interstate 94 to the south. The Project will consist of two buildings of frame construction with stucco exterior. In addition, there will be approximately 120 underground parking spaces and approximately 141 surface parking spaces. The Project also includes an outdoor, in-ground swimming pool, two tennis courts, patio area and fenced playground area. The Project site is approximately 19 acres and abuts Jim's Prairie, an 11-acre nature preserve owned and maintained by the Parks Department of the City of Maplewood. The Project site contains a wildlife pond and a duck habitat.

Each apartment will contain kitchen cabinets and appliances including a dishwasher, range, refrigerator and garbage disposal, and an individual air conditioning unit. In addition, each apartment will have either a balcony or a patio. Each building will have one elevator and be fully sprinklered.

The type, number, size and projected rent for the units are estimated as follows:

Type	Number	Size (Sq. Ft.)	Projected Stabilized Rent
1 bedroom/1 bath	12	721	$540
1 bedroom/1 bath (handicapped)	6	736	540
2 bedroom/1 bath (corner)	24	876	615
2 bedroom/2 bath	76	966	655
3 bedroom/2 bath	2	1,283	710

In addition, it is expected that the underground parking spaces will be rented for an additional $40.00 per month per space.

The Project architect is James M. Cooperman & Associates Architects, Inc., of Minneapolis, Minnesota. The general contractor is Kraus-Anderson Construction Company (St. Paul Division) ("Kraus-Anderson"). Kraus-Anderson is a privately-owned, full-service building company founded in the early 1900's. Kraus-Anderson is licensed in 28 states and handles all varieties of building activities, including multifamily housing, office, retail, health care, industrial and special-purpose projects. Kraus-Anderson will provide a 100% payment and performance bond for completion of the Project. The Partnership has entered into a fixed price contract with Kraus-Anderson, providing for a maximum construction price of $4,700,000.

PROPERTY LEASING AND MANAGEMENT

The Partnership will enter into a contract with Realty Management Services, Inc., of Minneapolis, Minnesota ("Realty Management") under which Realty Management will provide marketing, leasing and management services to the Project. Realty Management was founded in September, 1975, and since that time has specialized in the development, marketing and management of residential and commercial income property. Realty Management currently manages over 4,500 residential and multifamily units and over 5,000 square feet of commercial and office space. Realty Management is an accredited management organization by the Institute or Real Estate Management, is a licensed real estate broker in Minnesota, and is an approved property manager for HUD and Minnesota Housing Finance Agency.

THE ISSUER

The Issuer is a municipal corporation and political subdivision organized and existing under the laws of the State of Minnesota, duly authorized and existing under the Constitution and laws of the State of Minnesota, and is authorized to issue the Bonds pursuant to Minnesota Statutes, Chapter 462C, as amended (the "Act"). The Issuer has good, right and lawful authority to finance the acquisition, construction and installation of the Project pursuant to the Loan Agreement and to receive and pledge the revenues from the Project in accordance with the terms of the Loan Agreement and as provided in the Indenture. The Issuer is authorized to enter into the Indenture and the Loan Agreement. The Bonds are

special, limited obligations of the Issuer and do not constitute an indebtedness of the Issuer, or a loan of credit thereof, within the meaning of any constitutional or statutory provision. The Bonds shall not constitute or give rise to any pecuniary liability of the Issuer or a charge against the general credit or taxing power of the Issuer.

THE LOAN AGREEMENT

The following is a summary of certain provisions of the Loan Agreement. Such summary does not purport to be comprehensive or definitive, and reference is made to such document for a full and complete statement of its terms, a copy of which document may be obtained from the Underwriter during the period that the Bonds are offered and thereafter upon request to the Trustee.

Refunding; Construction of Project

The Loan Agreement provides that the Issuer will issue the Bonds to refund and redeem in part the 1985 Bonds and will lend the Transferred Proceeds of the 1985 Bonds to the Partnership to finance the Costs of the Project. Transferred Proceeds deposited in the Construction Fund will be disbursed by the Trustee to pay, or reimburse the Partnership for, the costs of the Project enumerated in the Loan Agreement. The Partnership agrees to install and construct the Project substantially in accordance with the plans and specifications referred to in the Loan Agreement, so as to be fully operable for use as a multifamily rental housing facility. The construction contract for the construction and installation of the Project will be assigned to the Trustee so that the contractor will perform its obligations thereunder for the Trustee at the Trustee's request should the Trustee decide to complete the Project after default by the Partnership.

The Partnership expects to complete the Project on or before July 1, 1989, subject to certain exceptions beyond its control. However, whether or not completed by such date, there shall be no resulting liability on the part of the Issuer and no diminution in the payments required to be paid by the Partnership under the Loan Agreement.

Term of Loan Agreement; Payments

The term of the Loan Agreement commences as of August 1, 1988, and shall continue until the Bonds are discharged as provided in the Indenture. During the term of the Loan Agreement, the Partnership agrees to make the following payments:

Basic Payments

The Partnership agrees to repay with interest the Loan made by the Issuer by making monthly payments sufficient to pay in full the principal of, premium, if any, interest on, and the purchase price of, the Bonds, when due, at maturity or upon call for redemption or upon an acceleration of maturity under the Indenture or upon the First Fixed Purchase Date, and to maintain the Reserve Fund and the Mortgage Reserve Fund. All Basic Payments received by the Trustee shall be deposited in the Bond Fund or the Reserve Fund, as the case may be. If the Partnership should fail to make any of the Basic Payments, the Trustee shall immediately give notice of such failure to the Partnership and the Partnership shall remain obligated to pay the amount in default in full with interest thereon. If on any date the balances in the Bond Fund or the Reserve Fund are not sufficient for these purposes, the Partnership will pay the deficiency. The Partnership's obligations to make payments under the Loan Agreement are unconditional; however, since the obligations are nonrecourse, meaning that claims for such payment may not be asserted as a personal obligation of the Partnership, the General Partner or any of its partners, and that the only assets of the Partnership available to remedy any deficiency in Basic Payments are the assets pledged under the Mortgage, the Trustee's remedies for failure by the Partnership to perform are limited. The sole recourse of the Trustee, if an Event of Default on the Bonds occurs and FHA Insurance is cancelled, will be to exercise its rights and remedies under the Indenture and the Mortgage including foreclosure of the Mortgage.

All sums credited to the Bond Fund to purchase or prepay the Bonds as provided in the Loan Agreement and the Indenture shall not be credited against currently payable installments of Basic Payments. See information under the heading "THE LOAN AGREEMENT--Prepayment" herein. Except during the continuance of an Event of Default, all available remaining sums in the Bond Fund and the Reserve Fund, not credited against currently payable installments of Basic Payments or applied to discharge the lien of the Indenture upon termination of the Loan Agreement upon the happening of certain events as provided therein or to prepay or purchase Bonds, shall be credited against the last installments of Basic Payments.

Additional Charges

The Partnership agrees to pay the full amount of the following items as Additional Charges under the Loan Agreement: (i) all reasonable fees and expenses of the Trustee

and Paying Agent and all payments to such other persons as are entitled to payment or reimbursement in connection with the transactions contemplated by the Loan Agreement and the Indenture; (ii) all expenses incurred by the Issuer, with the Trustee's or Partnership's prior approval, in relation to the Project not otherwise payable by the Partnership, all administrative or other fees required to be paid to the Issuer under the Loan Agreement and all indemnity payments required by the Loan Agreement; (iii) all advances to the Partnership, if any, plus interest thereon, made by the Trustee; and (iv) any interest on any payments not made when due by the Partnership.

Funding and Maintenance of Mortgage Reserve Fund

Pursuant to the Loan Agreement, the General Partner agrees to deposit and maintain cash or one or more Letters of Credit in the aggregate amount of $100,000* (the "Mortgage Reserve Fund Requirement") to fund the Mortgage Reserve Fund. Such cash or Letters of Credit shall be drawn upon by the Trustee as provided in the Indenture.

To secure payment of the required purchase price on the First Fixed Purchase Date, the General Partner has agreed under the Loan Agreement to enter into the Purchase Payment Agreement and a Partner Payment and Security Agreement pursuant to which it will pledge and grant to the Trustee a security interest in, and first lien on, the General Partner's partnership interest in the Partnership. Upon failure of the Partnership to pay sums sufficient to pay the required purchase price of the Bonds on the First Fixed Purchase Date, the Trustee may take actions as provided in the Purchase Payment Agreement and the Partner Payment and Security Agreements and as provided in the Indenture. See "THE PURCHASE PAYMENT AGREEMENT AND THE PARTNER PAYMENT AND SECURITY AGREEMENTS" herein.

Prepayment

The Partnership may, in the case of optional prepayment, and shall in the case of mandatory prepayment, prepay the Loan, in whole or in part, at such times and in such amounts so as to enable the Trustee to use the money to redeem Bonds which are redeemable according to their terms and in accordance with the terms of the Indenture, or to purchase and cancel Bonds in accordance with the terms of the Indenture. See information contained under the caption "THE BONDS--Redemption Prior to Maturity" herein.

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* Preliminary; subject to change.

1954 Code or the Code to qualify the Bonds as residential rental housing bonds under Section 103(b)(4)(A) of the 1954 Code, (b) not use the proceeds of the Bonds or any other sums treated as "bond proceeds" under Section 148(a) of the Code and applicable federal tax regulations in such a manner as to cause the Bonds to be classified as "arbitrage bonds" under said Section and applicable federal income tax regulations and (c) not otherwise use Bond proceeds, or take or fail to take any action, the effect of which would be to impair the tax exempt status of the interest on the Bonds.

Events of Default

The following events are Events of Default under the Loan Agreement:

(1) Failure of the Partnership to pay any Basic Payment (including Basic Payments required on the First Fixed Purchase Date or to restore the Reserve Fund to the Reserve Requirement) on or before the date the payment is due; or failure by the Partnership to pay any Additional Charges on or before the date that the payment is due and such failure has continued for ten (10) days after mailing of a notice to it by the Issuer or the Trustee;

(2) Failure of the Partnership to observe and perform any other covenant, condition or agreement on its part under the Loan Agreement for a period of thirty (30) days after written notice from the Issuer or the Trustee, unless such period of time is extended as provided in the Loan Agreement;

(3) Certain events of dissolution, liquidation, bankruptcy or reorganization involving the Partnership as further described in the Loan Agreement;

(4) Expiration or annulment of the partnership agreement of the Partnership, or dissolution or liquidation of the Partnership, as further described in the Loan Agreement;

(5) The occurrence of an Event of Default under the Indenture, the Purchase Payment Agreement, a Partner Payment and Security Agreement or the FHA Loan Documents and the expiration of the period for remedying such default;

(6) Any representation or warranty made by the Partnership in the Loan Agreement or by a partner or representative of the Partnership in any document or certificate furnished to the Trustee, the Issuer or the Underwriter in connection with the Loan Agreement or such

document or certificate, which shall prove at any time to be o to have been, in any material respect, incorrect or misleading as of the date made;

(7) Failure of the Partnership to observe and perfor any covenant or agreement set forth in the Regulatory Agreemen or the Declaration for a period of thirty (30) days after notice from the Issuer or the Trustee, unless such period is extended or such default is otherwise excused as provided in the Loan Agreement;

(8) Failure by the General Partner to provide or maintain the Letters of Credit or cash for the Mortgage Reserv Fund as required under the Loan Agreement.

Remedies

Whenever any Event of Default occurs, the Trustee, or the Issuer with the prior written consent of the Trustee, may take whatever action at law or in equity may appear necessary or appropriate to collect the Basic Payments and all other amounts due or to become due under the Loan Agreement and to enforce the performance of any agreement of the Partnership under the Loan Agreement, the Mortgage, the Regulatory Agreement, the Declaration, or of the Partnership or any of it general or limited partners under the Purchase Payment Agreement, the Partner Payment and Security Agreements or any related instrument; or to otherwise compensate the Issuer, Trustee or Bondholders for any damages on account of such Ever of Default.

In the event that the Trustee has accelerated the Outstanding Bonds upon the occurrence of an Event of Default, the Trustee, or the Issuer with the prior written consent of the Trustee, shall also declare all remaining installments of Basic Payments due under the Loan Agreement immediately due a payable (being the amount necessary to pay in full all Outstanding Bonds, interest thereon, any call premium and all other indebtedness under the Indenture).

Damage, Destruction and Condemnation

If, while any Bonds remain Outstanding under the Indenture, the Project is damaged or destroyed by fire or oth casualty, or the Project or any part thereof is taken by condemnation, the Partnership shall either restore the Projec as required by the Indenture and FHA Loan Documents (with any amount of Net Proceeds not used to restore the Project used t prepay the Bonds in part) or exercise its option (if availabl

under the terms of the Loan Agreement) to prepay the Loan in whole. See information under the heading "THE LOAN AGREEMENT--Termination of the Loan Agreement" herein.

Amendments, Changes and Modifications

No amendment, change or modification of the Loan Agreement is permissible without the prior written consent of the Trustee and HUD, except as otherwise permitted in the Loan Agreement or the Indenture. Except as otherwise provided in the Indenture, Bondholder consent is required for amendments, changes or modifications. See information under the heading "THE INDENTURE--Amendments, Changes and Modifications" herein.

Operation and Maintenance of the Project by Partnership

The Partnership will, at its own expense, keep the Project in good repair and operating condition, and make all repairs deemed reasonable by the Partnership for this purpose.

Sale, Assignment or Lease of Project

In addition to the leases to residents in the Project, the Partnership may lease the Project, in whole or in part, and assign its rights and obligations under the Loan Agreement, and sell, mortgage or otherwise encumber its interests in the Project, in whole or part, as provided in the Regulatory Agreement, the Declaration or the Loan Agreement, provided that in no event shall such lease, assignment or sale be permitted (a) if the effect thereof would be to impair the validity of the Bonds or the tax exempt status of the interest thereon, (b) if any such transaction would release the Partnership from its obligations under the Loan Agreement (except that the Partnership may be released from its obligations as provided in "THE LOAN AGREEMENT--Status of Partnership" below) or (c) if the purchaser or its general partner does not assume the obligations of the Partnership, in the case of an assignment and transfer, or enter into other obligations similar to those of the General Partner with respect to the Letters of Credit, the Purchase Payment Agreement and the Partner Payment and Security Agreements, in the case of a sale, lease or encumbrance. The Issuer and Trustee shall promptly be notified of any such sale, assignment or lease (other than leases to residents of the Project).

Status of Partnership

Throughout the term of the Loan Agreement, the Partnership will maintain its existence as a limited partnership under the laws of Minnesota and will not wind up or

otherwise dispose of all or substantially all of its assets, provided that the Partnership may sell or otherwise transfer all or substantially all of its assets to a transferee person or entity and wind up if such transferee assumes all of the obligations of the Partnership under the Loan Agreement, the FHA Loan Documents, the Regulatory Agreement, the Declaration and all related instruments by written instrument delivered to the Issuer, the Trustee and HUD. The Trustee shall be promptly informed of any change in the status of the Partnership (including a change in the identity of the General Partner by sale, substitution or otherwise). If the requirements for a sale of the Project and assignment of the Partnership's obligations under the Loan Agreement (described above) are met, as well as the restrictions and conditions of the Mortgage, the Regulatory Agreement and the Declaration, the General Partner whose interest in the Partnership is transferred or terminated may be discharged from further liability under the Loan Agreement. The Partnership shall not effect such assignment or transfer if the result thereof would be to violate any of the sale restrictions set forth in the Loan Agreement or to subject the interest payable on the Bonds (in the hands of any person who is not a "substantial user" of the Project or a "related person") to Federal income taxes under the 1954 Code or the Code.

Indemnity

The Partnership will indemnify the Issuer and the Trustee against liabilities, losses, expenses, damages and other costs and expenses in certain instances arising out of or related to the Project, the Bonds and this Official Statement. In case of matters relating to the Official Statement, the indemnity will also extend to each person who "controls" the Issuer or the Trustee within the meaning of the Securities Act of 1933 and to any officer, employee or agent of the Issuer or the Trustee.

Nonrecourse Obligation

The Loan Agreement, the Mortgage and the Mortgage Note are nonrecourse obligations of the Partnership, and as a result, the Loan Agreement is not intended to create any personal liability for the "debt" created on account of the issuance of the Bonds and the obligation of the Partnership to make payments thereunder and accordingly the remedies available to the Issuer and the Trustee upon an Event of Default insofar as they relate to the payment of any amounts due under the Loan Agreement are limited to the rights and remedies against the mortgaged property, the rents, issues and profits from the mortgaged property and such other security to secure the

repayment of the Loan as is given the Issuer or Trustee under the Indenture, the Loan Agreement, the Mortgage and related documents; provided that nothing in the Loan Agreement shall be deemed to relieve the Partnership from personal liability for the payment of certain Additional Charges or the performance of indemnification obligations, all as more fully provided for in the Loan Agreement.

THE INDENTURE

The following is a summary of certain provisions of the Indenture between the Issuer and the Trustee. Such summary does not purport to be comprehensive or definitive, and reference is made to such document for a full and complete statement of its terms, a copy of which document may be obtained from the Underwriter during the period that the Bonds are offered and thereafter upon request to the Trustee.

Pledge by Issuer

The Issuer will pledge and assign to the Trustee in trust all of the rights and interests of the Issuer in the Loan Agreement and under the Regulatory Agreement and Declaration, including but not limited to the Basic Payments and all sums the Issuer is entitled to receive from the Partnership under the Loan Agreement (except for certain rights to indemnification and payment of expenses) and all other sums required to be deposited in the trust accounts created pursuant to Article Five of the Indenture, the earnings derived from the investment of the foregoing sums, and all property mortgaged, pledged and assigned under the Mortgage and the Collateral Security Documents, all proceeds of FHA Insurance and any other property which may become subject to the lien of the Indenture. The Trustee is entitled to hold all of the above and enjoy all privileges related to such pledge by the Issuer, subject to the rights of the Partnership under the Loan Agreement and the Collateral Security Documents.

Construction Fund

The Construction Fund will be maintained by the Trustee. Transferred Proceeds, except for Transferred Proceeds required to be deposited in the Bond Fund and the Reserve Fund, shall be deposited in the Construction Fund and shall be used by the Trustee for the reimbursement of the Partnership or for paying the costs of constructing, installing and equipping the Project and other amounts payable with respect to the Project under the Loan Agreement.

Upon the date of Final Endorsement, the balance of the moneys remaining in the Construction Fund shall be transferred to the Bond Fund and used to redeem in part Bonds as further provided for in the Indenture.

Bond Fund

The Bond Fund will be maintained by the Trustee. The Trustee shall deposit in the Bond Fund upon receipt of the Transferred Proceeds the interest accrued on the Bonds from their nominal date to their delivery date together with Transferred Proceeds in an amount which, when added to such accrued interest and investment earnings to be derived therefrom, equal interest to come due on the Bonds before _____, 198_. Thereafter, all Basic Payments made by the Partnership and certain other amounts specified in the Indenture, including FHA Insurance benefits, will be deposited in the Bond Fund.

Money in the Bond Fund shall be used and withdrawn by the Trustee for the payment of principal of, premium, if any, interest on, and the purchase price of, the Bonds and for the redemption and prepayment of Bonds, to discharge Outstanding Bonds in accordance with Article Seven of the Indenture or to purchase and cancel any Bonds pursuant to Section 5-6 of the Indenture upon deposit by the Partnership of sufficient additional sums to do so.

Reserve Fund

Under the Indenture, a Reserve Fund is created and must be maintained in an amount equal to $300,000*, funded initially from Transferred Proceeds. Thereafter, the Trustee will deposit certain other sums to be paid and deposited in the Reserve Fund under the Loan Agreement or the Indenture.

If the amount in the Bond Fund on any Interest Payment Date is insufficient to pay the principal of, premium, if any, interest on, or the purchase price of the Bonds when due, whether at maturity or redemption or otherwise, the Trustee will transfer amounts on hand in the Reserve Fund to the Bond Fund to cure any deficit; provided, however, that no such transfer shall be made until the Trustee has delivered notice to FHA electing to assign the Mortgage to FHA for collection of FHA mortgage insurance benefits, and provided further that any such transfer by the Trustee shall not relieve the Partnership of any of its obligations under the Loan Agreement, Mortgage Note or Mortgage.

* Preliminary; subject to change.

Pursuant to the Loan Agreement, if a transfer of funds is made from the Reserve Fund to the Bond Fund, the Partnership is required to make a Basic Payment, on or before the first day of the second month immediately following the date on which the transfer was made, to restore the Reserve Fund to the Reserve Requirement.

Upon certain conditions set out in the Indenture, amounts in the Reserve Fund may be invested only to the extent permitted by Section 148 of the Internal Revenue Code of 1986, as amended, and applicable regulations.

As noted below under the caption "Application of Moneys," if an Event of Default should occur, the Trustee shall have a right to deduct all of its expenses, liabilities and advances, before any money collected pursuant to action taken under the Indenture is deposited in the appropriate fund required under the Indenture. That first lien, with right of payment prior to payment on account of debt service on the Bonds, also applies to any sums held in the Bond Fund and Reserve Fund. Further, upon an Event of Default, in applying moneys for the payment of debt service, the Trustee is required to determine, having due regard to the amount of such moneys available for application, the likelihood of additional moneys becoming available for such application in the future. This provision applies to sums held in the Bond Fund and the Reserve Fund that might otherwise be available for the purpose of making current debt service payments on the Bonds.

Mortgage Reserve Fund

A Mortgage Reserve Fund is created under the Indenture, into which shall be deposited and held (a) the Letters of Credit (or in lieu thereof, cash) in an amount equal to 1% of the principal amount of the Mortgage Loan, to be used to pay an FHA assignment fee in the event the Mortgage is assigned by the Trustee, in connection with a claim for mortgage insurance benefits or otherwise; (b) approximately $_____ in cash to fund any difference between the interest payments on the Bonds and the investment earnings on the Transferred Proceeds during the construction period; and (c) approximately $_____ in cash to fund interest accruing on the Bonds during a 30-day period preceding acceleration of maturity of the Bonds under the Indenture.

