BOARD OF DIRECTORS

California Housing Finance Agency
Board of Directors

Audit Committee

May 9, 2013

Holiday Inn Capitol Plaza
300 "J" Street
Sacramento, California
(916) 446-0100

9:00 a.m.

1. Roll Call.

2. Chairman comments.

3. Review and discussion of the Audited Financial Statements for the California Housing Loan Insurance Fund for the year ended December 31, 2012, including a discussion with auditors from CliftonLarsonAllen LLP.

4. Public testimony.

5. Adjournment.

Audit.Com.Agenda
#244695v1
05-09-13

CALIFORNIA HOUSING
LOAN INSURANCE FUND
Sacramento, California

FINANCIAL STATEMENTS,
SUPPLEMENTARY INFORMATION, AND
INDEPENDENT AUDITOR'S REPORT
Years Ended December 31, 2012 and 2011

CliftonLarsonAllen LLP
www.cliftonlarsonallen.com

Independent Auditors' Report

Board of Directors
California Housing Finance Agency
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of the California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency (the Agency), a component unit of the State of California, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the entity's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of December 31, 2012 and 2011, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Fund will continue as a going concern. As discussed in Note 2 to the financial statements, the Fund is experiencing difficulty in generating sufficient cash flow to meet its obligations and sustain its operations. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 - 10 are presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

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

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Baltimore, Maryland
April 25, 2013

CALIFORNIA HOUSING LOAN INSURANCE FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2012 AND 2011

The California Housing Finance Agency (the "Agency") was created in 1975 by an act of the California Legislature and commenced operations in 1976. The Agency is a component unit of the State of California (the "State") and is included in the State's Comprehensive Annual Financial Report. The Agency is authorized to administer the activities of the California Housing Loan Insurance Fund (the "Fund"), the California Housing Finance Fund ("CHFF"), and two State general obligation bond funds. The following Management Discussion and Analysis applies only to the activities of the California Housing Loan Insurance Fund and should be read in conjunction with the Fund's financial statements and the notes to the financial statements. The Agency is entirely self-funded and does not draw upon the general taxing authority of the State. Last year, the Governor introduced a wide-ranging government reorganization plan in order to improve efficiencies in state government. As part of the Governor's Reorganization plan, the Agency will transfer into the Department of Housing and Community Development and will be under the umbrella of the newly created Business, Consumer Services and Housing Agency effective July 1, 2013. It is not anticipated that the proposed changes will affect the Agency's statutory independence. The Agency is authorized to use the Fund's assets as at-risk capital in support of mortgage insurance programs which finance the acquisition, new construction, or rehabilitation of residential structures in California. The Fund insures loans made by the Agency; loans made by lenders for securitization by the Federal National Mortgage Association ("FNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"); and loans made by localities, nonprofit agencies, and the California State Teachers' Retirement System. In conducting business the Agency is authorized to reinsure any risk undertaken by the Fund.

While the Fund is subject to the same statutory requirements as private mortgage insurance companies with respect to the maintenance of policyholders' surplus, the Fund is exempt from regulatory control by the State Department of Insurance. The Fund is currently unrated.

Underwriting, acquisition, and issuance expenses are charged directly to the Fund as well as loss and loss adjustment expenses. Certain administrative and operating expenses, including office space, business services and supplies, legal services, accounting services, information technology support, and human resource support services, are provided by the Agency and indirectly charged to the Fund. The basic financial statements of the Fund include the statement of net position, statement of revenue, expenses and changes in net position and statement of cash flows.

FINANCIAL RESULTS 2012 – 2011

- Insurance in force decreased by $365.5 million, or 19.9 %, to $1.47 billion as of December 31, 2012, compared to $1.84 billion as of December 31, 2011. The Fund ceased committing to insure new loans in September 2009.

- The Fund had an operating loss of $19.4 million for 2012. Net operating results of the Fund decreased by approximately $21 million in 2012 compared to the operating income of $1.6 million in 2011. This was primarily due to losses incurred during 2012 and the $4.2 million increase to the Premium Deficiency Reserve during 2012. The Fund has a net deficit balance of $111.2 million at December 31, 2012, compared to a net deficit balance of $91.8 million at December 31, 2011.

- The number and amount of insured delinquencies declined from 1,278 or $356 million in 2011 to 999 or $276.8 million in 2012. Gross insurance claim payments were $99.6 million and $149.8 million in 2012 and 2011, respectively, before reinsurance.

- The Fund's reserve for loan losses decreased by $8 million in 2012 to $27.6 million as a result of the Fund's decreased number of delinquencies outstanding. The Agency continues to monitor delinquencies closely and is proactive in its attempts to mitigate losses.