Property Insurance and Award Fund

All Net Proceeds (i.e., proceeds remaining after payment of costs of collecting insurance or in connection with condemnation proceedings) from any property insurance proceeds

or condemnation award for damage, destruction or condemnation of the Project are to be paid into the Property Insurance and Award Fund and administered by the Trustee unless otherwise required by any of the FHA Loan Documents.

If the conditions for the termination of the Loan Agreement exist, and the Partnership exercises the option to terminate the Loan Agreement, the Trustee shall use the Net Proceeds and all other available sums not required to compensate and reimburse the Trustee to redeem and pay all Outstanding Bonds. If such conditions for termination do not exist or if the Partnership does not exercise its option to prepay the Loan, then the Partnership is required under the Mortgage to restore the Project in accordance with the terms of the Indenture. After reimbursement of the costs of restoration to the Partnership, the balance, if any, of the Net Proceeds will be transferred to the Bond Fund and used to redeem Bonds as provided in the Indenture.

If the Partnership shall within a reasonable period of time fail to restore the Project and an Event of Default has occurred, the Net Proceeds will be paid into the Reserve Fund for use in accordance with the terms of the Indenture.

Investment of Funds

Any moneys held as part of funds established under the Indenture shall be invested or reinvested by the Trustee upon the request of the Partnership in such securities as are authorized by then applicable Minnesota laws, and any securities purchased and any earnings on investments of the moneys held in the funds established under the Indenture shall be held by the Trustee in accordance with the Indenture. However, no investment may be made by the Trustee in such a manner as to cause the Bonds to be arbitrage bonds within the meaning of Section 148 of the Code.

Discharge of Lien of Indenture

Upon the Partnership's request, the lien of the Indenture, the Loan Agreement and the Mortgage will be terminated, and the Trustee and the Issuer will execute and deliver such instruments of satisfaction and release as necessary, whenever the following conditions exist:

(1) (A) with certain exceptions, all Bonds have been cancelled or delivered to the Trustee for cancellation, (B) the Issuer or the Partnership has deposited with the Trustee or Paying Agent in trust, cash and/or certain types of securities specified in the Indenture, which will, without reinvestment,

provide sufficient cash, when added to all other cash on hand, sufficient to discharge the entire indebtedness, including interest, on Outstanding Bonds; and

(2) the Trustee or Partnership has paid or arranged for payment of all sums payable under the Loan Agreement, the Indenture and the Mortgage Note; and

(3) the Partnership has furnished to the Trustee the report of an Independent Accountant that the payments on the securities referred to in clause (1)(B) above will be sufficient to pay all sums due on all Outstanding Bonds; and

(4) if discharge is to be effected under clause (1)(B) above, an opinion of Bond Counsel is delivered to the Trustee stating in effect that such discharge will not cause the interest on the Bonds to be includible in gross income for federal income tax purposes.

Upon such discharge, the rights of the Bondholders shall be limited to the cash or cash and securities deposited with the Trustee, and the Bonds shall no longer be deemed Outstanding under the Indenture.

Events of Default

Any of the following events is an "Event of Default" under the Indenture:

(1) failure to pay when due any interest on any Outstanding Bond, or the principal or the purchase price of any Outstanding Bond plus any premium, whether at the stated maturity date, the redemption date, the First Fixed Purchase Date or upon acceleration; or

(2) failure to pay any other moneys to the Trustee when due under the Indenture, if such failure continues for 30 days after written notice thereof has been given to the Partnership and the Issuer by the Trustee, or to the Issuer, the Partnership and the Trustee by the Holders of at least twenty-five percent (25%) of the total principal amount of the Outstanding Bonds; or

(3) failure by the Issuer to perform or observe any of the agreements or conditions in the Indenture or the Bonds, if such failure continues for 30 days after written notice is given as specified in clause (2) above; or

(4) an Event of Default under the Loan Agreement has occurred and is continuing. See information under the heading "THE LOAN AGREEMENT--Events of Default" herein.

Acceleration

Upon the occurrence of an Event of Default, the Trustee may, and upon the written request of the Holders of twenty-five percent (25%) of the aggregate principal amount of the then Outstanding Bonds, shall, by notice in writing delivered to the Issuer and the Partnership, declare the principal of all then Outstanding Bonds and the interest accrued thereon immediately due and payable.

Remedies

Upon the occurrence of an Event of Default, the Trustee may pursue any available remedies, including those under the Purchase Payment Agreement, the Partner Payment and Security Agreements, the Collateral Security Documents, the Regulatory Agreement and the Declaration. The Trustee may elect to cancel the FHA Insurance and foreclose on the Mortgage only with the consent of the Holders of all Outstanding Bonds, except that no Bondholder consent is required if the proceeds of a sale or other disposition of the Project will provide sufficient amounts to pay 100% of the principal of and accrued interest on the Outstanding Bonds upon acceleration of maturity under the Indenture. If an Event of Default has occurred under the Loan Agreement, the Trustee may enforce any and all rights of the Issuer thereunder. All remedies conferred upon or reserved to the Trustee or the Bondholders are cumulative and are in addition to any other remedy now or hereafter existing at law, in equity or by statute.

If any Event of Default shall have occurred, and if it shall have been requested to do so by the Holders of twenty-five percent (25%) of the total principal amount of the then Outstanding Bonds and shall have been indemnified as provided in the Indenture, the Trustee shall be obliged to exercise such rights and powers conferred by the Indenture, the Purchase Payment Agreement, the Partner Payment and Security Agreements, the Collateral Security Documents, the Regulatory Agreement and the Declaration as the Trustee, being advised by independent counsel, shall deem most expedient in the interests of the Bondholders; provided, however, that the Trustee shall have the right to decline to comply with any such request if the Trustee shall be advised by independent counsel that the action so requested may not lawfully be taken or if the Trustee in good faith shall determine that such action would be unjustly prejudicial to the Holders of Bonds not parties to such request.

Every right and power accruing to the Trustee or Bondholders upon an Event of Default may be exercised as often as deemed expedient; no delay or omission in exercising any such rights or powers shall be construed as a waiver of or acquiescence in an Event of Default.

Rights and Remedies of Bondholders

Direction of Proceedings by Bondholders

The Holders of a majority of the aggregate principal amount of Bonds then Outstanding shall have the right, upon fulfillment of certain conditions, to direct the method and place of conducting all proceedings to be taken in connection with the enforcement of the terms and conditions of the Indenture, the Loan Agreement, the Collateral Security Documents, the Purchase Payment Agreement, the Partner Payment and Security Agreements, the Regulatory Agreement and the Declaration, provided that such direction will not be contrary to the provisions of law and of the Indenture; the consent of the Holders of all Outstanding Bonds is required for cancellation of the FHA Insurance, unless the Trustee determines that the proceeds from a sale or other disposition of the Project will provide sufficient amounts to pay 100% of the principal of and accrued interest on the Outstanding Bonds upon acceleration of maturity under the Indenture.

Institution of Suit by Bondholders

No suit, action at law or in equity or exercise of any remedy under the Indenture, Loan Agreement, the Purchase Payment Agreement, the Partner Payment and Security Agreements or the Collateral Security Documents accruing upon the occurrence of an Event of Default shall exist under the document involved unless the Trustee has been requested in writing by the Holders of twenty-five percent (25%) of the aggregate principal amount of the then Outstanding Bonds to exercise the powers granted to it or to institute suit in its own name and offered a reasonable opportunity to do so, and the Trustee fails or refuses to act. This notice must also contain an offer from the Holders to indemnify the Trustee upon the exercise of its powers or the institution of suit. At the option of the Trustee, such written notice described above may be declared a condition precedent to any enforcement of or action for the enforcement of the Indenture and such other documents.

Nothing in the Indenture, however, shall affect or impair the right of the Bondholders to enforce the payment of principal and interest on the Bonds at or after their date of maturity or the obligation of the Issuer to pay the principal and interest on the Bonds as specified in the Indenture.

Application of Moneys

All moneys received by the Trustee pursuant to any right given or action taken under the provisions of the Indenture, Loan Agreement, Collateral Security Documents, Regulatory Agreement or Declaration shall, after payment of the costs and expense of the proceedings resulting in the collection of such moneys and of the expenses, liabilities and advances incurred or made by the Trustee, and after payment of all sums to which the Issuer is entitled under the Loan Agreement, be deposited in one or more funds established under the Indenture as the Trustee deems appropriate. Such funds shall be used to pay principal and interest on the Bonds and in accordance with the further provisions of the Indenture.

Waiver of Events of Default

As set forth in the Indenture, upon certain conditions, the Trustee may, with the consent of the FHA during any period that FHA Insurance is in effect, and otherwise in its discretion, waive any Event of Default under the Indenture and rescind any declaration of acceleration of maturity of principal, and shall also do so with the consent of the FHA during any period that the FHA Insurance is in effect, upon written request of the Holders of (i) a majority of the aggregate principal amount of all the then Outstanding Bonds in respect of which default in the payment of principal, premium and/or interest exists or (ii) a majority of the aggregate principal amount of all the then Outstanding Bonds in the case of any other Event of Default under the provisions of the Indenture. The Trustee shall not waive any Event of Default (whether or not such waiver is requested by Bondholders as described in (i) or (ii) of this paragraph) in the payment of principal of, or premium on any Outstanding Bond or in the payment of interest thereon, unless prior to such waiver all arrearages of principal, interest and premium and all expenses of the Trustee and the Paying Agent have been paid.

No waiver of an Event of Default by the Trustee or the Bondholders shall affect any subsequent Event of Default or impair any rights or powers accruing as a consequence of a subsequent Event of Default.

Notice of Default and Opportunity to Cure

Except for a default in the payment when due of interest or premium on or the principal of (including the purchase price of) any Bonds, no default under the Indenture shall constitute an Event of Default until the Issuer and Partnership are given actual notice by the Trustee and until the Issuer and the Partnership have had an opportunity to correct the default within the time permitted under the Indenture and the Loan Agreement. The Partnership is appointed the Issuer's attorney-in-fact and agent to perform any covenant of the Issuer constituting an Event of Default on the Issuer's behalf and upon notice to the Issuer of such intention, and the Issuer may in writing cancel, withdraw or limit such appointment of the Partnership.

The Trustee

The Trustee under the Indenture is First Trust National Association, located in Saint Paul, Minnesota. The Indenture provides that the Trustee shall, prior to the occurrence of any Event of Default under the Indenture and after the curing of all Events of Default which have occurred, perform only such duties as are specifically set forth in the Indenture. During the existence of any Event of Default, the Trustee shall exercise such of the rights and powers vested in it under the Indenture, and use the same degree of care and skill in their exercise, as a prudent trustee would under a corporate mortgage, subject to certain conditions.

The Trustee may acquire and hold Bonds with the same rights as if it were not Trustee under the Indenture.

The Trustee is not responsible for the sufficiency of any security and is not otherwise liable to the Bondholders except for its negligence or willful default and is protected from liability if it acts in reliance on counsel, or in reliance upon a document bona fide on its face.

In the Event of Default, the Indenture requires the Trustee to give the Holders notice thereof; except for an Event of Default in the payment of principal or interest on the Bonds, the Trustee may withhold notice on the good faith advice of its board of directors, executive or trust committee or its chief executive officer that such withholding of notice is in the interest of the Holders.

Supplemental Indentures

Except for certain specific purposes set out in the Indenture, supplemental indentures modifying, amending or rescinding the terms of the Indenture require the consent of the Holders of not less than fifty-one percent (51%) of the total principal amount of the then Outstanding Bonds. However, the consent of Holders of 100% of the principal amount of Outstanding Bonds is required for supplemental indentures extending the maturity of the principal of or interest on any Bond, or reducing the amount of the principal of or interest rate on any Bond, or giving any Bonds a privilege or priority over any other Bonds, or modifying the provisions of the Indenture relating to Bondholder consent to supplemental indentures.

The Trustee shall not enter into any supplemental indenture which is inconsistent with the provisions of any of the FHA Loan Documents or the National Housing Act of 1934, as amended or the FHA regulations thereunder or related administrative requirements without first obtaining the prior written consent of HUD.

Rights of Partnership

No supplemental indenture shall become effective that adversely affects the rights of the Partnership under the Loan Agreement unless and until the Partnership has consented to the execution and delivery of the supplemental indenture, after notice of the proposed execution of such supplement by the Trustee.

The Partnership will be deemed to have consented thereto if the Trustee does not receive a response from the Partnership within the time period and on the terms specified in the Indenture.

Amendments, Changes and Modifications

The Issuer and the Trustee may, without the consent of or notice to the Bondholders consent to any amendment, change or modification of the Related Documents (i) required or permitted by the provisions of the Loan Agreement, the Indenture or Related Documents, (ii) to cure any ambiguity or formal defect or omission, (iii) to more precisely identify additional land, equipment or improvements added to the Project or to substitute, add, sell or remove additional land or equipment, (iv) to reconcile the Related Documents with any amendment or supplement to the Indenture, or (v) in connection with any other changes which in the judgment of the Trustee do not prejudice any non-consenting Bondholders.

Any other amendments, changes or modifications of the Indenture, the Loan Agreement, the Related Documents require the publication of notice and the written consent of the Holders of at least fifty-one percent (51%) of the total principal amount of all then Outstanding Bonds. If the required number of Holders consent to any amendment or modification, no Holder shall have the right to object to the terms and provisions thereof or to enjoin or restrain the Issuer or Trustee from executing such amendment. Notwithstanding these provisions for amendment, no amendment or modification will be permitted that would reduce the amounts due under the Loan Agreement or the Mortgage or change the stated maturities of the Bonds.

Notwithstanding the foregoing, the Trustee shall not consent to amendment of a Related Document which is inconsistent with the provisions of any of the FHA Loan Documents or the National Housing Act of 1934, as amended, or the FHA regulations thereunder, or related administrative requirements without first obtaining the prior written consent of HUD.

Ownership of Bonds

The Holder of any Bond may be treated as the owner for the purpose of receiving payment and for all other purposes, and neither the Issuer (or any agent thereof) nor Trustee shall be affected by notice to the contrary.

THE PURCHASE PAYMENT AGREEMENT AND THE PARTNER PAYMENT AND SECURITY AGREEMENTS

The following is a summary of certain provisions of the Purchase Payment Agreement and the Partner Payment and Security Agreements. Such summary does not purport to be comprehensive or definitive, and reference is made to such documents for a full and complete statement of their terms, a copy of which documents may be obtained from the Underwriter during the period that the Bonds are offered and thereafter upon request to the Trustee.

To secure the obligations of the Partnership and the General Partner under the Loan Agreement and certain related documents, the General Partner and each limited partner of the Partnership will grant to the Trustee a security interest in their respective partnership interests in the Partnership, under the Partner Payment and Security Agreements. Upon failure by the Partnership to make a required payment under the Loan Agreement (including payment of amounts sufficient to

purchase Bonds on a Fixed Purchase Date) or upon certain events of bankruptcy or insolvency or other events of default set forth more fully in the Partner Payment and Security Agreements, the Trustee may realize on its security and take possession of or otherwise dispose of the partnership interests in the Partnership. Under the Purchase Payment Agreement, if the Partnership fails to pay the required purchase price of the Bonds on the First Fixed Purchase Date, the Trustee may elect any of the following alternative courses of action: (i) the Trustee may terminate the FHA Insurance and accelerate the outstanding indebtedness of the Partnership under the Loan Agreement; (ii) the Trustee may retain its rights and remedies under the Loan Agreement and related documents without terminating the FHA Insurance; or (iii) the Trustee may take possession of or otherwise dispose of the partnership interests in the Partnership as described above, without terminating the FHA Insurance or exercising any other remedies under the Loan Agreement or related documents.

The exercise of the Trustee's remedies under the Purchase Payment Agreement and the Partner Payment and Security Agreements is discretionary with the Trustee, and is subject to HUD approval as long as the FHA Insurance is in effect. There can be no assurance that the Trustee will elect to exercise any one or more of such remedies, or that any required HUD approval can be obtained. Moreover, there can be no assurance that such remedies, if exercised, will provide sufficient funds to pay the principal or purchase price of, premium, if any, and interest on the Bonds when due in the event of a default under the Loan Agreement. See "RISK FACTORS" herein.

RENTAL HOUSING REQUIREMENTS

The following is a summary of the Rental Housing Requirements (as defined below) applicable to the Project, including a summary of certain provisions of the Regulatory Agreement and the Declaration. Such summary does not purport to be comprehensive or definitive. Reference is made to such documents for a full and complete statement of their terms, which documents are available from the Underwriter during the period that the Bonds are offered and thereafter upon request to the Trustee.

Section 103(b)(4)(A) of the Internal Revenue Code of 1954, as amended (the "1954 Code"), which applies to the Project and the Bonds, provides that interest on certain governmental obligations, substantially all of the proceeds of which are to be used to provide a project for "residential rental property", shall be exempted from federal income

taxation if at all times during the Qualified Project Period (as defined below), twenty percent (20%) or more of the units in the project are occupied by tenants whose adjusted family income is 80% or less of the median income ("Median Income") for the Minneapolis/Saint Paul Standard Metropolitan Statistical Area as determined by the United States Department of Housing and Urban Development. Tenants meeting the foregoing income requirements are referred to as "Low Income Tenants". Minnesota Statutes, Chapter 462C (the "Housing Act"), also provides for certain limitations on the income of tenants occupying residential units in a project or certain requirements with respect to the affordability of such units in a project, unless the project is located in a "targeted area" (as defined by Minnesota law) or is occupied by the elderly or by handicapped persons. The Project is not located in a "targeted area," nor is it designed primarily for occupancy by elderly persons.

Section 1.103-8(b) of the Income Tax Regulations (the "Regulations") sets forth certain requirements for compliance with Section 103(b)(4)(A) of the 1954 Code. The Regulations require, among other things, that (1) the twenty percent (20%) Low Income Tenant occupancy requirement must be met on a continuous basis during the Qualified Project Period (as defined below), and (2) during the Qualified Project Period (as defined below) all of the units in the Project must be rented or available for rental to the general public on a continuous basis. Restrictions under the Housing Act apply on a continuous basis until the Bonds issued to provide the Project are no longer outstanding.

Under the Regulations, the failure to satisfy the Rental Housing Requirements of the Regulations with respect to any project may, unless corrected within a reasonable period (i.e., not less than sixty days) after such noncompliance is first discovered or should have been discovered by the exercise of reasonable diligence, cause the loss of the tax exempt status of the Bonds as of the date of their original issue, irrespective of the date such noncompliance actually occurred.

The Partnership will enter into a Regulatory Agreement with the Issuer and the Trustee, and the Partnership will execute and cause to be recorded a Declaration of Restrictive Covenants as covenants and restrictions running with the land on which the Project is located. In order to satisfy the rental housing requirements of the 1954 Code and Regulations and the Housing Act (collectively the "Rental Housing Requirements"), the Partnership will covenant in the Regulatory Agreement and Declaration to comply with certain provisions therein regarding the operation and occupancy of the Project.

The Declaration will be recorded and filed in the appropriate land records office of Ramsey County, Minnesota, and will bind the Partnership and its successors and assigns, including all subsequent owners of the Project or any part thereof. The provisions of the Regulatory Agreement and Declaration are intended to insure compliance with the Rental Housing Requirements and will remain in effect for the Qualified Project Period (except as provided above for Housing Act restrictions, which apply for so long as the Bonds remain outstanding). The Regulatory Agreement and Declaration will, however, terminate with respect to the Project in the event of an involuntary loss of the Project, including the substantial destruction of the Project (unless the Project is restored), provided the Bonds are redeemed.

The Regulatory Agreement and Declaration will provide as follows with respect to the Rental Housing Requirements:

(1) That the Qualified Project Period will commence on the date that ten percent (10%) of the units in the Project are first occupied, and will terminate on the later of (a) the date which is 10 years after fifty percent (50%) of the units in the Project are first occupied, (b) the date which is one-half the term of the obligation with the longest maturity in the Bond issue (including any refunding issue) after the date on which any unit in the Project is first occupied, or (c) the date on which any assistance provided under Section 8 of the United States Housing Act of 1937 terminates. Certificates will be filed and recorded in the appropriate land records office setting forth the commencement and termination dates of the Qualified Project Period for the Project.

(2) All of the residential units in the Project will remain available for occupancy on a rental basis until the later of the expiration of the Qualified Project Period or the date on which the Bonds have been paid in full.

(3) As required by the Regulations, during the Qualified Project Period, twenty percent (20%) of the residential units in the Project must be occupied at all times by persons or families whose adjusted family income at the time of their initial occupancy is equal to or less than eighty percent (80%) of the Median Income for the Minneapolis/St. Paul Standard Metropolitan Statistical Area, as determined by the United States Department of Housing and Urban Development. Each tenant's adjusted family income shall be determined in a manner consistent with income determinations under Section 8 of the United States Housing Act of 1937, as amended. The twenty percent (20%) requirement will be applied on a pro rata basis during initial lease-up of the Project.

(4) As required by the Housing Act, for so long as the Bonds are outstanding, at least an additional 55% of the units in the Project will be occupied by tenants whose adjusted family income is equal to or less than 110% of the Median Income for the Minneapolis/Saint Paul Standard Metropolitan Statistical Area ("Moderate Income Tenants"), all as more fully provided for in the Regulatory Agreement and the Declaration.

(5) The twenty percent (20%) of the units in the Project required to be occupied by Low Income Tenants will be substantially similar to all other residential units in the Project, and the Low Income Tenants will enjoy equal access to all common facilities included in the Project.

(6) The Partnership will report and certify its compliance with the Rental Housing Requirements as required by the Declaration and Regulatory Agreement, such reports and certifications to be submitted at the times required to the Issuer or Trustee.