- The Fund continued the reinsurance treaty and administrative services agreement with Genworth Financial ("Genworth"), previously known as GE Mortgage Insurance Corporation ("GEMICO"). This insurance treaty cedes to Genworth a 75% quota share of the insurance risk and 64.5% of the premium collected for most loans insured by the Fund. The treaty was amended for loans insured on or after May 1, 2008 to 67% of premium collected and amended again on April 1, 2009 to 69% of premium collected on loans insured on or after that date.

- Each month, the Fund continues to receive its share of premiums from policies still in force and uses the monthly premiums received along with any other available funds to pay the Fund's claims on a "first-in, first-out" basis in the order in which the claims are received after paying the monthly operating expenses of the Fund (see Note 2). The Fund continues to remain dependent upon the ability of the Fund's reinsurer to pay its share of the claims. (see Note 5).

- During 2012, Moody's Investor Services ("Moody's") rating of Genworth remained unchanged at "Ba1" and Standard and Poor's ("S&P") rating of Genworth remained unchanged at "B".

2012 COMPARED TO 2011

CONDENSED STATEMENTS OF NET POSITION

The following table presents condensed statements of net position for the Fund as of December 31, 2012 and 2011, and the change from year to year (dollars in thousands):

	2012	2011	Change
ASSETS			
Cash, cash equivalents, and investments	$ 208	$ 170	$ 38
Other assets	946	1,197	(251)
Total assets	$ 1,154	$ 1,367	$ (213)
LIABILITIES			
LIABILITIES:			
Unpaid losses and loss adjustment expenses	$ 27,577	$ 35,591	$ (8,014)
Premium deficiency reserve	49,849	45,643	4,206
Unearned premiums	75	119	(44)
Accounts payable and other liabilities	34,846	11,803	23,043
Total liabilities	112,347	93,156	19,191
NET POSITION:			
Invested in capital assets	18	23	(5)
Unrestricted	(111,211)	(91,812)	(19,399)
Total net position	(111,193)	(91,789)	(19,404)

Assets - Total assets of the Fund were $1.2 million as of December 31, 2012, a decrease of $0.2 million or 16% from December 31, 2011. Of the Fund's assets, 18% are represented by cash and investments. The Fund does not have a significant investment in capital assets.

Cash, cash equivalents, and investments were $208 thousand as of December 31, 2012, an increase of $38 thousand from December 31, 2011. The Agency invests the Fund's cash in the State's Surplus Money Investment Fund ("SMIF"). SMIF provides the Fund a variable rate of return and complete liquidity. Cash invested in SMIF is deposited within the State's Centralized Treasury System and managed by the State Treasurer.

Other assets were $946 thousand as of December 31, 2012, a decrease of $251 thousand or 21% from December 31, 2011. The decrease is primarily due to having a lower accounts receivable from Genworth as the number of active policies has declined.

Liabilities - The Fund's liabilities were $112.3 million as of December 31, 2012, an increase of $19.2 million or 21% from December 31, 2011.

The reserve for unpaid losses and loss adjustment expenses was $27.6 million as of December 31, 2012, a decrease of $8 million from December 31, 2011. However, the premium deficiency reserve increased $4.2 million to $49.8 million in 2012. As of December 31, 2012, 1099 insured loans with balances aggregating $304.5 million were either reported as delinquent by the lender or assumed delinquent but not reported. As of December 31, 2011, 1406 insured loans with balances aggregating $391 million were either reported as delinquent by the lender or assumed delinquent but not reported.

Unearned premiums were $75 thousand as of December 31, 2012, a decrease of $44 thousand from December 31, 2011. The decrease was due to policy adjustments between the servicer and reinsurer. The expected trend of this account is to decrease over time due to a change in premium collection practices. Beginning in 1996, management adopted the mortgage insurance industry norm of collecting monthly premium payments in arrears for newly established loan insurance products as compared to past practices of collecting annual premiums in advance. As a result, each year a greater percentage of insured loans require monthly premium payments, which are earned when received, rather than annual payments, which are received in advance and deferred and earned over a one-year period.

Accounts payable and other liabilities were $34.8 million as of December 31, 2012, an increase of $23 million from December 31, 2011. This increase is due to the change in claim payments process by Genworth and the increase in unpaid claims. Genworth is only paying their share of 75% claim payment and the Fund is paying 25% share of the claim payment. Also, the Fund's cash is temporarily depleted each month so an accounts payable was set up for CaHLIF's share of the claim payments that have not yet been paid.

Net Position - The Fund's net position are classified as unrestricted or invested in capital assets. Total net position of the Fund decreased by $19.4 million as a result of this current year's operations.