(7) The adjusted family income of each Low Income Tenant and Moderate Income Tenant will be verified by obtaining an income certification statement from such tenant, and by obtaining either federal income tax returns or employer income verifications.

If the Partnership violates the Rental Housing Requirements, the Issuer or the Trustee may exercise whatever remedies may then be available in law or equity, including specifically the right to compel compliance with the Rental Housing Requirements by an action for specific performance. In the event that the Partnership violates the Rental Housing Requirements, and such violation is not cured, or is incurable, or has not been discovered within a reasonable period, all as more fully set forth in the Loan Agreement, interest on the Bonds may become taxable. For so long as FHA Insurance is in effect, upon such violation, the Bonds will not be redeemed.

The Partnership must comply with certain other requirements of tax-exempt financing as well as the foregoing covenants with respect to the Rental Housing Requirements.

The Rental Housing Requirements may adversely affect the Partnership's ability to rent units, particularly during the lease-up period, in a manner sufficient to generate adequate cash flow to pay the Bonds solely from rental and rental-related income.

TAX EXEMPTION AND OTHER TAX CONSIDERATIONS

General

In the opinion of Bond Counsel, Briggs and Morgan, Professional Association, in Saint Paul and Minneapolis, Minnesota, based upon present Minnesota and federal laws (which excludes any pending legislation which may have a retroactive effect prior to the date on which the opinion of Bond Counsel is dated and delivered), regulations, rulings and decisions, unless the owner is a "substantial user" of the Project or a "related person" to a "substantial user" as defined in the Code, and except as provided below, the Bonds bear interest which is not includable in the gross income of the Bondholder for purposes of United States income tax and, to the same extent, is not includable in taxable net income of individuals, estates or trusts for State of Minnesota income tax purposes, but is subject to the State of Minnesota franchise tax measured by income imposed on corporations and financial institutions. The exemption for federal and state income taxation of the interest on the Bonds, however, depends upon compliance with certain continuing restrictions as to use and investment of Bond proceeds, with certain continuing restrictions as to use and operation of the Project under Section 103 of the 1954 Code and the regulations thereunder, and with certain continuing tax covenants made by the Partnership in the Loan Agreement, the Regulatory Agreement and the Declaration.

Alternative Minimum Tax for Corporations

For purposes of the alternative minimum tax of 20% imposed on corporations, the alternative minimum taxable income of any corporation for any taxable year commencing in 1987, 1988 and 1989 must be increased by 50% of the amount, if any, by which the adjusted net "book income" of the corporation exceeds the alternative minimum taxable income of such corporation (determined without regard to this book income adjustment). For taxable years commencing after 1989, the adjustment will be based on current earnings rather than book income. Interest on the Bonds is included in determining the adjusted net book income (and current earnings) of corporations and, therefore, interest on the Bonds may be subject to federal income taxation of corporations. This tax is applicable regardless of the date of issue or date of acquisition of the obligation in question.

Environmental Tax

Pursuant to the Superfund Amendments and Reauthorization Act of 1986 (the "Superfund Act"), an environmental tax is imposed on corporations equal to 0.12% (or

$1,200 per $1,000,000) of the excess of the "modified alternative minimum taxable income" of such corporation for the taxable year over $2,000,000. This tax applies to taxable years beginning after December 31, 1986 and before January 1, 1992, subject to earlier termination for certain specified reasons. Interest on the Bonds will be subject to the environmental tax to the extent included in adjusted net book income or adjusted current earnings of a corporation whose modified alternative taxable income exceeds $2,000,000 for the taxable years to which it applies.

Branch Profits Tax

A tax is imposed on any foreign corporation in an amount equal to thirty percent (30%) of the "dividend equivalent amount" for the taxable year. The "dividend equivalent amount" is the foreign corporation's "effectively connected earnings and profits" reduced for increase (or increased for decrease) in "US Net Equity." According to the Conference Committee Report provided in connection with the adoption of the Tax Reform Act of 1986, "the conferees intend that a branch's earnings and profits include income that would be effectively connected with a US trade or business if such income were taxable, such as tax exempt municipal bond interest."

Foreign Insurance Companies

The federal Budget Reconciliation Act of 1987, enacted in December, 1987, subjects foreign companies carrying on an insurance business in the United States to a tax on income which is effectively connected with their conduct of any trade or business in the United States. Such income includes "net investment income" which is effectively connected, which shall not be less than the product of (A) the "required U.S. assets" of each company, and (B) the "domestic investment yield" applicable to such company for such year. Net investment income includes, according to the conference report accompanying the law, "interest (including tax-exempt interest)".

Other Tax Consequences

The above is not a comprehensive list of all federal tax consequences which may arise from the receipt of interest on the Bonds. Investors should be aware that there may be other tax consequences applicable to the acquisition and ownership of the Bonds. Bond Counsel expresses no opinion regarding any such consequences. Investors should consult

their tax advisors regarding applicability of those consequences as well as the applicability of the above itemized taxes to their situation.

ENFORCEABILITY OF OBLIGATIONS

On the closing date for delivery of the Bonds, Briggs and Morgan, Professional Association, Bond Counsel, will deliver its opinion dated the date thereof, that the Bonds, the Loan Agreement, the Indenture and the Regulatory Agreement are valid and legally binding on the Issuer and enforceable in accordance with their terms, respectively. On such date, Lazarus and Kelley will deliver its opinion that the Loan Agreement, the Mortgage, the Regulatory Agreement, the Declaration, the Bond Purchase Agreement and the FHA Loan Documents to which the Partnership is a party, are valid and legally binding agreements of the Partnership enforceable in accordance with their terms, respectively, and that certain agreements of the General Partner are valid and legally binding agreements of the General Partner, enforceable against the General Partner in accordance with their respective terms. The foregoing opinions as to enforceability will be qualified to the extent that enforceability may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights generally and to the exercise of judicial discretion in accordance with general principles of equity.

While the Bonds are secured or payable pursuant to the Indenture, the Loan Agreement and the Mortgage Loan, practical realization of any security upon any default will depend upon the exercise of various remedies specified in their respective instruments. These and other remedies are dependent in many respects upon judicial action, which is subject to discretion and delay. Accordingly, the remedies specified by the Indenture, the Loan Agreement and the Mortgage may not be readily available or may be limited.

LEGAL MATTERS

Legal matters incident to the authorization, issuance and sale by the Issuer of the Bonds and with regard to the exclusion of interest thereon from gross income for purposes of federal income taxation and from taxable net income for purposes of Minnesota income taxation under existing laws are subject to the approving legal opinion of Briggs and Morgan, Professional Association, Minneapolis and Saint Paul, Minnesota, Bond Counsel. Certain legal matters will be passed

upon for the Partnership and the General Partner by Lazarus and Kelley , Minneapolis, Minnesota. The Underwriter has been represented in this transaction by Dorsey & Whitney, Minneapolis, Minnesota.

UNDERWRITING

The Bonds are being purchased from the Issuer by Piper, Jaffray & Hopwood Incorporated, of Minneapolis, Minnesota (the "Underwriter"). The Underwriter has agreed to purchase the Bonds at a price equal to the principal amount thereof pursuant to a Bond Purchase Agreement between the Issuer, the Partnership, the General Partner and the Underwriter. In connection with such purchase, the Underwriter will be paid a fee of $_____ at closing. The public offering prices as set forth on the cover page hereof may be changed from time to time by the Underwriter. The Underwriter may reoffer and sell the Bonds to certain dealers at prices lower than the public offering prices set forth on the cover page hereof. The Partnership has agreed under the Bond Purchase Agreement to indemnify the Underwriter and the Issuer against certain liabilities, including liabilities under the federal and state securities laws.

MISCELLANEOUS

The foregoing summaries do not purport to be comprehensive or definitive and all references to the documents summarized herein are qualified in their entirety by reference to each such document. All references to the Bonds are qualified in their entirety by reference to the forms thereof and the information with respect thereto included in the aforesaid documents. Copies of these documents are available for inspection during the period of the offering at the offices of the Underwriter in Minneapolis, Minnesota, and thereafter at the principal office of the Trustee. The Issuer has not reviewed or approved any information or statements contained in this Official Statement and assumes no responsibility for the sufficiency, completeness or accuracy of this Official Statement.

Dated: _____, 1988.

BEAVER CREEK APARTMENTS LIMITED PARTNERSHIP
By Knights Group, its General Partner

By_____
Kenneth D. Gervais
its Managing Partner

APPENDIX A

DEFINITIONS

Additional Charges: the payments required by Section 4.03 of the Loan Agreement;

Basic Payments: the payments required by Section 4.02 of the Loan Agreement and by the FHA Mortgage Note and FHA Mortgage;

Bond Fund: the fund so designated in Section 5-3 of the Indenture from which the principal of, interest on, and premium, if any, and purchase price of, the Bonds are payable;

Bondholder: the person in whose name a Bond is registered in the bond register maintained by the Trustee;

Bonds: the Issuer's $5,800,000 Multifamily Mortgage Revenue Refunding Bonds (Beaver Creek Apartments Project-FHA Insured Mortgage Loan), Series 1988, to be issued in fully registered form without coupons by the Issuer pursuant to the Indenture;

1985 Bonds: the $8,500,000 Variable Rate Demand Purchase Multifamily Housing Revenue Bonds, Series 1985 (Beaver Creek Apartments Limited Partnership Project) previously issued by the Issuer for the Project;

Building Loan Agreement: the Building Loan Agreement, dated as of August 1, 1988, between the Trustee, as mortgagee, and the Partnership with regard to the Project.

Business Day: any day other than Saturday, Sunday, legal holiday or a day on which banking institutions in the city where the principal corporate trust office of the Trustee is located are authorized or required by law or executive order to close;

Code: the Internal Revenue Code of 1986, as amended, and all applicable Treasury Regulations;

1954 Code: the Internal Revenue Code of 1954, as amended, and all applicable Treasury Regulations;

Collateral Security Documents: the FHA Mortgage, the FHA Mortgage Note, the Escrow Agreement, the Letters of Credit and any other letters of credit, any guaranty and any other

assignments, collateral agent agreements or other security agreements made for the benefit and with the consent of the Trustee as creditor to secure payment of the Bonds or the Loan;

Construction Fund: the fund so designated in Section 5-2 of the Indenture, to which the Transferred Proceeds, except for any capitalized interest and amounts used to fund the Reserve Fund or Mortgage Reserve Fund, are appropriated;

Declaration: that certain Declaration of Restrictive Covenants, dated as of December 1, 1985, as amended and restated as of August 1, 1988, and any further amendments thereto, executed by the Partnership and recorded against the Project in the appropriate public land records office in and for Ramsey County, Minnesota;

FHA: the Federal Housing Administration, an organizational unit within the United States Department of Housing and Urban Development;

FHA Insurance: the insurance provided for by the contract between the Trustee, as mortgagee, and FHA, with respect to mortgage insurance pursuant to Section 221(d)(4) of the National Housing Act of 1934, as amended, created by FHA endorsement of the FHA Mortgage Note and incorporating the terms of certain contractual, statutory and regulatory provisions;

FHA Loan Documents: the FHA Mortgage Note, the FHA Mortgage, the Escrow Agreement, the Building Loan Agreement, the FHA Regulatory Agreement and any other documents required in connection with the FHA Insurance;

FHA Regulatory Agreement: the FHA Regulatory Agreement for Multifamily Housing Projects dated as of August 1, 1988, between the Partnership and the Secretary of HUD;

First Fixed Purchase Date: August 1, 1998, or, if such day is not a Business Day, the next succeeding Business Day;

Fixed Purchase Date: the First Fixed Purchase Date and any subsequent date on which Outstanding Bonds are required to be surrendered for purchase or exchange as provided in the Indenture;

General Partner: the general partner of the Partnership;

Holder: the person in whose name a Bond is registered in the bond register maintained by the Trustee;

HUD: the United States Department of Housing and Urban Development;

Indenture: the Indenture of Trust, dated as of August 1, 1988, between the Issuer and the Trustee, as the same may from time to time be amended or supplemented, under which the Issuer will issue the Bonds;

Independent Accountant: a certified public accountant or firm of certified public accountants registered and qualified to practice as such under the laws of the State of Minnesota, and not regularly employed by the Issuer or the Partnership, except to perform independent audits of the books and records of either or both of them or other similar periodic reviews;

Interest Payment Date: each February 1 and August 1, commencing February 1, 1989;

Issuer: the City of Maplewood, Minnesota, its successors and assigns;

Knights Group: Knights Group, a Minnesota general partnership and the initial general partner of the Partnership;

Letter of Credit: a letter of credit meeting the requirements of the Loan Agreement and the Indenture and required to be deposited in the Mortgage Reserve Fund by or on behalf of the Partnership;

Loan: the loan of Bond proceeds by the Issuer to the Partnership described in Section 4.01 of the Loan Agreement;

Loan Agreement: the Loan Agreement, dated as of August 1, 1988, between the Issuer, the Partnership and the General Partner, as the same may from time to time be amended or supplemented, pursuant to which the Issuer will lend the proceeds of the Bonds to the Partnership;

Mortgage: the FHA form of mortgage to be delivered by the Partnership to the Trustee;

Mortgage Loan: the mortgage loan evidenced by the Mortgage Note;

Mortgage Note: the FHA form of mortgage note to be executed by the Partnership to evidence the Mortgage Loan;

Mortgage Reserve Fund: the fund so designated in Section 5-5(A) of the Indenture to be funded with Letters of Credit and/or cash in an amount equal to the Mortgage Reserve Fund Requirement;

Mortgage Reserve Fund Requirement: an aggregate sum equal to $100,000*;

Mortgage Servicer: Glaser Financial Group, Inc., or its successors or assigns under the Servicing Agreement;

Net Proceeds: with respect to any property insurance payment, condemnation award for or sale of any mortgaged property, the amount remaining therefrom after payment of all expenses incurred by the Partnership, Trustee and Issuer in the collection thereof;

Outstanding Bonds: as of the date of determination, all Bonds theretofore issued and delivered under the Indenture except:

(A) Bonds theretofore cancelled by the Trustee or Paying Agent or delivered to the Trustee or Paying Agent cancelled or for cancellation;

(B) Bonds for which payment or redemption moneys or securities (as provided in Article Seven of the Indenture) shall have been theretofore deposited with the Trustee or Paying Agent in trust for the Holders of such Bonds; provided, however, that if such Bonds are to be redeemed, notice of such redemption shall have been duly given pursuant to the Indenture or irrevocable action shall have been taken to call such Bonds for redemption at a stated redemption date; and

(C) Bonds in exchange for or in lieu of which other Bonds shall have been issued and delivered pursuant to the Indenture;

provided, however, that in determining whether the Holders of the requisite principal amount of Outstanding Bonds have given any request, demand, authorization, direction, notice, consent or waiver under the Indenture, Bonds owned by the Issuer or the Partnership shall be disregarded and deemed not to be Outstanding Bonds, except that in determining whether the Trustee shall be protected in relying upon any such request,

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* Preliminary; subject to change.

demand, authorization, direction, notice, consent, or waiver, only Bonds which the Trustee knows to be so owned shall be disregarded;

Paying Agent: the Trustee or any other entity designated pursuant to the Indenture as the agent of the Issuer and the Trustee to receive and disburse the principal of and premium, if any, and interest on the Bonds;

Partner Payment and Security Agreement: any Partner Payment and Security Agreement, dated as of August 1, 1988, between a partner of the Partnership and the Trustee, under which such partner pledges its interest in the Partnership as security for certain obligations of the Partnership specified therein;

Partnership: Beaver Creek Apartments Limited Partnership, a Minnesota limited partnership, its successors and assigns, and any surviving, resulting or transferee corporation or other entity which may assume its obligations under the Loan Agreement;

Permitted Investments: any of the following:

(A) Direct general obligations of the United States of America;

(B) Obligations the payment of the principal of and interest on which is unconditionally guaranteed by the United States of America;

(C) Shares of an investment company registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and whose only investments are obligations described in clauses (A) or (B) above;

(D) Any general obligation of the State of Minnesota or any of its political subdivisions, provided that securities described in clauses (A) or (B) above have been irrevocably deposited in escrow to effect discharge of the general obligations in the same manner and subject to the same conditions required to effect discharge of the Bonds under Article Seven of the Indenture;

(E) Certificates of deposit with fixed maturities, time deposits, repurchase agreements or any other direct obligation with or of any national or state bank or federally chartered savings and loan association whose senior debt obligations are rated AA or better by Moody's

Investors Service, Inc. ("Moody's") or Standard & Poor's Corporation ("S & P") or any other bank if the debt obligations for which such bank's letters of credit are the primary basis is rated AA or better by Moody's or S & P;

Project: the multifamily housing project financed with the Mortgage Loan, together with the personal property financed from Transferred Proceeds and used or installed thereon or therein and the land on which the same are located, as they may at any time exist;

Purchase Payment Agreement: the Purchase Payment Agreement dated as of August 1, 1988 by and between the Partnership, the General Partner and the Trustee;

Regulatory Agreement: the Regulatory Agreement amended and restated as of August 1, 1988 by and among the Issuer, Partnership and Trustee, providing for, among other things, compliance with certain requirements of federal and state law pertaining to the tax-exempt financing of residential rental property;

Redemption Price: the price at which Bonds are redeemable by optional or mandatory redemption on any redemption date as provided in the Indenture;

Related Documents: the Loan Agreement, Regulatory Agreement, Declaration, Servicing Agreement, FHA Mortgage, FHA Mortgage Note and any other Collateral Security Documents as described in the Indenture;

Remarketing Agent: Piper, Jaffray & Hopwood Incorporated or any successor Remarketing Agent designated under the Remarketing Agreement dated as of August 1, 1988, between the Remarketing Agent, the Issuer and the Partnership.

Reserve Fund: the fund so designated in Section 5-4 of the Indenture;

Reserve Requirement: a sum equal to $300,000*;

Reset Rate: the rate or rates of interest reset for the Bonds from and after each Fixed Purchase Date until the earlier of the final maturity date or the next succeeding Fixed Purchase Date, if any, as provided in Section 2-13 of the Indenture;

* Preliminary; subject to change.

Servicing Agreement: the Servicing Agreement, dated as of August 1, 1988, between the Trustee and the Mortgage Servicer;

Transferred Proceeds: (a) proceeds of the 1985 Bonds in an amount equal to the principal amount of the Bonds and (b) earnings on the entire original principal amount of the 1985 Bonds, which are transferred by the Trustee to the Construction Fund, Reserve Fund or Mortgage Reserve Fund upon refunding and redemption of the 1985 Bonds, and all earnings derived from the investment thereof;

Trustee: First Trust National Association, in Saint Paul, Minnesota, and any co-trustee or successor trustee appointed, qualified and then acting as such under the provisions of the Indenture;

Underwriter: Piper, Jaffray & Hopwood Incorporated.

APPENDIX B

FHA MORTGAGE INSURANCE

The Federal Housing Administration was created in 1934 pursuant to the National Housing Act of 1934 to provide a system of mutual mortgage insurance, to exert a stabilizing influence on the mortgage market and to encourage improvement in housing standards. FHA has operated as an organizational unit within the Department of Housing and Urban Development of the United States since 1965. The following is a general description of the FHA mortgage insurance program administered under Section 221(d)(4) of the National Housing Act of 1934, as amended (the "National Housing Act"), and the regulations promulgated thereunder (the "FHA Regulations"). This description is qualified in its entirety by reference to the National Housing Act and the FHA Regulations, and should not be construed as a full statement thereof.

General

To be eligible for insurance under Section 221(d)(4), a mortgage must (1) have been made by an FHA-approved mortgagee; (2) be secured by property which conforms to certain FHA-specified location criteria, has located thereon a dwelling conforming to certain other FHA-specified criteria, and meets the requirements of all applicable state and local laws, ordinances and regulations; (3) involve a principal obligation not to exceed certain specific amounts per dwelling unit; and (4) contain other terms and conditions as are prescribed by FHA.

Insurance benefits are payable in cash, unless the mortgagee files a written request with FHA to receive such benefit payments in FHA debentures, upon the fulfillment of certain procedural requirements. The payment of insurance benefits will generally be in an amount equal to the unpaid principal balance of the loan plus accrued interest, subject to the exceptions and deductions specified below.

Mortgage Insurance Processing

Under FHA's mortgage insurance program, the development sponsor submits an application to FHA for the issuance of a site appraisal and market analysis letter with respect to the project (the "SAMA letter"). The issuance of a SAMA letter by FHA usually indicates a determination of initial acceptability of the development site and recognition of a specific market need for the development. Upon receipt of the SAMA letter, the development sponsor and the mortgagee submit

an application for the issuance of a conditional commitment for mortgage insurance along with preliminary working drawings for the project, although FHA will, under certain circumstances, permit the sponsor and mortgagee to submit an application for a firm commitment for mortgage insurance in lieu of an application for a conditional commitment. The issuance by FHA of the conditional commitment for mortgage insurance usually indicates HUD's conditional approval of, among other things, the estimated cost of the development, the "as is" value of the development site, estimates of operating expenses and taxes, financial and credit capacity information concerning the development sponsor or the development owner, and the proposed amount of the mortgage.

Upon receipt of the conditional commitment for mortgage insurance, the mortgagee submits a application for the issuance of a firm commitment for mortgage insurance, which application includes, among other things, final working drawings and specifications, the contractor's trade payment breakdown which consists of a schedule of costs of material and labor, a management agreement and a property survey. The firm commitment for mortgage insurance evidences FHA's approval of the mortgagee's application for insurance, and establishes the terms and conditions upon which the mortgage will be insured. Under the FHA mortgage insurance program, the firm commitment for mortgage insurance may provide for insurance of advances (as in the case of the Mortgage Loan) or insurance upon completion of construction of a development.

The firm commitment requires the owner to pay, during the construction period, an annual insurance premium equal to 1/2 of 1% of the full anticipated principal amount of the loan. Following the construction period, the firm commitment requires the owner to pay an insurance premium to FHA in an amount equal to 1/2 of 1% of the outstanding principal balance of the mortgage loan, which fee is collected by the mortgagee on a monthly basis for payment to FHA annually. FHA will impose a late charge on the mortgagee in the event it fails to pay the FHA insurance premium in a timely manner, which charge may not be imposed on the owner.

Initial Closing and Construction

Mortgage. After receipt of the firm commitment for mortgage insurance, the owner of the development proceeds to an initial closing of the loan. At the initial closing, the owner executes an FHA form of mortgage note evidencing the loan, an FHA form of mortgage securing the mortgage note and other documents and certifications required by FHA. At the initial closing, FHA initially endorses the mortgage note for

insurance, and moneys are advanced by the mortgagee to provide for the initial costs of the development, including a portion of land acquisition and financing fees.

The standard form FHA mortgage note is a nonrecourse obligation since the maker is not personally liable for the payment of the principal thereof and interest thereon. The face amount of the mortgage note is approved by FHA and is endorsed for insurance by FHA at the initial closing of the mortgage loan. The amount of the mortgage insurance is increased from time to time during the construction period as FHA-approved advances are made by the mortgagee to the mortgagor. The mortgage note has a stated maturity date after commencement of amortization, which is scheduled to occur on a date determined by FHA and set out in the firm commitment.

To secure the payment of the debt evidenced by the mortgage note, the owner of the development grants, for the benefit of the payee under the mortgage note, a lien on or a security interest in the development site together with all buildings, improvements and fixtures to be constructed on the site and all articles of personal property of the owner located on the site (collectively, the "mortgaged property"), and, in addition, pledges to the mortgagee all rents, profits and income to be derived from the mortgaged property. Until final payment of the indebtedness, the owner agrees not to sell, encumber or alienate the mortgaged property in any way without the consent of the secured party and FHA.

Payments of interest only on the outstanding principal amount of the mortgage loan are made monthly commencing on the first day of the month immediately following the month in which initial endorsement occurs, and on the first day of each month prior to the month in which commencement of amortization is scheduled to occur (as set out in the FHA firm commitment), or such extension of the date for commencement of amortization as may be agreed upon by FHA, the owner and the mortgagee. Thereafter, monthly payments of principal and interest are made until maturity.

Building Loan Agreement. Construction of the project is required to proceed in accordance with the FHA form building loan agreement executed by the owner and the mortgagee. During construction of the project, an architect and FHA inspector make inspections to insure on-site conformity with approved plans and specifications. Construction progress is monitored and requests for further advances are submitted to FHA for approval. From each approved advance an amount is withheld until final completion and final inspection by FHA, provided that under certain conditions FHA may permit a reduction in such retainage.

The standard form FHA building loan agreement requires, among other things, that the development be completed in accordance with plans and specifications approved by FHA; that any changes in the plans and specifications may be effected only with the prior written approval of the mortgagee and FHA, and under such conditions as either the mortgagee or FHA may establish; that advances for construction are to be made only for work completed and accepted by FHA, together with the value of materials and equipment not incorporated in the work but delivered to and suitably stored at the development site; and that all advances will be subject to prior approval of the mortgagee and FHA.

Assurance of Completion. Pursuant to FHA regulations, the mortgagee must require the owner and general contractor for the project to execute a standard form FHA construction contract. Under the contract, the general contractor agrees to complete the construction of the development in accordance with the plans and specifications approved by FHA. To assure completion of construction, the general contractor is required to provide either payment and performance bonds in amounts approved by FHA and the mortgagee or to enter into a completion assurance agreement with the mortgagee secured, as required by FHA, by a deposit of cash or an unconditional, irrevocable letter of credit in favor of the mortgagee.

Final Closing and Final Endorsement

As dwelling units are completed with respect to the development, the owner begins marketing and rent-up of those dwelling units. When a development is completed a cut-off date is established for cost certification of the development. Final closing consists of a review and approval by FHA of the total cost of the development, certified by an independent certified public accountant, and of operating income and expenses through the cut-off date. FHA reviews the final closing documents and the mortgage note is finally endorsed for insurance before the final construction disbursement is made. The development owner is required to make monthly payments for reserves and escrows under the FHA forms of regulatory agreement and mortgage.

Collection of Insurance Benefits

Failure to make any payment due under the mortgage, and failure to perform any other covenant under the mortgage where the mortgagee accelerates the indebtedness, constitute defaults under the FHA insurance program. Before any default matures into an event upon which a claim for insurance benefits may be filed, the mortgagee must allow the mortgagor a 30-day

"grace period" within which to correct such default. If the default continues at the end of the grace period, the mortgagee becomes entitled to receive insurance benefits from FHA (the "entitlement date"), provided that the procedural steps outlined below are carried out.

Within 30 days after the entitlement date, the mortgagee must notify HUD in writing of the default and within 45 days of the entitlement date (the "election date"), the mortgagee must file a written notice with FHA of (1) its intention to file a claim for insurance benefits; and (2) its election to either (a) assign certain specified documents to FHA, or (b) acquire title to and convey the project to FHA. The Trustee has covenanted in the Indenture that, in the event of the occurrence of default with respect to the development which is not cured within the grace period, the assignment option will be elected. Mortgage insurance benefits are subject to a 1% reduction upon assignment rather than foreclosure of the mortgage. If the mortgagee elects the assignment option, upon receipt of documentation from HUD it must file an application for insurance benefits, complete the HUD documentation, and, upon approval from HUD, assign to FHA the credit and security instruments (the "assignment date"). In addition, the mortgagee must (1) notify FHA of the assignment and recordation of mortgage; (2) warrant as to the real property that (a) no act or omission of the mortgagee has impaired the validity or priority of the mortgage, (b) the mortgage is prior to all mechanics' liens filed of record subsequent to the recording of the mortgage, regardless of whether such liens attached prior to the recording date, (c) the mortgage is prior to all liens and encumbrances which may have attached, or defects which may have arisen, subsequent to recording, except for liens and other matters approved by FHA, (d) the amount stated in the instrument of assignment is actually due under the mortgage, and that there are no offsets or counterclaims against such, and (e) it has good right to assign the mortgage; and (3) warrant as to the personal property that (a) no act or omission of the mortgagee has impaired the validity or priority of the lien created by the security instruments, (b) the mortgagee has good right to assign the security instruments, and (c) the security instruments are a first lien on the items covered, except for liens and other matters approved by FHA.

Within 45 days of the assignment date (the "delivery date"), the mortgagee must deliver to FHA (a) an assignment of claims of the mortgagee against the mortgagor or others arising out of the mortgage transaction; (2) all policies of title or other insurance, or surety bonds or other guaranties, including evidence satisfactory to FHA that the effective date of the

original title insurance coverage has been extended to include the assignment of the mortgage to FHA; (3) all records, ledger cards, documents, books, papers and accounts relating to the mortgage transaction; (4) all property of the mortgagor held by the mortgagee or to which it is entitled (other than those cash items which are permitted to be retained by the mortgagee); and (5) any additional information or data which FHA may require. At the option of FHA, the mortgagee may also be required to deliver (1) any balance of the mortgage loan not advanced to the mortgagor; (2) any cash held by the mortgagee or its agents, or to which it is entitled, including deposits made to the account of the mortgagor, and which have not been applied to reduce the principal amount of the mortgage indebtedness; (3) all funds held by the mortgagee for the account of the mortgagor pursuant to any other agreement; and (4) the amount of any undrawn balance under a letter of credit used in lieu of a cash deposit.

If the mortgagee fails to make a timely election, or fails to deliver the assigned documents in a timely manner, FHA will not pay interest from the date such election or assignment should have been made to the date of insurance settlement, unless FHA has agreed to extend such period with interest.

The mortgagee is required to furnish FHA with a title policy which names FHA as the insured party and which assures FHA that the mortgage loan to be assigned constitutes a first lien on the mortgaged premises, subject only to such exceptions as shall have been previously approved by FHA. The mortgagee will be required to remove any intervening liens and to obtain an updated endorsement within the 45 day period during which documents are required to be submitted. FHA will deduct the amount of any liens which have priority over the mortgage lien from the mortgagee's FHA insurance claims.

Tax liens against the property which have priority over the lien of the mortgage must be paid by the mortgagee. Although the mortgagee will be reimbursed for funds it advances to pay real estate taxes on the mortgaged property, failure to pay taxes when due may result in a penalty which will not be reimbursed by FHA in connection with the insurance claim.

The mortgagee is required to inspect the mortgaged property at least annually and to advise FHA of its recommendations for actions necessary to protect or maintain the property and to maintain adequate hazard insurance coverage. Failure to maintain adequate coverage is grounds for termination of the FHA insurance contract, unless FHA has been timely notified of the unavailability of coverage. Losses

occurring as a result of a failure to properly insure the mortgaged property will be deducted from the mortgage insurance claim.

In certain circumstances the mortgagee is permitted to transfer some or all of its interests in the mortgage. The transfer, pledge or assignment of a mortgage in a manner which is not in compliance with FHA requirements is grounds for termination of the FHA insurance. Prior to final endorsement by FHA, the mortgage note may be assigned only to another FHA-approved mortgagee with the approval of FHA. Subsequent to final endorsement, the mortgage loan may be assigned to another FHA-approved mortgagee after notice to FHA on a prescribed form.

Although the mortgagee will be reimbursed for advances properly made for taxes, insurance premiums and preservation of the property, such reimbursement may not fully compensate the mortgagee for the making of such advances since the mortgagee will be paid only debenture interest on such advances from the date of default. FHA will reimburse the mortgagee for funds advanced to maintain or preserve the mortgaged property if the approval of FHA is received prior to the time such funds are advanced.

FHA is required to pay insurance benefits in cash, unless debentures are requested. The Trustee has covenanted in the Indenture that, in the event of the payment of FHA mortgage insurance benefits with respect to the development, cash payment of insurance benefits will be requested. FHA must pay interest to the mortgagee on cash benefits from the entitlement date to the date of the insurance settlement at the FHA "debenture rate" in effect on the date of the firm commitment for mortgage insurance or the date of initial endorsement, whichever is higher, except that if the mortgagee has failed to timely give the required notice to FHA, only interest from the date that such notice is actually given until the date of the insurance settlement will be paid.

In the case of a monetary default, the date of default is deemed to be the expiration of the 30-day grace period, after the date on which payment originally should have been received. Since interest is paid one month in arrears in FHA mortgage transactions, FHA will not, in the event of a claim for insurance benefits, reimburse for interest which accrued during the 30-day grace period. FHA will reimburse, in such event, only for interest at the debenture rate commencing on the date of default.

FHA is required to pay benefits in an amount equal to (1) the sum of (a) the unpaid principal amount of the mortgage on the date of default, (b) the amount of all payments made by

the Mortgagee for taxes, special assessments and water rates constituting liens prior to the mortgage, insurance on the project, and mortgage insurance premiums after default, (c) an allowance for reasonable payments made by the mortgagee, with FHA approval, for the completion and preservation of the project, and (d) provided the mortgagee has given timely notice to FHA, an amount equal to the debenture interest which would have been earned on cash benefits had they been paid on default; less (2) the sum of (a) any amount received by the mortgagee on account of the mortgage after the date of default, (b) any net income received by the mortgagee from the project, (c) the sum of certain cash items retained by the mortgagee, and (d) an amount equal to 1% of the mortgage funds advanced to the mortgagor and not repaid as of the date of default.

FHA is not required by law or contract to pay insurance claims within any specified time period, but typically pays a portion of an insurance claim prior to the delivery of required documents, including the mortgage note and the mortgage. If the claim is made in connection with a mortgage loan which has not yet been finally endorsed, FHA will usually, but is not obligated to, pay 70% of the outstanding principal balance of the loan promptly after the filing of an assignment of the mortgage loan to FHA, provided the pertinent data is submitted to FHA in a timely manner. In the case of the mortgage loan which has been finally endorsed, FHA will usually, but is not obligated to, pay 90% of the outstanding principal balance promptly after the filing of an assignment of the mortgage loan to FHA, provided the pertinent data is submitted to FHA in a timely manner. Any remaining balances are paid to the mortgagee after FHA has received final financial data, legal clearance has been obtained and all necessary documents have been delivered to FHA in acceptable form.

The mortgagee is responsible for all deposits made for the account of the owner of the development under its control and FHA will deduct from any insurance claim all such amounts. Where deposits made for the account of the owner of the development are held in the form of a letter of credit, the insured party under certain circumstances must convert the letter of credit to cash as needed. FHA, which does not review or approve letters of credit, generally views a letter of credit as its cash equivalent. Therefore, FHA mortgage insurance benefits may be reduced by the amount of any letter of credit deposited for the account of the owner of the development and held by or for the benefit of the mortgagee, even if the mortgagee fails or is unable to convert such letter of credit prior to its expiration. The mortgagee is required, in certain cases, to receive the approval of FHA prior to the release of deposits under its control. Failure to properly

protect deposits may result in a deduction from the insurance claim in an amount equal to any deposits FHA asserts have been improperly maintained. Since the Letters of Credit to be deposited in the Mortgage Reserve Fund are required to be issued for the account of a party other than the owner of the Project, there should not be any basis for FHA to reduce FHA mortgage insurance benefits by the amount of such Letters of Credit.

No. _____

PRELIMINARY CONFIDENTIAL OFFERING MEMORANDUM

Dated June 19, 1987

$29,807,400*
FEDERALLY INSURED REAL ESTATE SECURITIES TRUST
Mortgage Passthrough Certificates
Series 1987-2

Price ____ %

Passthrough Rate ____ %
Bond Equivalent Yield ____ %

Interest will be passed through monthly, on the twentieth day of each month (each, a "Distribution Date") commencing on the twentieth of the month following the closing of this offering. Each interest payment will include interest accrued through the last day of the month preceding the month in which the related Distribution Date occurs. Principal payments will be passed through as described herein.

Each Certificate offered hereby evidences a fractional undivided interest in a trust (the "Trust Fund") to be created by Piper Mortgage Incorporated ("PMI"). The trust property of the Trust Fund will consist of: (i) obligations of the Government National Mortgage Association ("GNMA") which are issued in connection with one or more loans coinsured by the FHA and Puller Mortgage Associates, Inc. (the "Servicer"), and (ii) Permitted Investments.

The Certificates are subject to redemption during a one year period prior to the expiration of five years from the date of initial delivery of the Certificates to the order of PMI. The Certificate Redemption will be made solely with funds realized from the remarketing of the GNMA Securities in the Trust Fund on or prior to the Certificate Redemption Date. See "THE CERTIFICATES — Certificate Redemption and Remarketing" herein. Principal of the Certificates may be repaid prior to the Certificate Redemption Date in the event GNMA Securities or certain other documents are not timely delivered to the Trustee, in the event a GNMA Security is prepaid and under certain other circumstances. See "PREPAYMENT CONSIDERATIONS" herein. See "THE CERTIFICATES — Realization Upon Default" and "RISKS — Risks Related to Investments" herein.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS MEMORANDUM. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

THIS OFFERING INVOLVES CERTAIN RISKS INCLUDING MATERIAL INCOME TAX RISKS AND OTHER RISKS RELATED TO THE INVESTMENTS (see "RISKS").

NEITHER THE ATTORNEY GENERAL OF THE STATE OF NEW YORK NOR THE SECURITIES LAW COMMISSIONER OF ANY OTHER JURISDICTION HAS PASSED ON OR ENDORSED THE MERITS OF THIS OFFERING. ANY REPRESENTATION TO THE CONTRARY IS UNLAWFUL.

The Series 1987-2 Certificates are being offered by Piper, Jaffray & Hopwood Incorporated (the "Selling Agent") an affiliate of PMI, at the price specified above. See "Plan of Distribution" herein.

A public market for the Certificates does not exist and is not likely to develop. The Certificates have not been registered under the Securities Act of 1933 or any state securities laws and may not be assigned, sold or transferred unless, among other things, the Certificateholder delivers an opinion of counsel satisfactory to the Trustee that such assignment, sale or transfer is registered under or exempt from the registration requirements of the Securities Act of 1933 and any applicable State securities laws. See "THE CERTIFICATES — Transfer of Certificates."

Piper, Jaffray & Hopwood
Incorporated

*Estimated

This Preliminary Confidential Offering Memorandum and the information contained herein are subject to completion or amendment. These securities may not be sold nor may offers to buy be accepted prior to the time the Confidential Offering Memorandum is delivered in final form. Under no circumstances shall this Preliminary Confidential Offering Memorandum constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

No person has been authorized to give any information or to make any representation other than those contained in this Confidential Offering Memorandum and, if given or made, such information or representations must not be relied upon. This Confidential Offering Memorandum does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the Certificates offered hereby and thereby nor an offer of the Certificates to any person in any state or other jurisdiction in which such offer would be unlawful. The delivery of this Confidential Offering Memorandum at any time does not imply that information herein is correct as of any time subsequent to its date; however, if any material change occurs while this Confidential Offering Memorandum is required by law to be delivered, this Confidential Offering Memorandum will be amended or supplemented accordingly.

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SUMMARY

The following summary is qualified in its entirety by reference to the detailed information appearing elsewhere in this Confidential Offering Memorandum. Certain capitalized terms used herein shall have the meanings given elsewhere in this Confidential Offering Memorandum or in the Pooling and Servicing Agreement referred to herein.

Title of Security ..... Mortgage Passthrough Certificates, Series 1987-2

Amount..... $29,807,400

Settlement Date ..... On or about , 1987.

Issuer ..... Piper Mortgage Incorporated ("PMI"), a wholly-owned subsidiary of Piper Jaffray Incorporated. The principal executive offices of PMI are located at Piper Jaffray Tower, P.O. Box 28, 222 South Ninth Street, Minneapolis, Minnesota 55440. PMI's telephone number is (612) 342-6000.

The Servicer ..... Puller Mortgage Associates, Inc. will be the servicer of the Insured Mortgage Loans. The Servicer is an FHA approved mortgagee, an approved seller/servicer of GNMA guaranteed securities, and an FHA approved coinsurance lender. The principal offices of the Servicer are located at 3939 Vincennes Road, Indianapolis, Indiana.

Description of Security .. Each Certificate represents a fractional undivided interest in the Trust Fund for this Series to be created by PMI. The trust property of the Trust Fund will consist of: (i) obligations of GNMA which are issued in connection with one or more loans coinsured by the Servicer and FHA, and (ii) Permitted Investments. Each Single Certificate will initially represent an investment of approximately $1,000. The Certificates will be offered in fully registered form only and will be subject to restrictions on transfer.

The Insured Mortgage Loans ..... The Trust Fund will include one or more of the Insured Mortgage Loans described below.

Project	Expected Principal Amount	FHA Insurance Program
Bonaventure.....	$22,335,300	221(d)(4) Coinsurance-backed GNMA Securities
The Greenhouse	$ 7,472,100	221(d)(4) Coinsurance-backed GNMA Securities

Principal and Interest ... Payments of principal and interest received with respect to each Insured Mortgage Loan, less certain expenses, will be passed through on the twentieth day of each month (the "Distribution Date") commencing on the twentieth of the month next succeeding the month in which the first Purchase Date occurs. Each interest payment will include interest accrued through the last day of the month preceding the month in which the related Distribution Date occurs. Principal will be passed through commencing in accordance with the schedule below and will be in an amount which approximates a 40 year amortization schedule commencing on such date.

Name of Project	Expected Principal Commencement Date
Bonaventure	, 1989
The Greenhouse.....	, 1988

See attached Exhibit B. See also, "THE CERTIFICATES — Distributions with Respect to the Certificates."

Trustee	First Trust Company Inc., a Minnesota corporation with offices in St. Paul, Minnesota will act as Trustee. See "THE CERTIFICATES — The Trustee."
Market and Transferability	The Certificates have not been registered under the Securities Act of 1933, as amended, and are subject to substantial restrictions on transfer. "THE CERTIFICATES — Restrictions on Transfer". There is no secondary market for the Certificates and one is not likely to develop.
Certificate Redemption	Piper Mortgage Incorporated has agreed to use to its best efforts to arrange for the sale of the GNMA Securities by the Trustee to a third party during a one year period prior to the expiration of five years from the initial delivery of the Certificates to the order of PMI (the "Certificate Redemption Date") and will enter into a Remarketing Agreement with Piper, Jaffray & Hopwood Incorporated and Norwest Investment Services, Inc. as remarketing agents. The Remarketing Agents will agree to assist PMI in arranging for such sale or transfer. The proceeds realized from such sale or transfer will be distributed to Certificateholders on the next succeeding Distribution Date. PMI will not arrange for a sale or transfer of a GNMA Security unless amounts realized from such sale or transfer equal at least 100% of the then outstanding principal amount of such GNMA Security. PMI has no obligation to provide, from its own funds or otherwise, any amounts for such redemption other than through the remarketing of the GNMA Securities in the Trust Fund. In the event PMI or its affiliates are unable to arrange for the remarketing of a GNMA Security at a price which equals at least 100% of the then outstanding principal amount of such GNMA Security, the Certificates held by the Certificateholders will not be redeemed by the Certificate Redemption Date. Such GNMA Security will then continue to be held by the Trustee until such time as such GNMA Security may be remarketed at a price which equals 100% of the then outstanding principal amount thereof. See "THE CERTIFICATES — Certificate Redemption and Remarketing" and "RISKS — Risks Related to Investments — Delays in Liquidating The GNMA Securities." In the event the Certificates are not redeemed on or prior to the Certificate Redemption Date the Passthrough Rate will increase to equal the weighted average interest rate on the GNMA Securities held in the Trust Fund at that time, less the trustee fees. The Trust Fund will terminate and be liquidated upon the maturity or other liquidation of the last remaining GNMA Securities, the disposition of all property acquired upon foreclosure of the last remaining Insured Mortgage Loan or upon other circumstances.
GNMA Securities Interest Rate	The interest rate on the GNMA Security issued with respect to the Bonaventure Project will be 9.75%. The interest rate on the GNMA Security issued with respect to the Greenhouse Project will be 9.75% during the construction period and 9% following Final Endorsement.
Compensation and Fees to PMI	PMI will receive a Financing and Placement Fee of 1% of the principal amount of the Insured Mortgage Loans and a non-accountable expense reimbursement of $60,000. PMI and the Servicer will also share Administrative Fees in an amount equal to the interest payable on the GNMA Securities in the Trust Fund the interest due on the Certificates at the Passthrough Rate. The Selling Agent will receive a Selling Commission of 1% of the stated principal amount of the Certificates.