CONDENSED STATEMENTS OF REVENUES AND EXPENSES

The following table presents condensed statements of revenues and expenses for the Fund for the years ended December 31, 2012 and 2011, and the change from year to year (dollars in thousands):

	2012	2011	Change
OPERATING REVENUES:			
Premiums earned	$ 10,683	$ 12,914	$ (2,231)
Investment income	-	37	(37)
Other revenues	1	4	(3)
Total operating revenues	10,684	12,955	(2,271)
OPERATING EXPENSES:			
Loss and loss adjustment expenses	17,895	25,066	(7,171)
Premium deficiency reserve expenses	4,206	(22,983)	27,189
Operating expenses	7,876	9,380	(1,504)
Other expenses	111	(80)	191
Total operating expenses	30,088	11,383	18,705
OPERATING INCOME(LOSS)	$ (19,404)	$ 1,572	$ (20,976)

Operating Revenues - Operating revenues were $10.7 million during 2012 compared to $13.0 million during 2011, a decrease of $2.3 million or 18%.

Premiums earned in 2012 decreased by $2.2 million or 17% compared to premiums earned in 2011. The decrease in premiums earned corresponds with the decrease in insurance in force. Insurance in force was $1.5 billion and $1.8 billion as of December 31, 2012 and 2011, respectively.

Investment income decreased to $77 dollars in 2012 from $37 thousand in 2011. This decrease was due to the decrease in interest rates and decrease in investment in SMIF. SMIF interest rates for the past two years are shown in the following table:

Interest Payment Periods	Fiscal Year 2012	Interest Payment Periods	Fiscal Year 2011
January — March	0.374%	January — March	0.508%
April — June	0.361%	April — June	0.480%
July — September	0.349%	July — September	0.377%
October — December	0.316%	October — December	0.378%

Other revenues decreased by $3 thousand to $1 thousand in 2012 from $4 thousand in 2011. Recoveries made on amounts owed from defendants in certain litigation decreased from last year.

Operating Expenses - Total operating expenses were $30.1 million during 2012 compared to $11.4 million during 2011, an increase of $18.7 million or 164%.

Loss and loss adjustment expenses decreased by $7.2 million in 2012 while the Premium deficiency reserve expenses increased by $27.2 million in 2012. The increase in Premium deficiency reserve expenses is attributable to the increase in required reserves to cover potential losses, and claims payable.

The Fund's operating expenses were $7.9 million during 2012 compared to $9.4 million during 2011, a decrease of $1.5 million or 17%. The decrease is primarily a result of lower ceded premiums to the reinsurer due to lower insurance in force.

Operating Loss - Operating loss for 2012 was $19.4 million compared to operating income of $1.6 million in 2011, a decrease of $21 million. The decrease is primary a result of increasing the premium deficiency reserve balance in 2012 rather than decreasing the premium reserve balance as in 2011.

Contact Information - If you would like additional information on the California Housing Loan Insurance Fund, please visit www.calhfa.ca.gov.

2011 COMPARED TO 2010

CONDENSED STATEMENT OF NET POSITION

The following table presents condensed statement of net position for the Fund as of December 31, 2011 and 2010, and the change from year to year (dollars in thousands):

	2011	As Restated 2010	Change
ASSETS			
Cash, cash equivalents, and investments	$ 170	$ 28,081	$ (27,911)
Other assets	1,197	1,019	178
Total assets	$ 1,367	$ 29,100	$ (27,733)
LIABILITIES			
LIABILITIES:			
Unpaid losses and loss adjustment expenses	$ 35,591	$ 49,596	$ (14,005)
Premium deficiency reserve	45,643	68,626	(22,983)
Unearned premiums	119	174	(55)
Accounts payable and other liabilities	11,803	4,065	7,738
Total liabilities	93,156	122,461	(29,305)
NET POSITION:			
Invested in capital assets	23	28	(5)
Unrestricted	(91,812)	(93,389)	1,577
Total net position, as restated	(91,789)	(93,361)	1,572

Assets - Total assets of the Fund were $1.4 million as of December 31, 2011, a decrease of $27.7 million or 95% from December 31, 2010. Of the Fund's assets, more than 12% are represented by cash and investments. The Fund does not have a significant investment in capital assets.

Cash, cash equivalents, and investments were $170 thousand as of December 31, 2011, a decrease of $27.9 million from December 31, 2010. The decrease is primarily due to an increase in claim payments. The Agency invests the Fund's cash in the State's Surplus Money Investment Fund ("SMIF"). SMIF provides the Fund a variable rate of return and complete liquidity. Cash invested in SMIF is deposited within the State's Centralized Treasury System and managed by the State Treasurer.

Other assets were $1.2 million as of December 31, 2011, an increase of $0.2 million or 17% from December 31, 2010. The increase is the result of changing the claim payment process. Genworth is only paying their share of the claim payments and remitted all the premium thus increasing the accounts receivable from Genworth.

Liabilities - The Fund's liabilities were $93.2 million as of December 31, 2011, a decrease of $29.3 million or 24% from December 31, 2010.

The reserve for unpaid losses and loss adjustment expenses was $35.6 million as of December 31, 2011, a decrease of $14.0 million from December 31, 2010. The decrease in the loss reserve is the result of the Fund's lower loss reserves required to cover potential losses. As of December 31, 2011, 1406 insured loans with balances aggregating $391 million were either reported as delinquent by the lender or assumed delinquent but not reported. As of December 31, 2010, 1927 insured loans with balances aggregating $542 million were either reported as delinquent by the lender or assumed delinquent but not reported.

Unearned premiums were $119,000 as of December 31, 2011, a decrease of $55,000 from December 31, 2010. The decrease was due to policy adjustments between the servicer and reinsurer. The expected trend of this account is to decrease over time due to a change in premium collection practices. Beginning in 1996, management adopted the mortgage insurance industry norm of collecting monthly premium payments in arrears for newly established loan insurance products as compared to past practices of collecting annual premiums in advance. As a result, each year a greater percentage of insured loans require monthly premium payments, which are earned when received, rather than annual payments, which are received in advance and deferred and earned over a one-year period.

Accounts payable and other liabilities were $11.8 million as of December 31, 2011, an increase of $7.7 million from December 31, 2010. This increase is due to the change in claim payments process by Genworth. Genworth is only paying their share of 75% claim payment and the Fund is paying 25% share of the claim payment. Also, the Fund's cash was temporarily depleted during the year so an accounts payable was set up for CaHLIF's share of the claim payment.

Net Position - The Fund's net position are classified as restricted, unrestricted or invested in capital assets. Total net position of the Fund increased by $1.6 million as a result of the current year operating income.

CONDENSED STATEMENTS OF REVENUES AND EXPENSES

The following table presents condensed statements of revenues and expenses for the Fund for the years ended December 31, 2011 and 2010, and the change from year to year (dollars in thousands):

	2011	As Restated 2010	Change
OPERATING REVENUES:			
Premiums earned	$ 12,914	$ 16,502	$ (3,588)
Investment income	37	255	(218)
Other revenues	4	8	(4)
Total operating revenues	12,955	16,765	(3,810)
OPERATING EXPENSES:			
Loss and loss adjustment expenses	2,083	29,727	(27,644)
Operating expenses	9,380	11,958	(2,578)
Other expenses	(80)	10	(90)
Total operating expenses	11,383	41,695	(30,312)
OPERATING INCOME(LOSS)	$ 1,572	$ (24,930)	$ 26,502

Operating Revenues - Operating revenues were $13.0 million during 2011 compared to $16.8 million during 2010, a decrease of $3.8 million or 23%.

Premiums earned in 2011 decreased by $3.6 million or 22% compared to premiums earned in 2010. The decrease in premiums earned corresponds with the decrease in insurance in force. Insurance in force were $1.8 billion and $2.3 billion as of December 31, 2011 and 2010, respectively.

Investment income decreased $218,000 to $37,000 in 2011 from $255,000 in 2010. This decrease was due to the decrease in interest rates and decrease in investment in SMIF. SMIF interest rates for the past two years are shown in the following table:

Periods	Year 2011	Periods	Year 2010
January — March	0.508%	January — March	0.551%
April — June	0.480%	April — June	0.559%
July — September	0.377%	July — September	0.503%
October — December	0.378%	October — December	0.456%

Other revenues decreased by $4,000 to $4,000 in 2011 from $8,000 in 2010. Recoveries made on amounts owed from defendants in certain litigation increased from last year.

Operating Expenses - Total operating expenses were $11.4 million during 2011 compared to $41.7 million during 2010, a decrease of $30.3 million or 73%.

Loss and loss adjustment expenses decreased by $27.6 million in 2011. The decrease is attributable to the decrease in required reserves to cover potential losses and premium deficiency reserve.

The Fund's operating expenses were $9.4 million during 2011 compared to $12.0 million during 2010, a decrease of $2.6 million or 22%. The decrease is primarily a result of lower ceded premiums to the reinsurer due to lower insurance in force and a decrease in salary expenses.

Operating Loss - Operating income for 2011 was $1.6 million compared to $24.9 million loss in 2010, a decrease of $26.5 million. The decrease in operating loss is a result of the decrease in loss and loss adjustment expenses.