See "THE CERTIFICATES — Compensation and Fees to PMI and Affiliates."

Certain Federal Income Tax Consequences ..... In the opinion of Counsel, the Trust Fund will be classified as a grantor trust for Federal income tax purposes and not as an association which is taxable as a corporation. The Holder of Certificates of any Series will be treated for such purposes as the owner of an undivided interest in the Investments held in the Trust Fund. Accordingly, such Holder must report on his Federal income tax return his share of the income from such Investments and may deduct his share of the expenses of such Trust Fund, determined in accordance with such Holder's tax accounting method.

The Certificates may be issued with original issue discount, in which case interest income may be includable in a Certificateholder's income prior to receipt of the corresponding cash payment. See "CERTAIN FEDERAL INCOME TAX CONSEQUENCES."

Definitions of Terms .... See "GLOSSARY".

The foregoing summary is qualified in its entirety by reference to the more complete explanations in this Confidential Offering Memorandum.

THE GNMA MORTGAGE-BACKED SECURITIES PROGRAM

The Government National Mortgage Association ("GNMA") is a wholly-owned corporate instrumentality of the United States within the Department of Housing and Urban Development ("HUD") with its principal office in Washington, D.C.

The GNMA Securities will be "fully modified pass-through" mortgage-backed securities issued and serviced by the Servicer. The Servicer will be required to pass through to the Trustee, as the holder of the GNMA Securities, by the fifteenth day of each month the monthly scheduled installments of principal and interest on the Mortgage Notes backing such Certificates (less the GNMA guarantee fee and the Servicer's servicing fee), whether or not the Servicer receives such payment from the Mortgagor, plus any unscheduled prepayments of principal of the Mortgage Notes backing such Certificates received by the Servicer. GNMA guarantees the timely payment of the principal of and interest on the GNMA Securities.

During the construction period for each of the Mortgaged Properties, GNMA is expected to authorize the Servicer to issue GNMA Construction Loan Certificates monthly as advances under the FHA Coinsured Loan are approved by the Servicer and coinsured by the Servicer and FHA pursuant to the Guaranty Agreement to be entered into between the Servicer and GNMA. The Servicer is expected to issue a GNMA Project Loan Certificate with respect to each FHA Coinsured Loan upon the maturity or earlier redemption of the GNMA Construction Loan Certificates, which generally occurs with two months of construction completion. It is anticipated that the Trustee will acquire the first GNMA Securities from the Servicer approximately 75 days following Initial Endorsement, as such acquisition date may be extended pursuant to the terms of the Pooling and Servicing Agreement. The purchase of the GNMA Securities is subject to the following conditions, among others: (i) the closing of the respective FHA Coinsured Loan, (ii) endorsement of the Mortgage Note for coinsurance by HUD, upon the submission to HUD by the Servicer of certain documents required by HUD, (iii) the submission by the Servicer to GNMA of certain documents required by GNMA in form and substance satisfactory to GNMA, (iv) the Servicer's continued compliance, on the date of issuance of the GNMA Securities, with all of GNMA's eligibility requirements, specifically including, but not limited to, certain net worth requirements, (v) the absence of the Servicer's bankruptcy, insolvency or reorganization. In addition, the issuance of the GNMA Securities by the Servicer is subject to the condition that GNMA must have entered into a Guaranty Agreement with the Servicer. The conditions to GNMA entering into such an agreement may change from time to time and there can be no assurance that the Servicer will be able to satisfy all such requirements in effect at the time the GNMA Securities are to be issued.

GNMA Guaranty

GNMA is authorized by Section 306(g) of Title III of the National Housing Act, as amended (the "Act"), to guarantee the timely payment of the principal of, and interest on, securities which are based on and backed by mortgage pools consisting of a single mortgage coinsured by the Federal Housing Administration ("FHA") and the Servicer under Section 207 of the Act, pursuant to Sections 223(f), 221(d)(4) and 244 of the Act. Section 306(g) of the Act further provides that "[T]he full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guaranty under this subsection." An opinion, dated December 12, 1969, of the then Assistant Attorney General of the United States, states that such guaranties under Section 306(g) of mortgaged-backed securities of the type being delivered to the Trustee on behalf of the Authority are authorized to be made by GNMA and "would constitute general obligations of the United States backed by its full faith and credit."

Pursuant to such authority, GNMA, upon delivery of the GNMA Securities (with the executed GNMA Guaranty Agreement attached thereto) to the Servicer, will have guaranteed the timely payment of the principal of and interest on the GNMA Securities.

It is expected that interest and principal payments on the Mortgage Note backing a GNMA Security will be the source of moneys for payments on the GNMA Securities. If such payments are less than what is due, the Servicer is obligated to advance its own funds to ensure timely payment of

scheduled installments of principal and interest due on the GNMA Securities. GNMA guarantees such timely payment in the event of the failure of the Servicer to pass through such scheduled principal and interest payments when due.

The Servicer is required to advise GNMA in advance of any impending default on scheduled payments so that GNMA as guarantor will be able to continue such payments as scheduled on the fifteenth day of each month. If, however, such payments are not received as scheduled, the Trustee has recourse directly to GNMA.

The GNMA Guaranty Agreement to be entered into by GNMA and the Servicer upon issuance of a GNMA Security (the "GNMA Guaranty Agreement") will provide that, in the event of a default by the Servicer, including (i) a request to GNMA to make a payment of principal or interest on the GNMA Securities when the Mortgagor is not in default under the Mortgage Note backing a GNMA Security, (ii) insolvency of the Servicer, or (iii) default by the Servicer under any other guaranty agreement with GNMA, GNMA shall have the right, by letter to the Servicer, to effect and complete the extinguishment of the Servicer's interest in the Mortgage Note backing a GNMA Security, and the Mortgage Note backing a GNMA Security shall thereupon become the absolute property of GNMA, subject only to the unsatisfied rights of the holders of the GNMA Securities. In such event, the GNMA Guaranty Agreement will provide that on and after the time GNMA directs such a letter of extinguishment to the Servicer, GNMA shall be the successor in all respects to the Servicer in its capacity under the GNMA Guaranty Agreement and the transaction and arrangements set forth or arranged for therein, and shall be subject to all responsibilities, duties, and liabilities (except the Servicer's indemnification of GNMA), theretofore placed on the Servicer by the terms and provisions of the GNMA Guaranty Agreement, provided that at any time, GNMA may enter into an agreement with any other eligible issuer of GNMA securities under which the latter undertakes and agrees to assume any part or all such responsibilities, duties or liabilities theretofore placed on the Servicer, and provided that, no such agreement shall detract from or diminish the responsibilities, duties or liabilities of GNMA in its capacity as guarantor of the GNMA Securities, or otherwise adversely affect the rights of the holders thereof.

Payment of Principal and Interest on the GNMA Securities

Payment of interest on the GNMA Securities is required to be made in monthly installments on or before the fifteenth day of each month commencing the month next following the date of issue of the GNMA Securities. Payment of principal on the GNMA Securities is expected to commence 15 days after the commencement of amortization of principal of the Mortgage Note backing a GNMA Security.

Upon the issuance of the GNMA Securities and commencement of the payment of principal thereon, the GNMA Securities will be subject to prepayment due to prepayment of the Mortgage Note backing a GNMA Security. Each Installment on the GNMA Securities is applied first to interest and then in reduction of the principal balance then outstanding on the GNMA Securities. The amount of principal due on the GNMA Securities is the scheduled principal amortization currently due on the Mortgage Note backing such GNMA Security. The maturity date of the GNMA Securities will be approximately 39 years, 11.5 months after commencement of amortization on the related Mortgage Notes.

The monthly installments are not subject to adjustment by reason of any prepayments or other early or unscheduled recoveries of principal balance then outstanding. The Servicer is required to pay to the Trustee, as holder of the GNMA Securities, monthly installments of not less than the interest due on the GNMA Securities at the rate specified in the GNMA Securities, together with any scheduled installments of principal, whether or not collected from the Mortgagor, and any prepayments or early recoveries of principal. Final payment shall be made upon surrender of the outstanding certificate.

Liability of The Servicer

The GNMA Securities will not constitute a liability of nor evidence any recourse against the Servicer. The GNMA Securities are based on and issued in connection with the coinsured Mortgage

on the real property securing the related Mortgage Note. Recourse may be had to GNMA in the event of any failure of timely payment as provided for in the GNMA Guaranty Agreement appended to the GNMA Securities.

THE MORTGAGED PROPERTIES

The Bonaventure Project

Location and Description of the Mortgaged Property. The Bonaventure Project, to be named "Bonaventure" is a 284 unit retirement living center which is to be located in the Bonaventure master planned community in Fort Lauderdale, Florida. The Bonaventure master planned community, when completed, will contain approximately 5,000 residential units in addition to a 612 room hotel, two 18 hole championship golf courses, 23 tennis courts, indoor and outdoor swimming pools, and several restaurants. The Bonaventure Project will be marketed to the upper end of the retirement market. The facility will include an exercise room, steambath, locker facilities, sauna, an indoor theatre with a seating capacity of 222 persons and various crafts and hobby rooms. The Bonaventure Project will consist of one building plus a clubhouse, and will contain 82 one bedroom, one bath dwelling units and 202 two bedroom, two bath dwelling units.

The Mortgagor and the Contractor. Bonaventure Retirement Associates, a Florida general partnership, was formed in 1986 for the sole purpose of developing and owning the Project. The general partners are Thomas K. Ireland and Herbert Sadkin.

Mr. Sadkin and Mr. Ireland are the principal developers of the Bonaventure complex. The contractor for the Project will be Bonaventure Retirement Associates, the Mortgagor.

The Leasing and Management Agent. Bonaventure Retirement Associates expects to enter into a Management and Leasing Agreement with Basic American Medical, Inc. (the "Manager"). The Manager currently manages approximately 1400 retirement service center units and 475 apartment units, all of which are in HUD Insured projects.

The Greenhouse Project

Location and Description of the Mortgaged Property. The Greenhouse Project, to be named "The Greenhouse", will consist of the renovation of an 81 year old, eight story building into 135 residential loft dwelling units and 10,668 square feet of rentable commercial space located in Omaha, Nebraska. Off-site improvements will be completed by the City of Omaha under a Redevelopment Agreement with the general partner of the Mortgagor, including an extension of the Central Park Mall (a linear urban park) adjacent to the subject property and an attached three level parking garage. The residential dwelling units in the Mortgaged Property will consists of seven two bedroom, two bath dwelling units containing a solarium, eight one bedroom, two bath loft units, 32 two bedroom, two bath dwelling units and 88 one bedroom, one bath dwelling units.

The Greenhouse Project is located near the Central Park Mall in a section of town referred to as the Old Market Area. This area contains many renovated buildings consisting of numerous specialty shops, restaurants and night clubs. 145 parking spaces are to be leased from the City pursuant to the terms of a 99 year lease in a three story parking garage to be constructed to the east of the Project and connected to The Greenhouse.

The Mortgagor and the Contractor. Farnam Associates Limited Partnership, a Delaware limited partnership was formed in 1986 for the purpose of developing and owning The Greenhouse Project. The general partner of the Mortgagor is Schneider Ten, Inc., a corporation beneficially owned by Herbert M. Schneider.

Andersen Construction Co. of Council Bluffs, Inc. will be the contractor for The Greenhouse Project. Herbert E. Andersen founded the predecessor of the contractor in 1956. The contractor has been active in commercial and multifamily development since that time.

The Leasing and Management Agent. The Mortgagor expects to enter into a Management and Leasing Agreement with Schneider Development, Inc., a corporation beneficially owned by Herbert M.

Schneider (the "Manager"). The Manager is an affiliate of the Mortgagor and is based in Ann Arbor, Michigan. The Manager currently manages a total of 135 apartment units, in two locations in Baltimore, Maryland and Muskegon, Michigan, none of which are in HUD Insured Projects.

SOURCE AND USE OF FUNDS*

The net proceeds from the sale of the Certificates will be deposited in the Project Loan Account under the Pooling and Servicing Agreement for purpose of financing the construction of the Mortgaged Property through advances to the Mortgagor pursuant to the Loan. The estimated source and use of funds is as follows:

The Bonaventure Project

SOURCES:	
Certificate Proceeds	$22,335,300
Additional Cash Requirements	730,719
TOTAL	$23,066,019
USES:	
Acquisition of GNMA Securities	$22,335,300
Initial Negative Arbitrage Deposit	250,413
Offering Legal Fees	33,600
Financing Fee to PMI	223,353
Selling Agent's Compensation	223,353
TOTAL	$23,066,019

The Greenhouse Project

SOURCES:	
Certificate Proceeds	$ 7,472,100
Additional Cash Requirements	224,005
TOTAL	$ 7,696,105
USES:	
Acquisition of GNMA Securities	$ 7,472,100
Initial Negative Arbitrage Deposit	63,363
Offering Legal Fees	11,200
Financing Fee to PMI	74,721
Selling Agent's Compensation	74,721
TOTAL	$ 7,696,105

*Estimated, subject to change

SUITABILITY STANDARDS

Suitability

Certificates offered hereby are suitable only for those investors (i) whose business and investment experience makes them capable of evaluating the merits and risks of their prospective investment; (ii) who can afford to bear the economic risk of their investment for an indefinite period; and (iii) who have no need for liquidity in this investment. Additionally, each Investor must qualify as one of the following financial institutions:

A bank as defined in Section 3(a)(2) of the Securities Act; an insurance company as defined in Section 2(13) of the Securities Act; an investment company registered under the Investment Company Act of 1940, as amended, or a business development company as defined in

Section 2(a)(48) of that Act; a small business investment company licensed by the U.S. Small Business Administration under Section 301(c) or (d) of the Small Business Investment Act of 1958; an employee benefit plan within the meaning of Title I of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in Section 3(21) of such act, which is either a bank insurance company, or a registered investment advisor, or if the employee benefit plan has total assets in excess of $5,000,000; or a private business development company as defined in Section 202(1)(22) of the Investment Advisers Act of 1940.

Each investor will be required to represent that it is acquiring the Certificates being purchased by it for its own account as principal for investment and not with a view to resale or distribution and that it is aware that its transfer rights are restricted.

The Certificates will not be registered under the Securities Act of 1933, as amended, in reliance on the exemption from registration provided by that Act with respect to "transactions by an issuer not involving any public offering." The Issuer may elect Regulation D under such Act, which provides that an offering made in accordance with all of its conditions is deeded exempt from such registration.

Certificates may be sold only to a limited number of Plan Investors (as defined in the "GLOSSARY"). Less than 25% of outstanding Certificates may be held by Plan Investors.

Each purchaser of the Certificates will be required to deliver to the Selling Agent an Investment Letter substantially in the form of Appendix A hereto, representing that the Certificates are being purchased for investment and not with a view to resale or distribution.

RISKS

This offering involves certain risks. Therefore, prospective investors should consider, in addition to matters set forth elsewhere in this Confidential Offering Memorandum, the following factors before making a decision to invest:

Risks Related to Investments

Possible Lack of Diversification. PMI anticipates that the Trust Fund will acquire Insured Mortgage Loans with respect to which Initial Endorsement has previously occurred or is occurring simultaneously with such acquisition. It is possible that one or more of the Insured Mortgage Loans described herein may not obtain Initial Endorsement on or prior to the date the Certificates are to be delivered to Certificateholders. In such event PMI may determine that the Trust Fund will not acquire such Insured Mortgage Loan, and the principal amount of Certificates offered hereby will be reduced accordingly. In such event, the Trust Fund will contain a fewer number of Insured Mortgage Loans with a resulting lack of diversification.

In the event an Insured Mortgage Loan is prepaid for any of the reasons described in "PREPAYMENT CONSIDERATIONS" herein or otherwise, there will be a fewer number of Insured Mortgage Loans with a resulting lack of diversification.

Delays in Liquidating GNMA Securities. PMI anticipates that the Trust Fund will not hold any GNMA Security for more than five years following initial delivery of the Certificates to PMI by the Trustee, however, the Trustee is not required to dispose of any GNMA Security by any particular time. In such event, Certificateholders will not receive a return of principal (other than scheduled amortization) until a GNMA Security is transferred to a third party. PMI has agreed to use its best efforts to arrange for the sale of the GNMA Securities by the Trustee to a third party at any time from the end of the fourth through the fifth year following the initial delivery of the Certificates to the order of PMI (the "Certificate Redemption Date") and will enter into a Remarketing Agreement with Piper, Jaffray & Hopwood Incorporated and Norwest Investment Services, Inc. as Remarketing Agents whereby the Remarketing Agents will agree to assist PMI in arranging for such sale or transfer. PMI will not arrange for a sale or transfer of GNMA Securities unless amounts realized from such sale or transfer equals at least 100% of the then outstanding principal amount of such GNMA Securities. Neither PMI nor the Remarketing Agents have any obligation to provide, from their own funds or

otherwise, any amounts for such Certificate Redemption other than through the remarketing of the GNMA Securities in the Trust Fund. In the event PMI and the Remarketing Agents are unable to arrange for the remarketing of a GNMA Security in the Trust Fund at a price which equals at least 100% of the then outstanding principal amount of such GNMA Security, such GNMA Security will not be sold or transferred by the Certificate Redemption Date and will be held by the Trustee until such time as such GNMA Security may be remarketed at a price which equals 100% of the then outstanding principal amount of such GNMA Security. Any failure to remarket would not, in itself, entitle the Certificateholders to receive payments pursuant to any Mortgage Insurance, if the GNMA Security is not otherwise in default. The Certificate Redemption requirement cannot be insured, guaranteed or secured by a security interest in the Mortgaged Property. The terms of any remarketing will be determined at the time of remarketing. There can be no assurance that PMI or the Remarketing Agents will be able to remarket the GNMA Securities. In particular, the ability to remarket the GNMA Securities at par is primarily dependent upon prevailing interest rates at that time.

Construction Loans. All construction loan advances on the Insured Mortgage Loans will, following issuance of a GNMA Construction Loan Certificate, be guaranteed by GNMA. Completion of construction is subject to various risks, including, among other things, the possibility of financial difficulties of the developer, labor strikes, unavailability of materials and adverse environmental conditions. If the construction of such Mortgaged Property is not completed, it is anticipated that the GNMA Construction Loan Certificates will be redeemed by the Servicer and/or GNMA.

Financial Aspects and Governmental Regulation of Retirement Living Centers. The Bonaventure is a retirement living center. While retirement living centers typically do not provide the level of skilled nursing care and other significant services provided by nursing homes, retirement living centers provide for substantially more services to the resident than do multifamily rental apartment projects. As a result of providing such additional services, investments in retirement living centers may be subject to different risks from those encountered by multifamily rental apartment projects. In addition, retirement living centers, in general, historically experience slower rent-up periods than conventional apartment projects.

Risks Related to Management

Absence of Management. The Trust Fund will be a fixed investment fund, and neither PMI, the Trustee, the Servicer nor the Certificateholders will have the ability to manage the assets of the Trust Fund. The Servicer, the Trustee and PMI will have no ability to take any action to protect assets of the Trust Fund unless a default by the Mortgagor occurs.

Conflicts of Interest. Certain agreements and arrangements are not the result of arm's-length negotiations. Piper, Jaffray & Hopwood Incorporated ("PJH"), an affiliate of PMI, will act as Selling Agent for PMI and will assist in the purchase of Certificates. These relationships and the payment of such amounts may create conflicts in connection with the fulfillment of due diligence obligations under federal securities laws.

Absence of Regulation. The Trust Fund is not a real estate investment trust and does not intend to operate so as to be an investment company. Thus, the Trust Fund is not supervised or regulated by any federal or state authority.

Risks Related to Ownership of Certificates.

Transferability. The Certificates have not been registered under the Securities Act of 1933, as amended, and may not be assigned, sold or transferred without the delivery of an opinion of counsel satisfactory to the Trustee that such assignment, sale or transfer is registered under or exempt from the registration requirements of the Securities Act of 1933, as amended and any applicable state securities laws. See "THE CERTIFICATES — Transferability."

ERISA Risks. Investment by Plan Investors on the Certificates is limited. Fiduciaries of Plan Investors, in consultation with their advisors, should carefully consider whether an investment in the Certificates is consistent with their fiduciary responsibilities, including the prudence and diversification and liquidity standards of ERISA, the other factors discussed in "ERISA CONSIDERATIONS."

Certain Income Tax Risks

Classification as a Grantor Trust. If the Trust Fund was classified as an association taxable as a corporation rather than as a grantor trust for federal income tax purposes, income from the Investments would be taxed at the Trust Fund level, and after-tax distributions to Certificateholders would be substantially reduced. However, PMI has received an Opinion of Counsel to the effect that the Trust Fund will be classified as a grantor trust and not as an association which is taxable as a corporation. Nevertheless, such opinion is not binding on the IRS. See "CERTAIN FEDERAL INCOME TAX CONSEQUENCES — Tax Status of the Trust Fund."