Contact Information - If you would like additional information on the California Housing Loan Insurance Fund, please visit www.calhfa.ca.gov.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF NET POSITION
DECEMBER 31, 2012 AND 2011

	2012	2011
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 195,629	$ 144,185
Investment in Surplus Money Investment Fund	12,000	26,000
Interest receivable	12	13
Other current assets	932,968	1,179,044
Total current assets	1,140,609	1,349,242
NONCURRENT ASSETS — Other assets	13,553	17,681
Total assets	$ 1,154,162	$ 1,366,923
LIABILITIES		
CURRENT LIABILITIES:		
Reserves for unpaid losses and loss adjustment expenses	$ 27,576,790	$ 35,591,608
Premium deficiency reserve	49,849,000	45,643,000
Unearned premiums	74,850	118,659
Reinsurance payable	364,839	471,954
Claims payable	33,499,477	10,771,829
Accounts payable and other liabilities	117,861	56,042
Compensated absences	94,546	9,252
Due to other funds	175,051	184,140
Total current liabilities	111,752,414	92,846,484
NONCURRENT LIABILITIES — OPEB	595,000	309,440
Total liabilities	112,347,414	93,155,924
CONTINGENCIES (Note 8)		
NET POSITION		
Invested in capital assets	17,681	22,587
Unrestricted	(111,210,933)	(91,811,588)
Total net position (deficit)	(111,193,252)	(91,789,001)

See notes to financial statements.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
OPERATING REVENUES		
Premium earned	$ 10,682,849	$ 12,913,859
Investment income	77	37,582
Other revenues	900	3,750
Total operating revenues	10,683,826	12,955,191
OPERATING EXPENSES		
Loss and loss adjustment expenses - net of recoveries	17,894,768	25,065,603
Premium deficiency reserve expenses	4,206,000	(22,983,000)
Operating expenses	7,876,511	9,380,104
Other expenses - net	110,798	(79,983)
Total operating expenses	30,088,077	11,382,724
OPERATING(LOSS)/INCOME	(19,404,251)	1,572,467
NET POSITION - Beginning of year	(91,789,001)	(93,361,468)
NET POSITION - End of year	$ (111,193,252)	$ (91,789,001)

See notes to financial statements.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$ 10,859,056	$ 12,520,412
Payments to suppliers	15,464,349	(875,611)
Payments to employees	(653,824)	(554,976)
Payment to other government entities	276,471	(10,501)
Other payments	(25,908,687)	(39,066,384)
Net cash provided by (used in) operating activities	37,365	(27,987,060)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	88,000	65,236,000
Purchase of investments	(74,000)	(37,216,000)
Interest on investments	79	76,689
Net cash provided by investing activities	14,079	28,096,689
INCREASE IN CASH AND CASH EQUIVALENTS	51,444	109,629
CASH AND CASH EQUIVALENTS — Beginning of year	144,185	34,556
CASH AND CASH EQUIVALENTS — End of year	$ 195,629	$ 144,185
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating income (loss)	$ (19,404,251)	$ 1,572,467
Adjustments to reconcile operating income (loss) to net cash used in operating activities:		
Interest on investments	(77)	(37,582)
Unpaid loss and loss adjustment expenses	(8,014,818)	(14,004,532)
Premium deficiency reserve expense	4,206,000	(22,983,000)
Depreciation expense	4,906	5,429
Deferred policy acquisition expense	25,280	115,498
Effects of changes in certain operating assets and liabilities:		
Other assets	220,016	(337,444)
Unearned premiums	(43,809)	(56,003)
Reinsurance payable	(107,114)	(2,928,507)
Compensated absences	85,294	(114,319)
Claims payable	22,727,648	10,771,829
Accounts payable and other liabilities	61,819	19,605
Due to other government entities	276,471	(10,501)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ 37,365	$ (27,987,060)

1. AUTHORIZING LEGISLATION AND ORGANIZATION

The California Housing Loan Insurance Fund (the "Fund") is one of two continuously appropriated funds administered by the California Housing Finance Agency (the "Agency"). The Agency was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended, as a public instrumentality, a political subdivision, and a component unit of the state of California (the "State"), and is in the State's Annual Financial Report and administers the activities of the Fund and the California Housing Finance Fund ("CHFF"). These funds allow the Agency to carry out its purpose of meeting the housing needs of persons and families of low and moderate income within the State. The Agency is authorized to insure mortgage loans and to issue bonds, notes, and other obligations to fund loans to qualified borrowers for single-family houses and multifamily developments. The Agency has no taxing power and is exempt from federal income taxes and state franchise taxes. Last year, the Governor introduced a wide-ranging government reorganization plan in order to improve efficiencies in state government. As part of the Governor's Reorganization plan, the Agency will transfer into the Department of Housing and Community Development and will be under the umbrella of the newly created Business, Consumer Services and Housing Agency effective July 1, 2013. It is not anticipated that the proposed changes will affect the Agency's statutory independence.

The accompanying financial statements are the statements of the Fund and do not include the financial position or the results of operations of the Agency. As of June 30, 2012, the Agency had total assets of $8.75 billion and fund equity of $1.45 billion (not covered by this independent auditor's report).

The Agency is also authorized to use the Fund to provide mortgage insurance for loans made by the Agency and others which finance the acquisition, new construction, or rehabilitation of residential structures in California. Total risk in-force was $519.6 million and $653.9 million at December 31, 2012 and 2011, respectively. Of the insured first mortgage loans outstanding at December 31, 2012, 86.8% have loan-to-value ratios, measured as of the funding date of the loan, greater than 90%.

The Fund's reserve for loan losses decreased during 2012 as a result of the slight decrease in the number of insured California home mortgage delinquencies. The Fund is currently unrated. In 2012, Moody's rating of Genworth's Mortgage Insurance Corporation remained unchanged at "Ba1" and Standard and Poor's rating remained unchanged at "B".

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Accounting - The Fund is accounted for as an enterprise fund. Accordingly, the accompanying financial statements have been prepared using the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America (hereinafter referred to as "Generally Accepted Accounting Principles"), which differ from statutory accounting practices followed by insurance companies in reporting to insurance regulatory authorities.

The financial statements of the Fund were prepared using generally accepted accounting principles that are applicable to a going concern. Management of the Fund has concluded that there is substantial doubt as to the Fund's ability to continue to fully meet its designated purpose of paying claims and expenses. The financial statements of the Fund do not include any adjustments that might result from the outcome of this uncertainty. As of December 31, 2012, the Fund's cash and cash equivalents are not sufficient to meet the Fund's total anticipated cash requirements to pay its obligations over the next twelve months. Management believes that attempts to raise any additional capital will be unsuccessful and does not believe that, under the terms of the agreement with the CHFF, the Fund will be able to draw on the interfund credit agreement (see note 6). Subsequent to that event, the Fund will continue to receive its share of premiums from policies still in force and will use the premiums received along with any other available funds to pay the Fund's obligations on a "first-in, first-out" basis in the order in which the claims are received after paying the monthly expenses of the Fund. Further, management of the Fund is actively managing the Fund and continuously reviewing the reinsurance agreement with Genworth to determine the best course of action for both the expiring (unreinsured) and reinsured books of business.

Accounting and Reporting Standards - The Fund follows the Standards of Governmental Accounting and Financial Reporting, as promulgated by the Governmental Accounting Standards Board (GASB). The Fund has adopted the option under GASB Statement No. 20, which allows the Fund to apply all GASB pronouncements and only Financial Accounting Standards Board (FASB) pronouncements which date prior to November 30, 1989.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents - The Fund considers cash on hand and cash on deposit with the State Controller's office other than the investment in the State's Surplus Money Investment Fund (SMIF) to be cash and cash equivalents.

Investments - The Agency invests the Fund's excess cash in SMIF, which represents a portion of the State's Pooled Money Investment Account (PMIA). These PMIA funds are on deposit within the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters, and maximum maturity of investments. Investments in SMIF are recorded at fair value. The Office of the State Treasurer of California issues a Pooled Money Investment Board Report with information on the PMIA's portfolio composition. A copy of that report may be obtained from the Office of the State Treasurer, 915 Capitol Mall, Room 106, Sacramento, CA 95814 or via the internet at www.treasurer.ca.gov.

Deferred Policy Acquisition Costs - The Fund defers certain costs related to the acquisition of new insurance policies and amortizes these costs over the expected life of the policies. These costs are associated with the acquisition, underwriting, and processing of new policies. Deferred policy acquisition costs were fully amortized as of December 31, 2012, compared to $25,280 as of December 31, 2011.

Other Current Assets - The Fund considers current accounts receivable, equipment, and deferred policy acquisition costs as other current assets. Of the total amount, $932,968 was current accounts receivable.

Claims Payable - The Fund establishes claims payable for claims received but not yet paid. As of December 31, 2012, the Fund's claims payable were $31,701,719 and $1,797,758 for CHFF and other external parties, respectively. The claims payable as of December 31, 2011 were $10,295,110 and $476,719 for CHFF and other external parties, respectively.

Reserves for Unpaid Losses and Loss Adjustment Expenses - The Fund establishes reserves for losses and loss adjustment expenses, to recognize the estimated liability for potential losses and related loss expenses in connection with borrower default on mortgage payments. The liability for unpaid losses and loss adjustment expenses resulting from mortgage insurance is an estimate based upon the unpaid delinquent balance on mortgage loans reported by lenders as of the close of the accounting period, estimates of incurred but not reported (IBNR) claims, and historical and expected frequency and loss severity information.

There is a high level of uncertainty inherent in the evaluation of the required loss and loss adjustment expense reserves. Management has selected frequency of claims paid and severity loss ratios that it believes are reasonable and reflective of anticipated ultimate experience. The ultimate costs of claims are dependent upon future events, the outcomes of which are affected by many factors. The Fund's claim reserving procedures and settlement practices, economic inflation, court rulings, real estate market conditions, and many other economic, scientific, legal, political, and social factors all can have significant effects on the ultimate cost of claims.