Tax-Exempt Certificateholders. Some portion of a tax-exempt Certificateholder's income may be classified as unrelated business taxable income to such Certificateholders, including qualified retirement plans and individual retirement accounts. See "CERTAIN FEDERAL INCOME TAX CONSEQUENCES — Special Classes of Investors."

Treatment of Fees. Certain fees and reimbursements to PMI that are intended to be deductible to Certificateholders may be challenged by the IRS. If a challenge by the IRS were successfully made to the treatment of a fee, the asserted deductions would be deferred, reduced or eliminated and the Certificateholders may have to pay additional tax. See "CERTAIN FEDERAL INCOME TAX CONSEQUENCES — Treatment of Certain Fees."

Limitations on Deductions. Under new provisions of the Code, certain deductions may be limited with respect to certain Certificateholders. See "CERTAIN FEDERAL INCOME TAX CONSEQUENCES — Limitations on Deductions."

PREPAYMENT CONSIDERATIONS

In the event Initial Endorsement of an Insured Mortgage Loan has not occurred by the first closing of this offering of Certificates or if a Transfer Agreement has not been entered into with respect to an Insured Mortgage Loan by such time, PMI may elect to allow a Mortgagor up to 90 days to obtain Initial Endorsement or execute a Transfer Agreement, as the case may be. The proceeds of the offering allocable to such Insured Mortgage Loan held in the related Project Loan Account will be returned to Certificateholders on the next Distribution Date following the 90 day period if either Initial Endorsement has not occurred or a Transfer Agreement has not been executed with the required time period. In such event, Certificateholders will experience an early return of principal. Initial Endorsement of the related Mortgage Note is subject to several conditions, including the submission to HUD of certain documents required by HUD in form and substance satisfactory to HUD, and certain other conditions. It is possible these conditions may not be met. The satisfactory execution of a Transfer Agreement is subject to certain conditions, including, but not limited to, HUD approval. There can be no assurance that HUD approval will be obtained. PMI will not elect to allow any additional time beyond the first closing of the offering of Certificates hereunder unless the Mortgagor or the Servicer deposits with the Trustee cash in an amount necessary to pay interest on the principal amount of offering proceeds held in the related Project Loan Account at the Passthrough Rate through the extension date less interest earnings on funds held in the related Project Loan Account for such period.

Upon closing of this offering, the proceeds therefrom to be used to purchase GNMA Securities will be deposited in the related Project Loan Account and disbursed therefrom to acquire GNMA Securities when, as and if issued. It is anticipated that the Trustee will acquire the first GNMA Securities from the Servicer approximately 75 days following Initial Endorsement of the related Insured Mortgage Loan. The acquisition of the GNMA Securities by the Trustee is subject to several conditions, including the submission to HUD by the Servicer of certain documents required by HUD, the submission by the Servicer to GNMA of certain documents required by GNMA in form and substance satisfactory to GNMA, the Servicer's continued compliance, on the date of issuance of the GNMA Securities, with all of GNMA's eligibility requirements, the requirement that a Yield Maintenance Agreement, Transfer Agreement, and related security documents have been executed and delivered, and certain other conditions. It is possible that these conditions may not be met, in which case, some or all of the GNMA Securities may not be issued by the Servicer. In the event that a

GNMA Construction Loan Certificate has not been issued by the Servicer with respect to any particular FHA Coinsured Loan prior to 120 days following Initial Endorsement, the Trustee is directed to distribute to each Certificateholder his pro rata share of amounts held in the Construction Loan Subaccount for such FHA Coinsured Loan for which a failure to deliver the GNMA Securities occurred. In addition, in the event a GNMA Security is not issued with respect to any particular FHA Coinsured Loan for three consecutive months following the initial issuance of a GNMA Security with respect to such project, the Trustee is directed to distribute to each Certificateholder his pro rata share of amounts held in the Construction Loan Subaccount with respect to such Insured Mortgage Loan. Any such distribution will constitute a return of principal to the Certificateholders prior to the Certificate Redemption Date. The above referenced 120 day period may be further extended an additional 60 days if the Servicer certifies to the Trustee that the delay is due solely to processing delays by GNMA.

PMI has the option to remarket the GNMA Securities held in the Trust Fund at any time after four years following the initial delivery of the Certificates to the order of PMI by the Trustee. In such event, Certificateholders may receive a return of principal up to one year prior to the Certificate Redemption Date.

In the event of a default by a Mortgagor on an Insured Mortgage Loan, the Servicer has the option of immediately prepaying the related GNMA Security or continuing to pay interest and principal thereon until GNMA pays the Servicer under the Mortgage Insurance.

SUMMARY OF CERTAIN DOCUMENTS

The Mortgages and Mortgage Notes

The construction and permanent loans to the Mortgagors will be made pursuant to a Building Loan Agreement, a Mortgage and a Mortgage Note. Each Mortgage Note is coinsured by FHA and the Servicer under Section 207 of the National Housing Act, as amended, pursuant to Sections 223(f) and 244 thereof and the regulations thereunder, including 24 CFR Part 255 relating to coinsurance.

Each Mortgage Note will be coinsured by FHA pursuant to and in accordance with the provisions of Sections 221(d)(4) and 244 of the National Housing Act and applicable regulations thereunder. Each Mortgage Note will be secured on a nonrecourse basis pursuant to the respective Mortgage and will not be subject to prepayment prior to July 15, 1994, except that each Mortgage Note shall be subject to mandatory prepayment in whole or in part at any time upon 15 days' prior written notice to the Servicer and the Trustee, from the proceeds of any casualty insurance or condemnation awards received following a partial or total destruction or condemnation of the Project, in the event and to the extent that such casualty proceeds or condemnation awards are not applied to the repair or restoration of the Project in accordance with the loan documents. Each Mortgage Note shall be subject to prepayment in whole but not in part, at the option of the Mortgagor, on or after July 15, 1994, but before July 15, 1995 at a price of 102% of the then outstanding principal balance thereof, on or after July 15, 1995 but before July 15, 1996 at a price of 101% of the then outstanding principal balance thereof, and on or after July 15, 1996 at a price of 100% of the then outstanding principal balance thereof.

The Mortgage Notes will bear the following interest rates: the Bonaventure Project — 10%; the Greenhouse Project — 10% during the construction period and 9.25% thereafter. The GNMA Security will bear interest at .25% less than the related Mortgage Note.

A Mortgage Note (and consequently the Certificates) may be prepaid without premium at any time if HUD determines that prepayment of a Mortgage Note will avoid a mortgage insurance claim and is therefore in the best interests of the Federal government.

The Regulatory Agreement

The Mortgagor and HUD will enter into the FHA form of Regulatory Agreement (the "Regulatory Agreement"). The Mortgagor is required to give priority to persons and families displaced from their houses by government action, and to maintain the Mortgaged Property in good condition. Dwelling units shall not be rented for a period of less than thirty (30) days.

The Regulatory Agreement also prohibits the conveyance, transfer or encumbrance of the Mortgaged Property or any right to manage or receive rents and profits therefrom without the prior written approval of FHA. The Mortgaged Property may not make, receive, or retain any distribution of assets or income from the Mortgaged Property except, in certain circumstances stipulated in the Regulatory Agreement, from "surplus cash" without the prior written approval of FHA and only as permitted under applicable laws.

The Mortgagor is prohibited, without the prior written approval of FHA, from remodeling, adding to or demolishing any part of the Mortgaged Property or engaging in any other business or activity or incurring any obligation or liability not in connection with the Mortgaged Property or requiring as a condition of occupancy of any unit a deposit greater than the prepayment of the first month's rent plus a security deposit of one month's rent or permit the use of the Mortgaged Property for any other use.

The Mortgaged Property and all books, records, and documents relating thereto are required to be subject to examination and inspection at any reasonable time by FHA. Books and accounts of the Mortgaged Property are to be kept in accordance with FHA requirements and complete annual financial reports are to be furnished to FHA within 60 days of the end of each fiscal year.

In the event of a default in the performance of the Mortgagor's obligations under the Regulatory Agreement, even in the absence of a default under the Mortgage Note of the Mortgage, FHA may (a) notify the Servicer of such default and request the Trustee to declare a default under the Mortgage Note and the Mortgage and the Trustee may, at its option, declare the whole indebtedness due and proceed with foreclosure on the Mortgage Note or make an assignment of the Mortgage Note and the Mortgage to FHA, (b) collect all rents and charges in connection with the operation of the Mortgaged Property and use such collections to pay the Mortgagor's obligations under the Regulatory Agreement and under the Mortgage Note and the expenses of maintaining the Mortgaged Property, (c) take possession of and operate the Mortgaged Property, and (d) apply for specific performance, an injunction, appointment of a receiver or such other relief as may be appropriate.

The Yield Maintenance Agreement

On the first Investment Date, cash, a letter of credit or a certificate of deposit must be delivered to the Trustee in an amount equal to one hundred fifty percent (150%) of the sum of interest at the Passthrough Rate on the aggregate principal amount of the Insured Mortgage Loans through the date of construction completion as projected by the Mortgagors, less projected earnings on undisbursed funds held during such period and less projected interest to be disbursed under the terms of the Mortgage Notes for such period. Approximately six (6) months from the first Investment Date, and semiannually thereafter until construction completion, the Trustee is required to recompute the projected earnings on undisbursed proceeds and projected interest to be received under the Mortgage Notes so as to calculate the amounts needed to be held by the Trustee in order to pay interest on Certificates at the Passthrough Rate through construction completion. Cash, a letter of credit or a certificate of deposit must be deposited with the Trustee to be held under the Yield Maintenance Agreement in the event the amounts so held are less than one hundred fifty percent (150%) of the estimated funds required, and any amounts held in excess of the required amount will be refunded to the Servicer. In addition, in the event that any construction draw is less than fifty percent (50%) of the amount of such draw projected to be made under the most recent construction draw schedule provided to the Trustee, the Trustee is required to again compute estimated required funds for such purpose. Cash, a letter of credit or a certificate of deposit are required to be deposited so that the amounts held will equal or exceed one hundred fifty percent (150%) of the estimated required amount. At such time as the sum of interest payable to the Trustee on the GNMA Securities then held in the Trust Fund and investment earnings payable to the Trustee on funds held in the Trust Fund exceeds the interest payable to the Certificateholders at the Passthrough Rate on the next Distribution Date, funds held in the Negative Arbitrage Subaccount will be returned to the Servicer. If such refund occurs prior to the date GNMA Project Loan Certificates have been delivered with respect to each Insured Mortgage Loan held in the Trust Fund and, subsequent to such refund, the sum of interest payable to the Trustee on the GNMA Securities then held in the Trust Fund and investment earnings payable to

the Trustee on funds held in the Trust Fund becomes less than interest payable to the Certificateholders at the Passthrough Rate, the Servicer will make additional Negative Arbitrage Deposits in an amount necessary to allow payment to Certificateholders of interest at the Passthrough Rate on each Distribution Date occurring prior to the delivery of all GNMA Project Loan Certificates.

The Transfer Agreement

The Trustee and each Mortgagor will enter into a Transfer Agreement to provide for the repayment of the Insured Mortgage Loan prior to its stated maturity date. The Mortgagor will be required to arrange for the purchase of the related Mortgage Note or GNMA Security prior to the expiration of ten years following Initial Endorsement. As security for the obligation of the Mortgagor under the Transfer Agreement, the partners of the Mortgagor will pledge to the Trustee a security interest in some or all of the partnership interests of the Mortgagor. In the event the Mortgagor fails to arrange for the purchase of the Insured Mortgage Loan within the required time period, the Trustee (or its successor in interest) will be able to exercise certain remedies, including the ability to foreclose on the security interest granted in the partnership interests of the Mortgagor. The failure of the Mortgagor to arrange for the the transfer of a Insured Mortgage Loan within the required time period does not constitute a default under the related Mortgage Note and will not entitle the Trustee or any Certificateholder to any Mortgage Insurance as a result thereof.

THE CERTIFICATES

The Certificates will be issued pursuant to a Pooling and Servicing Agreement (the "Agreement") to be entered into between PMI, the Trustee, and the Servicer. PMI will provide, without charge, on written request, a copy of the Agreement. Requests should be addressed to Piper Mortgage Incorporated, Piper Jaffray Tower, 222 South Ninth Street, P.O. Box 28, Minneapolis, Minnesota 55440, Attention: Treasurer. The following summaries do not purport to be complete and are subject to, and are qualified in their entirety by reference to, all of the provisions of the Agreement.

General

The Certificates will be issued in fully registered form only and will represent fractional undivided interests in the Trust Fund created pursuant to the Agreement. The Trust Fund will consist of (i) the proceeds of the offering of Certificates transferred to the Trustee by PMI to be held in the Project Loan Account pending disbursement; (ii) the GNMA Securities; (iii) all payments on or collections in respect of such GNMA Securities; (iv) all property acquired by foreclosure or deed in lieu of foreclosure with respect to the GNMA Securities that has not theretofore been assigned to GNMA; (v) all rights under any primary insurance policies and all other insurance policies required by the Pooling and Servicing Agreement to be maintained with respect to such Insured Mortgage Loan; and (vi) all proceeds received in connection with the liquidation of defaulted Investments, including proceeds of Mortgage Insurance.

Each Single Certificate will initially evidence $1,000 aggregate original principal amount of the Insured Mortgage Loan. The Certificates will be exchangeable only on the Certificate Register to be maintained at the corporate trust office of the Trustee or such other office or agency maintained for such purposes by the Trustee. Under the Pooling and Servicing Agreement, the Trustee will initially be appointed as the Certificate Registrar. Assignment, sale or transfer of Certificates will not be made unless an opinion of counsel satisfactory to the Trustee is delivered stating that such assignment, sale or transfer is in compliance with applicable federal and state securities laws. See "Transfer of Certificates" below. A service charge may be made for any registration of transfer or exchange of Certificates.

Distributions of principal of and interest at the Passthrough Rate on the Certificates will be made by the Trustee on the twentieth day of each month, commencing on the twentieth of the month next succeeding the month in which this offer is closed (each, a "Distribution Date") to the persons in whose names the Certificates are registered at the close of business on the last business day of the preceding month (the "Record Date"). Distributions of interest and principal are expected to be made in accordance with Appendix B attached hereto.

Distributions will be made by check or money order mailed to the person entitled thereto at the address appearing in the Certificate Register for such series, or upon written request by the Certificateholder, by wire transfer (in the case of any Certificateholder owning at least 1000 single certificates) or by such other means as are agreed upon with the person entitled thereto; provided, however, that the final distribution in retirement of the Certificates for each series will be made only upon presentation and surrender of the Certificates at the office or agency of the Trustee specified in the notice to Certificateholders of such final distribution.

Purchase of GNMA Securities

At the time of initial delivery of the Certificates to PMI by the Trustee, a portion of the proceeds of the sale of the Certificates will be deposited in a Project Loan Account created for each Insured Mortgage Loan. Such funds will be disbursed to purchase GNMA Securities as described in "THE CERTIFICATES — Project Loan Account" below.

Assignment of Certain Documents

At the time of issuance of the Certificates, PMI will arrange for the delivery to the Trustee of:

(1) a copy of the GNMA Commitment;

(2) certain opinions of counsel;

(3) an original counterpart of the Yield Maintenance Agreement; and

(4) such other documentation as PMI may determine.

The Certificate Account

The Pooling and Servicing Agreement will require that the Trustee establish and maintain an account (the "Certificate Account") for the benefit of the holders of the Certificates, in which the Servicer will deposit payments due under the GNMA Securities.

The Escrow Funds Account

The Servicer is required to maintain an Escrow Funds Account on behalf of the Trustee at a national bank (which may be the Trustee). The portion of payments by Mortgagor or others representing amounts which are required to be placed into escrow or reserve accounts pursuant to the terms of the Insured Mortgage Loan (such as real property taxes, hazard insurance premiums, and replacement reserve payments) shall be deposited in the Escrow Funds Accounts. The funds in the Escrow Funds Account shall be invested by the Servicer in accordance with HUD Regulations.

In the event that the amounts in the Escrow Funds Account are insufficient to pay the amounts required to be paid from escrows or reserves pursuant to the terms of the applicable loan documentation or related regulatory requirements, the Servicer may advance such amounts and in such event will be entitled to reimbursement. The Servicer is entitled to reimbursement of such advances from the Certificate Account only where the insufficiency was not due to Cause on the part of the Servicer.

Project Loan Account

The Trustee will establish and maintain a Project Loan Account for each Insured Mortgage Loan. The proceeds of an Insured Mortgage Loan not yet disbursed to the Mortgagor shall be deposited in the Construction Loan Subaccount of the Project Loan Account. The proceeds will be maintained in the Project Loan Account and disbursed therefrom only to acquire GNMA Securities at a price equal to the principal amount thereof plus accrued interest thereon to the date of delivery.

In the event (i) the initial GNMA Construction Loan Certificate is not issued to the Trustee with respect to any FHA Coinsured Loan on or before 120 days following Initial Endorsement of such FHA Coinsured Loan; (ii) following initial delivery of a GNMA Security to the Trustee with respect to a particular FHA Coinsured Loan, no GNMA Security is issued for 120 days, and (iii) if a GNMA Project Loan Certificate is delivered in a principal amount less than the amounts on hand in the related Construction Loan Subaccount of the Project Loan Account plus the GNMA Construction Loan Certificates to be redeemed for such GNMA Project Loan Certificate, the excess amounts in the

related Construction Loan Subaccount of the Project Loan Account shall be transferred to the Certificate Account and distributed to Certificateholders on the next Distribution Date. The above referenced 120 day period may be extended up to an additional 60 days (but in no event beyond the maturity date of any GNMA Construction Loan Certificates then held in the Trust Fund with respect to such Insured Mortgage Loan) upon the certification of the Servicer to the Trustee that such extension is needed solely due to the delay in processing by GNMA.

Amounts deposited with the Trustee under a Yield Maintenance Agreement for the purpose of making payments of interest on the Certificates during the construction period (an Initial Negative Arbitrage Deposit) will be deposited in the Negative Arbitrage Subaccount and disbursed therefrom to the Certificate Account on any Distribution Date to pay interest on the Certificates when amounts deposited in the Certificate Account with respect to the Distribution Period to which such Distribution Date relates less than the amount of interest which would have accrued with respect to the Distribution Period to which such Distribution Date relates at the Passthrough Rate.

Permitted Investments

The proceeds from the sale of the Certificates deposited in the Trust Fund will be invested by the Trustee in Permitted Investments, which generally are: (i) direct obligations of or obligations the principal of and interest on which are guaranteed by the United States Government; or (ii) obligations of any agency or instrumentality of the United States Government backed by the full faith and credit of the United States; (iii) certificates of deposit or repurchase agreements issued by the Trustee or any of its affiliates or by any state or national bank which has combined capital, surplus and undivided profits of not less than $50,000,000, or any savings and loan institutions having deposits of not less than $100,000,000, which are fully insured by FDIC or FSLIC or fully secured by investments described in (i) or (ii) above; (iv) general corporate debt obligations of issuers whose senior debt securities are rated in one of the three highest short or long term rating categories of a national rating agency; (v) shares in a registered investment company whose assets consist substantially of investments described in (i) through (iv) above; or (vi) shares or certificates of any money market fund maintained by or available to the Trustee, provided that the principal amount of such shares or certificates owned by the Trustee at any one time shall not exceed $25,000.

Funds in the Project Loan Account and Escrow Funds Account may be co-mingled by the Trustee with other funds only where permitted by applicable law and HUD Regulations.

Withdrawals from the Certificate Account

The Trustee is required to make withdrawals from time to time from the Certificate Account for the purposes set forth below:

(1) to make payments to Certificateholders in an amount to which they are entitled on any distribution date or special distribution date;

(2) to compensate, indemnify and reimburse the Servicer for reimbursable expenses;

(3) to clear and terminate the Certificate Account upon final distribution;

(4) to compensate, reimburse PMI and its affiliates as described in "THE CERTIFICATES — Compensation and Fees to PMI and Affiliates".

(5) to compensate, reimburse, or indemnify the Trustee;

(6) to make payments of all premiums due on mortgage insurance.

In the event that there are insufficient funds to make such payments as they become due, the Trustee shall make payments in the following order of priority: (6), (5), (4), (2), (3) and (1).

The Trustee may defer payment of any items listed in Sections (2), (4) and (5) for such time as the Trustee shall determine. In the case of such deferral, amounts so deferred shall bear interest at the rate of interest announced by Norwest Bank Minneapolis, National Association, as its Base Rate of interest.

Distributions with Respect to the Certificates

The Trustee shall distribute to each Certificateholder of record on the Monthly Record Date to which such Distribution Date relates (other than in connection with the final distribution to Certificateholders), by direct deposit in immediately available funds to the account of any Certificateholder owning at least one thousand single Certificates ($1,000,000 original principal amount) at such Certificateholder's direction, if such Certificateholder has advised the Trustee to make such a direct deposit, or, if such Certificateholder has not so notified the Trustee, and in all other cases, by check mailed to each Certificateholder at the address of each Certificateholder appearing in the Certificate Register, such Certificateholder's pro rata share of all Cash Available for Distribution on deposit in the Certificate Account on such Distribution Date). Provided, however, that each Certificateholder's pro rata share of Cash Available For Distribution shall not exceed such Certificateholder's pro rata share of all Cash Available For Distribution which consists of payments of principal of the Mortgage Note plus interest at the Passthrough Rate on the aggregate Certificate Principal Balance of all Certificates owned by such Certificateholder. Each Certificateholder's pro rata share of Cash Available for Distribution shall be based upon a fraction, the numerator of which is the aggregate Certificate Principal Balance of all Certificates owned by such Certificateholder, and the denominator of which is the aggregate Certificate Principal Balance of all Certificates. Interest on the Certificates will be passed through at the Passthrough Rate on each Distribution Date, commencing on the date indicated in "SUMMARY" herein. In the event the Certificates are not redeemed on or prior to the Certificate Redemption Date, the Passthrough Rate will increase to equal the weighted average interest rate on the GNMA Securities held in the Trust Fund at that time, less trustee fees. Principal of the Certificates will be passed through on each Distribution Date commencing on the date indicated in "SUMMARY" herein.

Compensation and Fees to PMI and Affiliates

The following paragraphs summarize the compensation and reimbursements anticipated to be paid to PMI and its Affiliates from the proceeds of the offering and by third parties.

PMI and PJH will receive up-front aggregate fees totaling two percent (2%) of the Insured Mortgage Loans, plus a non-accountable expense reimbursement of $60,000. Of such amount, one percent (1%) will be paid to PJH and the balance retained by PMI. PMI will bear all legal, accounting and printing expenses in connection with the offering.

PMI and the Servicer will share (in a mutually agreeable method) the Administrative Fees, payable monthly, in an amount equal to the excess of interest payable to the Trustee on the GNMA Securities held in the Trust Fund over the interest payable to Certificateholders at the Passthrough Rate. The amount of such compensation received will vary over the life of the Trust Fund since GNMA Construction Loan Certificates are issued only with respect to amounts actually disbursed during the construction period. The Administrative Fees will not be payable at any time following the Certificate Redemption Date, and will not be payable to the Servicer prior to such date in the event the Servicer is in default under the Yield Maintenance Agreement.

PMI is entitled to reimbursement by the Trust Fund for the actual out-of-pocket costs of direct telephone and travel expenses of PMI and personnel, direct out-of-pocket fees, expenses and charges for rendering legal, auditing, accounting, bookkeeping, computer, printing and public relations services, expenses of preparing and distributing any reports to investors, an allocable portion of the salaries and fringe benefits of employees of companies affiliated with PMI who provide services to the Trust Fund, the cost of compliance with all state and federal regulatory requirements, stock exchange and rating agency fees and charges and third-party payments for services rendered for the benefit of the Trust Fund. In lieu of reimbursing PMI, the Trust Fund may bear such expenditures directly.

The Servicer

Puller Mortgage Associates, Inc., an Indiana corporation, was incorporated in 1976 to engage in the mortgage financing business, including the origination and servicing of residential, commercial, industrial, agricultural and institutional mortgages, government insured, guaranteed and/or conventional mortgages. In 1977, the company was approved as an FHA mortgagee to conduct business with HUD and obtained approval to act as a seller/servicer with the Government National Mortgage Association and the Federal National Mortgage Association for selling and servicing the tandem programs and direct sales to the secondary market. The company received full approval as a GNMA

Mortgage-Backed Security seller/servicer in 1982 and in 1983 received the first national FHA approval for the FHA coinsurance program for Section 223(f) Mortgage Insurance for Existing Structures.

In 1985, Puller Mortgage Associates, Inc. obtained full approval to coinsure Section 221(d)(4) Mortgage Insurance for New Construction of Multifamily projects for HUD. The coinsurance approval provides the company with the ability to originate, underwrite, commit and close insured mortgages as agent for HUD. Puller Mortgage Associates, Inc. has originated and is servicing $167,180,100 of Section 221(d)(4) multifamily mortgages and has acted as servicer for many public housing authorities. Puller Mortgage Associates, Inc. is owned by Kenneth Puller.

Among its servicing duties, the Servicer will process all insured advances and collect all payments of principal and interest due on all Mortgage Notes.

The Pooling and Servicing Agreement provides that neither the Servicer nor any of the directors, officers, employees or agents of the Servicer shall be under any liability to the Trustee or the Certificateholders for any action taken by it or for its refraining from the taking of any action in good faith pursuant to the Agreement, or for errors in judgment; provided, however, that this provision shall not protect the Servicer or any such person against any liability (a) arising from any act or failure to act which would constitute Cause, (b) which violates the obligations of the Servicer to maintain certain hazard insurance, or (c) be a basis for a claim under any insurance policy carried by the Servicer. The Servicer, and any director, officer, employee or agent of the Servicer shall be indemnified by the Trust Fund and held harmless against any loss, liability, or expense incurred in connection with any legal action relating to the Pooling and Servicing Agreement or the Certificates, other than a loss, liability or expense relating to: (i) the servicing of the Insured Mortgage Loan, or (ii) incurred by reason of Cause.

The Servicer is required to furnish the Trustee certain information concerning the Insured Mortgage Loans no later than the fifth business day of each month.

In the event (1) the Servicer fails to perform any of the covenants or agreements required under the Pooling and Servicing Agreement, or (2) the Servicer is subject to bankruptcy or similar proceedings, the Trustee may terminate the rights and obligations of the Servicer under the Pooling and Servicing Agreement. The Trustee is then required to appoint a new Servicer, which may be the Trustee. The ability of the Trustee to exercise its right of termination in the event of a bankruptcy of the Servicer may be limited by bankruptcy law.

Servicing Compensation and Payment of Expenses

PMI and the Servicer will share (in a mutually agreeable method) the Administrative Fees, payable monthly, in an amount equal to the excess of interest payable to the Trustee on the GNMA Securities held in the Trust Fund over the interest payable to Certificateholders at the Passthrough Rate. The amount of such compensation received will vary over the life of the Trust Fund since GNMA Construction Loan Certificates are issued only with respect to amounts actually disbursed during the construction period. The Administrative Fees will not be payable at any time following the Certificate Redemption Date. and will not be payable to the Servicer prior to such date in the event the Servicer is in default under the Yield Maintenance Agreement.

Under contractual arrangements between the Servicer and GNMA, the Servicer is responsible for servicing and otherwise administering the Insured Mortgage Loan for which a GNMA Security was issued in accordance with generally accepted practices of the mortgage banking industry and the GNMA Servicer's Guide.

The servicing fee on GNMA Securities is 0.25% per annum, payable monthly, calculated on the principal balance of the GNMA Securities outstanding on the last day of the month preceding such calculation. Of the 0.25% total fee, part is paid to GNMA as a guaranty fee, and the remainder is retained by the Servicer as a servicing fee. The GNMA Security carries an interest rate that is 0.25% per annum less than the interest rate on the related Mortgage Note because the servicing and guaranty fee is deducted from payments on the Mortgage Note.

Certificate Redemption and Remarketing

PMI has agreed to use to its best efforts to arrange for the sale of the GNMA Securities by the Trustee to a third party during a one year period prior to the expiration of five years from the initial delivery of the Certificates to the order of PMI (the "Certificate Redemption Date"). The proceeds realized from such sale or transfer will be distributed to Certificateholders on the next succeeding Distribution Date. PMI will not arrange for a sale or transfer of a GNMA Security unless amounts realized from such sale or transfer equal at least 100% of the then outstanding principal amount of such GNMA Security. PMI has no obligation to provide, from its own funds or otherwise, any amounts for such Certificate Redemption other than through the remarketing of the GNMA Security in the Trust Fund. In the event PMI or the Remarketing Agents (see below) are unable to arrange for the remarketing of the GNMA Security in the Trust Fund at a price which equals at least 100% of the then outstanding principal amount of such GNMA Security, the Certificates will not be redeemed by the Certificate Redemption Date. Such GNMA Security will then be continued to be held by the Trustee until such time as such GNMA Security may be remarketed at a price which equals 100% of the then outstanding principal amount of such GNMA Security.

PMI will enter into a Remarketing Agreement with Piper, Jaffray & Hopwood Incorporated and Norwest Investment Services, Inc. as Remarketing Agents under which the Remarketing Agents will assist PMI in arranging for the transfer of the GNMA Securities within the required time period. The Remarketing Agents are obligated only to use their best efforts in remarketing the GNMA Securities and are under no obligation to purchase the GNMA Securities. The Remarketing Agents may resign their remarketing obligations at any time giving 60 days notice to PMI.

The Trustee

First Trust Company, Inc., a Minnesota corporation, is trustee under the Pooling and Servicing Agreement. The Trustee may resign at any time, in which event PMI will be obligated to appoint a successor Trustee. PMI may also remove the Trustee if the Trustee ceases to be eligible to continue as such under the Pooling and Servicing Agreement or if the Trustee becomes insolvent. In such circumstances, PMI will be obligated to appoint a successor Trustee. Any resignation or removal of the Trustee and appointment of a successor Trustee does not become effective until acceptance of the appointment by the successor Trustee.

Transfer of Certificates

The Trustee is required to maintain a Certificate Register, in which there is recorded the name and address of each Certificateholder. Each Certificate may only be transferred by surrender or registration of transfer of any Certificate at the designated office of the Trustee accompanied by an opinion of counsel satisfactory to the Trustee that such transfer is registered under or exempt from the registration requirements of the Securities Act of 1933, as amended and any similar registration or qualification requirements of any applicable laws of any state or other jurisdiction. The Trustee will execute and deliver, in the name of the designated transferee or transferees, one or more new Certificates representing the same number of single certificates. Each Certificate presented or surrendered for registration of transfer or exchange shall be in duly endorsed by, or be accompanied by a written instrument of transfer in form satisfactory to the Trustee and duly executed by, the Holder thereof or his attorney duly authorized in writing, and be accompanied by the opinion of counsel described above. A service charge may be made for any registration of transfer or exchange of Certificates.

Amendment

The Pooling and Servicing Agreement may be amended by PMI, the Servicer and the Trustee, without Certificateholder consent, to comply with the requirements of any federal or state securities administrator, to cure any ambiguity, to correct or supplement any provision therein which may be inconsistent with any other provision therein, or to make any other provisions with respect to matters or questions arising under the Pooling and Servicing Agreement which are not inconsistent with the provisions of such Agreement, provided that such action will not, as evidenced by an Opinion of Counsel, adversely affect in any material respect the interest of the Certificateholders, and by the Trustee with the consent of the holders of Certificates representing more than 50% of the number of

single Certificates held by all Certificateholders for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Pooling and Servicing Agreement or of modifying in any manner the rights of Certificateholders of that series, provided, however, that no such amendment may (i) reduce in any manner the amount of, or delay the timing of, payments received on the Insured Mortgage Loan which are required to be distributed in respect of any such Certificate without the consent of the holder of such Certificate or (ii) reduce the aforesaid percentage of Certificates, the holders of which are required to consent to any such amendment without the consent of the holders of all Certificates of such series then outstanding.

Termination

The obligations of PMI and the Trustee created by the Pooling and Servicing Agreement will terminate upon the payment to Certificateholders of all amounts held in the Certificate Account and required to be paid to them pursuant to the Pooling and Servicing after the later of (i) the maturity or other liquidation of the Insured Mortgage Loan subject thereto or the disposition of all property acquired upon foreclosure of the Insured Mortgage Loan or (ii) the expiration of 21 years from the death of the survivor of certain persons named in the Pooling and Servicing Agreement. The Trustee will give written notice of termination of the Pooling and Servicing Agreement to each Certificateholder, and the final distribution will be made only upon surrender and cancellation of the Certificates at an office or agency of the Trustee specified in such notice of termination.

List of Certificateholders

Upon written request of three or more Certificateholders of record for purposes of communicating with other Certificateholders with respect to their rights under the Pooling and Servicing Agreement for such series, the Trustee will afford such Certificateholders access during business hours to the most recent list of Certificateholders of that series held by the Trustee. If such list is as of a date more than 90 days prior to the date of receipt of a request from such Certificateholders, the Trustee shall promptly prepare a current list and will afford such requesting Certificateholders access to such list promptly.

PIPER MORTGAGE INCORPORATED

THE CERTIFICATES DO NOT REPRESENT AN OBLIGATION OF OR AN INTEREST IN PIPER MORTGAGE INCORPORATED OR ANY AFFILIATE THEREOF. NEITHER PIPER MORTGAGE INCORPORATED NOR ANY OF ITS AFFILIATES HAVE ANY LIABILITY FOR THE PAYMENT OF INTEREST ON, PRINCIPAL OF OR PREMIUM ON THE CERTIFICATES OR THE INSURED MORTGAGE LOAN.

PMI, a Delaware corporation organized in August, 1981, is a wholly-owned subsidiary of Piper Jaffray Incorporated, a Delaware corporation. Piper Jaffray Incorporated is the sole owner of PJH, which is the Selling Agent with respect to the Certificates. Piper Jaffray Incorporated, a publicly held company, and its subsidiaries are engaged principally in providing investment banking, securities and commodities brokerage and related financial services. PMI has been recently reorganized to act as depositor and issuer in connection with this and future offerings.

ERISA CONSIDERATIONS

Fiduciaries of qualified corporate pension, profit sharing or other employee retirement benefit plans and trusts should consider (1) whether the investment is in accordance with the documents and instruments governing such Plan Investor; (2) whether the investment satisfies the diversification requirements of Section 404(a) of ERISA, if applicable, (3) whether the investment provides sufficient liquidity; (4) the fiduciary's need to value the assets of the plan annually; and (5) whether the investment is prudent.

An Investment in the Certificates in not liquid due to the substantial restrictions or transfer described in "THE CERTIFICATES — Transfer of Certificates" herein.

Fiduciaries of certain types of Plan Investors are required to determine annually the fair market value of the assets of the plan as of the close of such plan's fiscal year. Plan fiduciaries will thus be required to independently determine the value of the Certificates owned by the Plan at that time.

Section 406 of ERISA prohibits "parties in interest" with respect to an employee benefit plan from engaging in certain transactions involving such plan and its assets unless a statutory or administrative exemption applies to the transaction. Section 4975 of the Code imposes certain excise taxes on such prohibited transactions. In the absence of such an exemption, the purchase, sale or holding of Certificates by an employee benefit plan subject to Section 406 of ERISA and Section 4975 of the Code might result in prohibited transactions and the imposition of excise taxes.

The Department of Labor has recently adopted a regulation that describes what constitutes "Plan Assets" for purposes of the above described provisions of ERISA. The final regulation applies to all Plan Investors, including IRAs.

Generally, when an employee benefit plan makes an investment, the plan's assets consist of that investment. However, under the regulation, an investment by a plan in an "equity security" will be considered an investment in the assets owned by the entity under certain circumstances. The regulation specifically provides that an investment such as the Certificates constitutes an equity security for purposes of the regulation.

An investment in the Certificates will not be considered an investment in the underlying Insured Mortgage Loans or other Investments so long as less than 25% of the total dollar value of outstanding Certificates of any particular Series is held by Plan Investors.

The Pooling and Servicing Agreement will provide that the Trustee is directed to reject any requests for transfer of any Certificate if certain certifications regarding the status of the transferor and/or transferees as Plan Investors is not provided to the Trustee or if, as a result of the transfer, 25% or more of the outstanding Certificates of such Series would then be held by Plan Investors.

ERISA and the Code prohibit fiduciaries of Plan Investors from engaging in various acts of self-dealing. Accordingly, no Plan Investor will be permitted to purchase Certificates if PMI, PJH, the Trustee, or any other Selling Agent, their employees, affiliates or financial consultants (1) manage the portion of the Plan Investor's investment portfolio invested in Certificates on a discretionary basis or (2) regularly give the Plan Investor investment advice pursuant to an agreement or understanding, written or unwritten, with the individual employee or trustee with discretion over the assets of the Plan Investor invested in Certificates. Although PJH, the trustee and other underwriters may serve as custodians of IRAs and Keogh plans that invest in Certificates, PJH, other underwriters and the Trustee will neither exercise investment discretion with respect to an IRA or Keogh Plan which may become an investor nor render investment advice with respect to any such IRA or Keogh Plan.

CERTAIN FEDERAL INCOME TAX CONSEQUENCES

Introduction

The following is a general summary of the anticipated federal income tax consequences of the purchase, ownership and disposition of Certificates. The summary is based upon laws, regulations, rulings and decisions now in effect, all of which are subject to change or possibly differing interpretations. The discussion below does not purport to deal with federal income tax consequences applicable to all categories of investors, some of which may be subject to special rules (e.g., banks, insurance companies and foreign investors). Investors should consult their own tax advisors in determining the federal, state, local and any other tax consequences to them of the purchase, ownership and disposition of Certificates.

Tax Status of the Trust Fund

Holmes & Graven, Chartered, counsel to PMI, has advised PMI that, in its opinion, the Trust Fund will be classified as a grantor trust for federal income tax purposes and not as an association which is taxable as a corporation. Accordingly, each holder of a Certificate will be treated for federal income tax purposes as the owner of an undivided interest in the Investments included in the Trust

Fund. Such holder must report on his federal income tax return its pro rata share of the entire income from the Investments, and may deduct his pro rata share of the reasonable fees paid by the Trust Fund, at the same time as such items would be reported under such holder's tax accounting method if he held directly a pro rata interest in the assets of the Trust Fund and received and paid directly a pro rata share of the amounts received and paid by the Trust Fund.

Original Issue Discount

The Certificates may be issued with "Original Issue Discount" for federal income tax purposes. Such Original Issue Discount will equal the excess of the principal amount of the Insured Mortgage Loans allocable to each Certificate over the original issue price of each Certificate. The original issue price for each Certificate will be the price paid by each Certificateholder for its Certificates. A Certificateholder must include such Original Issue Discount in gross income as ordinary interest income over a term ending on the Certificate Redemption Date under a method embodying an economic accrual of the discount. Original Issue Discount will accrue on a daily basis and the daily portions which accrue during the taxable year of a Certificateholder will be includable in taxable income irrespective of the date such Certificateholder receives the corresponding cash payment of interest. The amount of Original Issue Discount with respect to any Certificate will be considered to be zero if it is less than a *de minimus* amount as determined under the Code.

To the extent that the interval between the first Investment Date and the first Distribution Date is longer than one month, the IRS could contend that the aggregate of all payments received under the Certificates in excess of the original issue price constitutes Original Issue Discount. In such case, Original Issue Discount will accrue on a daily basis and the daily portions which accrue during the taxable year of a Certificateholder will be includible in taxable income irrespective of the date such Certificateholder receives the corresponding cash payment of interest.

Amortizable Bond Premium

To the extent that the purchase price of a Certificate (other than to a right to receive any accrued interest) is greater than the portion of the principal balance of the Insured Mortgage Loans allocable to the Certificate, the interest in the Insured Mortgage Loans will be deemed to have been acquired with amortizable bond premium. Under Section 171 of the Code, the amount of such amortizable bond premium properly allocable to a taxable year is allowed as a deduction. Since the Insured Mortgage Loans may be prepaid and the Certificates redeemed prior to their stated maturity, the total amount of the amortizable bond premium is determined with respect to the amount of prepayment allowed at the earliest possible date of prepayment, which will be one year prior to the Certificate Redemption Date. The amount of amortizable bond premium properly allocable to each accrual period must be calculated based on the formula set forth below:

$$\text{Accrued bond premium for accrual period} = \text{Total remaining bond premium} \times \frac{\text{Stated interest paid in accrual period}}{\text{Total stated interest remaining to be paid at beginning of accrual period.}}$$

Sale of Certificates

A Certificateholder who sells a Certificate will recognize gain or loss equal to the difference between its adjusted tax basis in the Certificate and the amount realized in the sale (exclusive of any portion thereof which is allocable to interest on Insured Mortgage Loans that has accrued but not yet been distributed on the Certificate). In general, such adjusted tax basis will equal the Certificateholder's cost for the Certificate (exclusive of any portion thereof which is allocable to interest on the Insured Mortgage Loans that has accrued but has not yet been distributed on the Certificate), increased by the amount of any Original Issue Discount income previously reported with respect to the Certificate and decreased by the amount of any losses previously reported with respect to the Certificate, the amount of any distributions of principal received thereon and the amount of any

amortizable bond premium previously deducted. Under the new rules of the Code, any such gain or loss will be treated as ordinary gain or loss.

Special Classes of Investors

The statements contained in the above discussion are primarily directed to investors who are United States citizens or resident alien individuals. The tax consequences relating to a purchase of Certificates by other investors, such as foreign corporations and tax-exempt entities will vary substantially from those affecting United States citizens and resident individuals. The following discussion is not comprehensive as to any such class of potential investors and accordingly, each such investor (including Tax-Exempt Certificateholders) should consult with his personal tax advisor, accountant or counsel prior to making any investment in Certificates.

Tax-Exempt Certificateholders

Certificates may be held by Plan Investors and other investors which are intended to be exempt from federal income taxation under the Code. Such investors, however, would be subject to federal income tax with respect to any "unrelated business taxable income," which is unrelated business income ("UBI"), reduced by certain deductions and modifications, derived from any unrelated trade or business. Among the items excluded from unrelated business taxable income, with respect to Plan Investors and certain other exempt organizations are (i) interest income; (ii) rents from real property (other than debt financed property or property from which participating rentals are derived); and (iii) gains on the sale, exchange or other disposition of assets held for investment. None of these exceptions to unrelated business taxable income, however, apply to income derived from debt-financed property. A Plan Investor should note that UBI would result if it borrows funds or continues existing borrowing to purchase Certificates.

The Trust Fund will hold the Insured Mortgage Loans for the investment purposes of the Certificateholders and will not incur any indebtedness in acquiring or carrying the Insured Mortgage Loans. Therefore, no UBI should result from the receipt of payments of interest and principal or the sale, exchange or other disposition of those assets. Due to the inherently factual nature of this issue, however, Counsel can render no opinion thereon.

The foregoing discussion is intended to apply only to Plan Investors. The application of the unrelated business taxable income rules may vary with respect to certain types of tax-exempt organizations which are not Plan Investors. For social clubs, voluntary employee beneficiary associations, supplemental unemployment benefits trusts, and qualified group legal services plans exempt from federal income taxation under Code Sections 501(c)(7), (c)(9), (c)(17) and (c)(20), respectively, income from an investment in the Certificates will constitute UBI unless the organization is able to properly deduct amounts set aside or placed in reserve for certain purposes so as to offset the UBI generated by its investment in the Certificates. Such prospective investors should consult their own tax advisors concerning these "set aside" and reserve requirements.