Changes in operations and management practices may also cause actual developments to vary from past experience. Since the emergence and disposition of claims are subject to uncertainties, the net amounts that will ultimately be paid to settle the liability may vary significantly from the estimated amounts provided for in the accompanying financial statements. Any adjustments that may be material to reserves are reflected in the operating results of the periods in which they are made.

Premium Deficiency - The Fund establishes reserves for a premium deficiency wherein future paid losses and expenses on unexpired business exceed the related premium revenue for such business, along with the current loss reserves. A premium deficiency is therefore recognized in the balance sheet as an accrued liability, recorded as a Premium Deficiency Reserve for the excess amount. The liability for the premium deficiency reserve is an estimate based upon the delinquent balance on mortgage loans reported by lenders as of the close of the accounting period, historical claim payment and loss incurred pattern development, future estimated premium, and future estimated losses on currently performing mortgage loans.

Net Position - Fund net position is classified as invested in capital assets, restricted equity or unrestricted equity. Invested in capital assets represents investments in office equipment and furniture net of depreciation. Restricted net assets represent net assets that are restricted pursuant to the Agency's enabling legislation. Unrestricted net assets represent net assets not restricted for any purpose. There were no restricted net assets at either December 31, 2012 or 2011.

Operating Revenues and Expenses - The Fund's primary operating revenue is derived from premiums earned on private mortgage insurance written. The primary expenses are the expenses associated with the underwriting, acquisition, issuance, administration, and the reinsurance of private mortgage insurance products and policies, as well as the losses associated with these products and policies.

Recognition of Premium Income - Primary mortgage insurance policies are contracts that are generally non-cancelable by the insurer and provide payment of premiums on a monthly, annual, or single basis. Premiums written on a monthly basis are earned as coverage is provided. Premiums written on an annual basis are deferred as unearned premiums and amortized on a monthly pro rata basis over the year of coverage. Primary mortgage insurance premiums written on policies covering more than one year are referred to as single premiums. A portion of single premiums is recognized immediately in earnings, and the remaining portion is deferred as unearned premiums and amortized over the expected life of the policy.

Reinsurance - Effective March 1, 2003, the Fund entered into a reinsurance treaty and administrative services agreement with Genworth. This agreement cedes to Genworth a 75% quota share of the insurance risk for most loans insured by the Fund and provides for certain administrative services to be performed by Genworth. The Fund uses reinsurance to reduce net risk in force and optimize capital allocation.

New GASB Pronouncements - In 2011, GASB issued GASB 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB 65, *Items Previously Reported as Assets and Liabilities*. These statements clarify the reporting for deferred inflows and deferred outflows and other reporting issues in governmental financial statements and re-define the definitions and reporting of assets and liabilities. The requirements of GASB 63 are effective for years beginning after December 15, 2011 and for GASB 65, for years beginning after December 15, 2012. The Fund has adopted GASB 63 during the year ended December 31, 2012. The implementation of this new standard resulted in a change in terminology on the Statement of Net Position for 2012.

3. INVESTMENT RISK FACTORS

There are many factors that can affect the value of investments. Some, such as credit risk, custodial credit risk, concentration of credit risk, and interest rate risk, may affect both equity and fixed-income securities. Equity and debt securities respond to such factors as economic conditions, individual company earning performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates. It is the investment policy of the Fund to invest substantially all of its funds in fixed income securities, which limit the Fund's exposure to most types of risk. For the investments in the Surplus Money Investment Fund cost approximates market.

Investments by type at December 31, 2012 and 2011, consist of the following:

	2012	2011
Surplus Money Investment Fund — State of California	$ 12,000	$ 26,000

Credit Risk - Fixed income securities are subject to credit risk, which is the risk that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. At December 31, 2012, the Fund does not have any investments exposed to credit risk.

Custodial Credit Risk - Custodial credit risk is the risk that in the event of the failure of the custodian, the investments may not be returned. At December 31, 2012, the Fund did not have any investments exposed to custodial credit. All investments are held by the State of California.

Concentration of Credit Risk - Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the Fund to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. At December 31, 2012, the Fund does not have any investments exposed to concentration of credit risk.

Interest Rate Risk - Interest rate risk is the risk that the value of fixed income securities will decline due to decreasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. At December 31, 2012, the Fund does not have any debt investments that are highly sensitive to changes in interest rates.

Effective Duration - The effective duration is the approximate change in price of a security resulting from a 100 basis points (one percentage point) change in the level of interest rates. It is not a measure of time. The Fund's investments are not affected by effective duration.

4. RESERVES FOR UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The following tables summarize the changes in the reserves for unpaid losses and loss adjustment expenses for the years ended December 31, 2012 and 2011. The first table presents reserves on a gross basis (before reinsurance) and the second table presents the reserve on a net basis (after reinsurance). The total net reserve for loss and loss adjustment is reflected in the financial statements.