Foreign Investors

Under the Code, unless interest (including original issue discount) paid on the Certificates is considered to be "effectively connected" with a trade or business conducted in the United States by a nonresident alien individual, foreign partnership or foreign corporation ("Non-residents"), such interest will normally qualify as portfolio interest (except where the recipient is a holder, directly or by attribution, of 10% or more of the capital or profits interest in the securities broker) and be exempt from federal income tax. Upon receipt of appropriate ownership statements, a foreign investor's securities broker (or other payor) normally will be relieved of obligations to withhold tax from such interest payments. These provisions supersede the generally applicable provisions of the United States law that would otherwise require the securities broker to withhold at a 30% rate (unless reduced or eliminated by an applicable tax treaty) on, among other things, interest and other fixed or determinable, annual or periodical income paid to nonresidents.

Treatment of Certain Fees

Counsel has not opined on the treatment for federal income tax purposes of the fees payable to PMI or the Servicer, because the appropriate tax characterization involves factual determinations which may be contested by the IRS.

Although PMI believes that the Administrative Fees will be currently deductible by the Certificateholders as an ordinary and necessary business expense under Section 162 of the Code or as an expense incurred for the production of income under Section 212 of the Code, the determination of whether the fee is deductible in full involves factual questions. Thus, there can be no assurance that the IRS will not contest the amount of the deduction by asserting that it is excessive and the expenditure is in whole or in part a capital expense or other nondeductible expenditure. If a challenge by the IRS were successfully made to the treatment of the Administrative Fees the asserted deductions would be deferred, reduced or eliminated and the Certificateholders may have to pay additional tax. The IRS might also contend that the Administrative Fee should be characterized as an ownership interest in a portion of each interest payment on the GNMA Securities rather than as compensation for the ongoing obligations of PMI and the Servicer. In that event, the Certificates would be subject to the "stripped bond" rules of the Code, which generally require Certificateholders to report all income currently as it accrues in accordance with the provisions of the Code dealing with original issue discount described above. Application of the "stripped bond" rules is not expected to have any substantial effect on holders of Certificates acquired at par; in the case, however, of Certificates acquired at a discount, application of the "stripped bond" rules may accelerate the reporting of income by holders.

Limitations on Deductions

The deductibility of investment interest for all Certificateholders is generally limited to the amount of net investment income in a taxable year. Interest disallowed is carried forward and treated as investment interest in the succeeding taxable year. Interest disallowed is allowed in a subsequent year only to the extent the taxpayer has net investment income in such year. Note that the deductibility of amortizable bond premium may be limited by this provision, as such premium is treated as interest for the purposes of this rule.

Backup Withholding

A Certificateholder may be subject to backup withholding at the rate of 20% with respect to interest paid (including original issue discount) on the Certificate if the Certificateholder, upon issuance, (i) fails to furnish his taxpayer identification number under penalty of perjury, (ii) furnishes his securities broker an incorrect taxpayer identification number, (iii) fails to properly report interest, dividends or other "reportable payments" as defined under the Code or (iv) under certain circumstances, fails to provide his securities broker with a certified statement, under penalty of perjury, that he is not subject to backup withholding.

PLAN OF DISTRIBUTION

Subject to the terms and conditions set forth in this Confidential Private Offering Memorandum, up to $29,807,400 original principal amount of Certificates in the denomination of $1,000 per Single Certificate, with a minimum purchase of $25,000 are being offered.

In the event one or more of the Insured Mortgage Loans described in this Memorandum fails to obtain Initial Endorsement by the date on which the Certificates are initially delivered to the order of PMI by the Trustee, PMI may determine that the Trust Fund will not include such Insured Mortgage Loan, and the principal amount of Certificates offered hereby shall be reduced by an amount equal to the Insured Mortgage Loan or Loans which did not obtain Initial Endorsement.

The Certificates are offered only to certain persons who meet the Investor Suitability Standards. Prospective investors who wish to subscribe for Certificates must represent that they meet these standards, which are set forth under "SUITABILITY STANDARDS."

The Certificates are offered through PJH pursuant to a Selling Agreement between PJH and PMI that provides for sales of Certificates on a best efforts basis, which means that PJH is not obligated to purchase any Certificates. There is no minimum number of Certificates which must be sold. PMI will pay PJH a selling commission equal to 1% of the aggregate denomination of all Certificates sold. PMI

and PJH have agreed to indemnify each other against certain liabilities arising in connection with the offer and sale of the Certificates, including liabilities under the Securities Act of 1933, as amended.

PJH has appointed Norwest Investment Services, Inc. as a Selected Dealer to act as an agent of PJH for the sale of the Certificates, and may appoint other Selected Dealers. PJH and each Selected Dealer are expected to indemnify each other against certain liabilities arising in connection with the offer and sale of the Certificates, including liabilities under the Securities Act of 1933, as amended.

Offering Period

The offering period for the Certificates shall expire one year from the date of the Preliminary Confidential Offering Memorandum.

Subscription for the Certificates

Prospective Investors who satisfy the investor suitability standards may subscribe for Certificates by completing and executing the Investment Letter in the form found as Appendix A hereto. This form should be delivered to the Selling Agent or Selected Dealer. Funds for the purchase of Certificates must be wire transferred in accordance with the instructions in the Investment Letter.

LEGAL MATTERS

Certain legal matters in connection with the Certificates offered hereby will be passed upon for PMI and PJH by Holmes & Graven, Chartered, 470 Pillsbury Center, Minneapolis, Minnesota 55402.

FURTHER INFORMATION

PMI will make available, during the offering and prior to any sale of Certificates, to any person who receives this Confidential Offering Memorandum and such person's purchaser representative(s), if any, the opportunity to ask questions of, and receive answers from Chare Rober of Piper Mortgage Incorporated whose address is Piper Jaffray Tower, 222 South Ninth Street, P.O. Box 28, Minneapolis, Minnesota 55440, and who may be contacted at (612) 342-6319. Ms. Rober will assist prospective purchasers in getting additional information from the Mortgagor, the Servicer and Trustee concerning the terms and conditions of the offering, to inspect any documents summarized in this Confidential Offering Memorandum, and to obtain any additional information necessary to verify the accuracy of the information presented, to the extent that such persons possess such information or can acquire it without unreasonable effort or expense.

GLOSSARY

The definitions of most of the capitalized terms used in this Confidential Offering Memorandum are set forth below.

"Affiliate" means, when used with reference to a specified person, (i) any person who directly or indirectly controls or is controlled by or is under common control with the specified person, (ii) any person who is (or has the power to designate) an officer of, general partner in or trustee of, or serves (or has the power to designate a person to serve) in a similar capacity with respect to, the specified person or of which the specified person is an officer, general partner or trustee or with respect to which the specified person serves in a similar capacity, and (iii) any person who, directly or indirectly, is the beneficial owner of 10% or more of any class of equity securities of the specified person or of which the specified person is directly or indirectly the owner of 10% or more of any class of equity securities.

"Cash Available for Distribution" means, with respect to any Distribution Period, all funds in the Certificate Account which are available for distribution to the Certificateholder.

"Cause" means conduct which constitutes fraud, bad faith, negligence, misconduct or breach of a fiduciary duty.

"Certificate" means any one of the certificates substantially in the form attached to the Pooling and Servicing Agreement as Exhibit A, signed and countersigned by the Trustee.

"Certificate Account" means the account of that name established and maintained by the Trustee pursuant to the Pooling and Servicing Agreement.

"Certificate Principal Balance" means with respect to any Single Certificate $1,000 (or such other amount as stated thereon) reduced by (i) any distributions to the Certificateholders representing a return of principal for federal income tax purposes and (ii) principal losses, if any; provided, however, that the Certificate Principal Balance shall not be reduced to less than zero.

"Certificate Redemption" means the obligation of PMI to arrange for the transfer of the GNMA Securities in the Trust Fund described in "THE CERTIFICATES — Certificate Redemption and Remarketing".

"Certificate Register and Certificate Registrar" means the register maintained pursuant to the Pooling and Servicing Agreement and the Trustee maintaining such Register, respectively.

"Certificateholder or Holder" means the person in whose name a Certificate is registered in the Certificate Register, except that, solely for the purposes of giving any consent pursuant to the Pooling and Servicing Agreement, any Certificate registered in the name of PMI or any affiliate thereof shall, so long as all Certificates shall not be so registered, be deemed not to be outstanding and the Single Certificate evidenced thereby shall not be taken into account in determining whether the requisite percentage of Certificateholders necessary to effect any such consent has been obtained.

"Certificate Redemption Date" means the date which is five years from the first Investment Date (or the next succeeding Business Day).

"Code" means the Internal Revenue Code of 1986, as amended, or any corresponding provision or provisions of succeeding law.

"Consent of Certificateholders" means the consent of holders of Certificates representing more than 50% of the number of Single Certificates held by all Certificateholders. Consent of the Certificateholders given after an act or thing has occurred for which the Consent of the Certificateholders is given shall relate back to and be deemed to be given as of the date such act or thing occurred.

"Distribution Date" means the twentieth day of each month, commencing on the twentieth day of the month next succeeding the month in which the Certificates are initially delivered to PMI by the Trustee.

"Distribution Period" means a calendar month.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended and the rules and regulations thereunder.

"Escrow Agreement" means the agreement, if any, under which the proceeds of such Insured Mortgage Loan are held prior to the disbursement of such moneys to the developer of the related Mortgaged Property under the Construction Loan Agreement.

"Escrow Funds Account" means a separate account maintained by the Servicer.

"FHA" means the Federal Housing Administration.

"FHA Coinsured Loan" means any mortgage loan coinsured by FHA and the Servicer.

"Final Endorsement" means the date a Mortgage Note is finally endorsed for insurance by FHA, and which will occur following construction completion.

"Financing and Placement Fee" means the fee payable to PMI in connection with the acquisition of the Insured Mortgage Loans.

"GNMA" means Government National Mortgage Corporation.

"GNMA Securities" means GNMA Construction Loan Certificates and GNMA Project Loan Certificates.

"GNMA Construction Loan Certificates" means obligations of GNMA which are backed by an FHA Coinsured Loan and are issued during the construction period following advancement of funds for Construction.

"GNMA Project Loan Certificates" means obligations of GNMA which are backed by an FHA Coinsured Loan and which are issued at the maturity or earlier redemption of GNMA Construction Loan Certificates.

"Initial Endorsement" means the date a Mortgage Note is originally endorsed for insurance of advances by the FHA.

"Insurance Proceeds" means amounts paid or payable by the insurer under any Mortgage Insurance, and proceeds of any other insurance policy covering any Participating Investments or Mortgaged Property, including, without limitation, any hazard insurance policy and any applicable title insurance policy.

"Insured Mortgage Loan" means any loan or interest in a loan backing a GNMA Security transferred to the Trust Fund.

"Investment Date" means the date or dates as of which the Trustee issues Certificates to the Issuer.

"Investments" means the Insured Mortgage Loans and other securities selected by PMI or the Trustee.

"IRA" means an individual retirement account.

"Monthly Record Date" shall be the last day of each month.

"Mortgage" means the mortgage or deed of trust creating a first lien on a fee simple interest in real property securing a Mortgage Note.

"Mortgage Note" means the note evidencing the indebtedness of the Mortgagor assigned to or made payable to the Trustee.

"Mortgage Insurance" means mortgage guaranty insurance provided by GNMA under the GNMA Guaranty Agreement.

"Mortgaged Property" means any and all real property, improvements, fixtures, appurtenances, personal property and other interests, rights, pledges, agreements, rents, income and profits securing the indebtedness of the Mortgagor under the Insured Mortgage Loan.

"Mortgagor" means the obligor on the related Mortgage Note.

"Opinion of Counsel" means a written opinion of such legal counsel as shall be reasonably acceptable to the Trustee and who may be counsel for the Servicer, the Trustee or PMI.

"Permitted Investments" means the investments described in "THE CERTIFICATES — Permitted Investments" herein.

"Plan Investor" means a qualified corporate pension, profit-sharing and any other employee retirement benefit plan, Keogh (H.R.10) plan, a Bank commingled trust fund for such plan or trust, and an IRA.

"PJH" means Piper, Jaffray & Hopwood Incorporated, a corporation organized under the laws of the State of Delaware.

"PMI" means Piper Mortgage Incorporated, a corporation organized under the laws of the State of Delaware.

"Purchase Date" means the date as of which the Trustee will acquire an interest in an Insured Mortgage Loan.

"Record Date" means the last business day of the month immediately preceding the month of the related Distribution Date.

"Remarketing Agents" means PJH and Norwest Investment Services, Inc.

"Remarketing Agreement" means the agreement so titled by and between PMI and the Remarketing Agents relating to the remarketing of the GNMA Securities held in the Trust Fund.

"Servicer" means such other person or persons as may be designated as the Servicer by the Trustee pursuant to the Pooling and Servicing Agreement and as may at any time be acting as servicer.

"Servicer's Certificate" means a certificate, completed by and executed on behalf of the Servicer in accordance with the Pooling and Servicing Agreement.

"Servicing Officer" means any officer of the Servicer or designee of any such officer involved in, or responsible for, the administration and servicing of Participating Investments.

"Single Certificate" means a Certificate or a portion of a Certificate which bears an original face amount of $1,000 or such other face amount as determined by PMI.

"Transfer Agreement" means the agreement so titled by and between a Mortgagor and the Trustee relating to the Mortgagor's obligations to arrange for the transfer of the related GNMA Security.

"Trust Fund" means the corpus of the trust created by the Pooling and Servicing Agreement, such Trust Fund to consist of:

(i) the Proceeds of an Insured Mortgage Loan;

(ii) the Investments;

(iii) all payments on or collections in respect of such Investments;

(iv) the obligation of the Servicer to deposit payments and proceeds except for certain amounts required to be placed in escrow or reserve accounts or to pay fees of the Servicer;

(v) all property acquired by foreclosure, deed in lieu of foreclosure or otherwise with respect to any Investment; and

(vi) all rights under any Mortgage Insurance and all other insurance policies required to be maintained with respect to the Investments.

"Trustee" means First Trust Company, Inc. or its successor in interest, or any successor trustee appointed as herein provided.

APPENDIX A

INVESTMENT LETTER

Piper Mortgage Incorporated
Piper Jaffray Tower
222 South Ninth Street
Minneapolis, Minnesota 55402

Federally Insured Real Estate Securities Trust
Mortgage Passthrough Certificates
Series 1987-2

The undersigned (the "Investor") hereby subscribes for and offers to purchase the principal amount of Mortgage Passthrough Certificates indicated below (the "Certificates"), all upon and subject to the following terms and conditions:

1. Upon acceptance by Piper Mortgage Incorporated ("PMI"), this Investor Letter (the "Agreement") shall become a binding agreement, and the Investor shall be obligated to purchase and pay for the Certificates. PMI has the unconditional right to accept or reject this Agreement. If this Agreement is rejected by PMI, the Selling Agent will promptly refund all amounts paid by the Investor, without interest. The Investor hereby agrees to deliver to the Selling Agent on the Closing Date by wire transfer or other immediately available funds the purchase price of the Certificates. The "Closing Date" shall be the date on which sale of the Certificates to the Investor is confirmed in writing by the Selling Agent but not later than the termination of the offering specified in the Preliminary Confidential Offering Memorandum for the Certificates.

2. The Investor represents, warrants and agrees as follows:

(a) The Investor is aware that the Certificates have not been registered under federal or state securities laws and that there are restrictions on the transferability of the Certificates, that there is no market for the Certificates, and that it is unlikely that a market will ever develop. Accordingly, it is unlikely that the Investor will be able to liquidate an investment in the Certificates by resale of the Certificates into the market in case of an emergency or for any other reason.

(b) The Investor's commitment to investments that are not readily marketable is not disproportionate to its net worth, and an investment in the Certificates will not cause such commitment to become excessive. The Investor has adequate means of providing for its current needs and has no need for liquidity with respect to its investment in the Certificates. The Investor has such knowledge and experience in financial and business matters that the Investor is capable of evaluating the merits and risks of an investment in the Certificates.

(c) Investment in the Certificates by the Investor is not prohibited by law or regulation of the federal or any state government, or any department or agency of either, or any documents pertaining to the formation or operation of the Investor, and all corporate or other acts required to be taken prior to an investment in the Certificates have been duly taken by the Investor.

(d) The Investor has received a Preliminary Confidential Offering Memorandum dated June 19, 1987 (the "Memorandum") and has had adequate opportunity to review the same and to ask questions and receive answers concerning the Certificates from representatives of PMI concerning the terms and conditions of the Offering and to obtain any additional information necessary to verify the accuracy of the information presented and the statements made in the Memorandum.

(e) The Investor is acquiring the certificates for its own account and not with a view to distribution.

(f) The Investor qualifies as one or more of the following (as checked):

_____ (i) a National Bank.

_____ (ii) a banking institution organized under the laws of any state, territory, or the District of Columbia, the business of which is substantially confined to banking and is supervised by the state or territorial banking commission or similar official.

_____ (iii) an insurance company whose primary and predominate business activity is the writing of insurance or the re-insuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner, or a similar official or agency of a state or territory or the District of Columbia.

_____ (iv) an investment company registered under the Investment Company Act of 1940 or a business development company as defined in section 2(a)(48) of that Act.

_____ (v) a Small Business Investment Company licensed by the U.S. Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; or an employee benefit plan within the meaning of Title I of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such Act, which is either a bank, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in excess of $5,000,000.

_____ (vi) a private business development company as defined in section 202(a)(22) of the Investment Advisers Act of 1940.

(g) By checking the appropriate box below, the undersigned represents that it is or is not, as the case may be, a Plan Investor, which is defined to mean a qualified corporate pension, profit-sharing and any other employee retirement benefit plan, Keogh (H.R.10) plan, a Bank commingled trust fund for such plan or trust, and an IRA.

The undersigned is a Plan Investor	The undersigned is not a Plan Investor
☐	☐

The Investor agrees to indemnify and hold harmless PMI and the Selling Agent, and their affiliates, and any of their respective counsel from any liability, loss or expense (including reasonable attorneys' fees) if the Investor, alone or with others, defaults in any of the foregoing representations or warranties.

3. Under penalties of perjury, the Investor certifies (i) that the number shown below on this form is its correct taxpayer identification number or social security number and (ii) that it is not subject to backup withholding either because it has not been notified that it is subject to backup withholding as a result of a failure to report all interest or dividends, or the Internal Revenue Service has notified it that it is no longer subject to back-up withholding under Section 3406(a)(1)(c).

Dated: _____

_____
Name of Investor (Print or Type)

_____
Signature of Investor

Title if any: _____

_____
Social Security or Taxpayer I.D. Number

Principal Amount of Certificates Purchased: $ Price: %

TO BE COMPLETED BY PMI

Accepted as of , 1987

PIPER MORTGAGE INCORPORATED

By _____

Its _____

APPENDIX B

SCHEDULED REPAYMENTS OF PRINCIPAL

The following table shows expected scheduled principal and interest payments from 1987 through , 199 for each Single Certificate ($1,000 original principal amount) purchased.

Commencement of repayments of principal may be delayed in the event the construction period for an Insured Mortgage Loan is extended and may be accelerated in the event of prepayment.

Date	Payment	Principal	Interest	Outstanding Principal Following Payment	Date	Payment	Principal	Interest	Outstanding Principal Following Payment

This schedule does not purport to identify what portions of any payments are "interest" or "principal" for federal income tax purposes or whether any Certificates are issued or sold with Original Issue Discount or Amortizable Bond Premium. See "Certain Federal Income Tax Consequences" herein.

In the Matter of the Adoption of the Rules of the State Commerce Department Governing Municipal Bonds.

DECLARATION OF COUNSEL

I, Gregory P. Huwe, Assistant Attorney General, do hereby declare that I have examined the above-captioned rules, and the supporting rulemaking record, and that, based on my examination, the Administrative Procedure Act and Minnesota Rules, chapter 2010 have been followed. Any exceptions are listed below. For Attorney General billing purposes, the four-digit client code is 0110.

Gregory P. Huwe

GREGORY P. HUWE
Assistant Attorney General

Dated: October 10, 1988
.br4

SF-00006-05 (4/86)

STATE OF MINNESOTA

Office Memorandum

DEPARTMENT : ATTORNEY GENERAL

DATE : OCTOBER 10, 1988

TO : RITA DESMOND
515 Transportation Building

FROM : GREGORY P. HUWE GPH
Assistant Attorney General

PHONE : 6-3546

SUBJECT : COMMERCE MUNICIPAL BOND RULES

Enclosed and herewith submitted to you for the Attorney General's review pursuant to the Administrative Procedure Act and Minnesota Rules Chapter 2010, are the rules of the Minnesota Department of Commerce governing municipal bonds.

Please contact me if you have any questions.

GPH:lf
Enc.
cc: Heidi Almquist

SF-00006-03

DEPARTMENT

STATE OF MINNESOTA

Office Memorandum

TO: Al Gilbert

DATE: 10/5/88

FROM: Heidi Almquist HA

PHONE: 297-3238

SUBJECT: Municipal Bond Rules

Enclosed are copies of the following materials regarding the above-captioned rules:

1. Notice of Intent to Solicit Outside Opinion as published in State Register (2010.0300 A)

2. Copy of the Proposed Rules with Revisor's Certificate (2010.0300 D)

3. Notice of Intent to Adopt Rule Without Public Hearing (2010.0300 E)

4. Statement of Need and Reasonableness (2010.0300 F)

5. Affidavit of Mailing Notice of Intent to Adopt Rule Without Public Hearing (2010.0300 G)

6. Copy of Notice of Intent to Adopt Rule Without Public Hearing and Rules as published in the State Register (2010.0300 H)

7. Four copies of Rule as adopted (2010.0300 I)

8. Findings of Fact, Conclusion & Order Adopting Rule (2010.0300 K)

9. Written Comments, Submission & Requests on Rule (2010.0300 L)