Gross	**2012**	**2011**
Gross reserve for loss and loss adjustment — beginning of year balance	$ 133,389,854	$ 187,458,542
Incurred (recovered) related to:		
Provision attributable to the current year	85,157,449	117,987,516
Change in provision attributable to prior years	(14,134,629)	(22,251,701)
Total incurred	71,022,820	95,735,815
Payments related to:		
Current year	(14,749,505)	(21,682,276)
Prior years	(84,806,413)	(128,122,228)
Total payments	(99,555,918)	(149,804,504)
Gross reserve for loss and loss adjustment — end of year balance	$ 104,856,756	$ 133,389,853

Net of Reinsurance	**2012**	**2011**
Net reserve for loss and loss adjustment — beginning of year balance	$ 35,591,608	$ 49,596,140
Incurred (recovered) related to:		
Provision attributable to the current year	21,921,908	30,912,318
Change in provision attributable to prior years	(4,027,140)	(5,846,715)
Total incurred	17,894,768	25,065,603
Payments related to:		
Current year	(3,730,522)	(5,563,964)
Prior years	(22,179,064)	(33,506,171)
Total payments	(25,909,586)	(39,070,135)
Net reserve for loss and loss adjustment — end of year balance	$ 27,576,790	$ 35,591,608

The change in provision attributable to prior year (net of reinsurance) decreased by $4.0 million for the year ended December 31, 2012 due to a decrease in loan delinquencies from the year ended December 31, 2011, while the change in provision attributable to prior year (net of reinsurance) decreased by $5.8 million for the year ended December 31, 2011 from the year ended December 31, 2010 is also due to a decrease in loan delinquencies.

Reserves for loss and loss adjustment expenses relate to delinquent loans, net of reinsurance. Such estimates were based on historical experience, which management believes is representative of expected future losses at the time of estimation. As a result of the extended period of time that may exist between the report of a delinquency and claim payment thereon, significant uncertainty and variation exist with respect to the ultimate amount to be paid because economic conditions and real estate markets will change.

5. REINSURANCE

Effective March 1, 2003, the Fund entered into a 75% quota share reinsurance agreement with Genworth to reinsure most (currently, approximately 96%) of the Fund's portfolio. Under the terms of this agreement, the reinsurer will indemnify the Fund for 75% of all losses paid on the insured loans to which the Fund cedes 64.5% of the related premiums. The treaty was amended for loans insured on or after May 1, 2008 to cede 67% of premiums collected and amended again on April 1, 2009 to cede 69% of premiums collected on loans insured on or after that date. However, there are no loans currently ceded at 69%. The Fund's reinsurance agreement typically provides for a recovery of a proportionate level of claim expenses from the reinsurer. The Fund remains liable to its policyholders if the reinsurer is unable to satisfy its obligations under the reinsurance agreement. The amount of earned premiums ceded to Genworth for the years ended 2012 and 2011 was $7.4 million and $8.2 million, respectively.

According to the terms of the reinsurance agreement, Genworth's reinsurance is for a period up to the end of the tenth calendar year for each existing book year. Therefore, insurance policies issued in 2003 book year had reinsurance through December 31, 2012. The Agency elected not to renew the reinsurance on the expiring 2003 book. If the reinsurance is not renewed after the expiration date, the Fund receives 100% of the related premiums, pays for 100% of any related claims, and receives Genworth's reserves set aside for the related book year.

6. ARRANGEMENTS WITH THE CALIFORNIA HOUSING FINANCE FUND

Certain administrative and operating expenses charged to the Fund are provided by the Agency. These expenses, initially paid from the CHFF, include office space, business services, legal services, accounting services, information systems support, and human resource support services. The Fund is charged monthly for these expenses and a payable is recorded. For the years ended December 31, 2012 and 2011, total expenses allocated to the Fund by the Agency were $573,538 and $733,813, respectively.

As part of CalHFA's Loan Modification Program, Genworth remits pre-claim advance payments to the Fund. The payments received are remitted directly to the CHFF. The total pre-claim advance payments due to CHFF were $67,487 and $58,179 at December 31, 2012 and 2011, respectively.

The Agency Board of Directors approved Resolution 03-19 on March 20, 2003, authorizing the Agency to utilize the resources of CHFF to support the mortgage guaranty insurance programs of the Agency in the following two ways: (1) the Executive Director of the Agency is authorized to create one or more supplementary reserve accounts within the Supplementary Bond Security Account of CHFF to indemnify the Mortgage Insurance Fund for losses incurred or to pay claims against the Mortgage

Insurance Fund in connection with loans financed by the Agency and (2) the Executive Director of the Agency may establish an interfund credit agreement by which the Fund may borrow such sums from CHFF as may be required to maintain the claims paying rating of any credit rating service.

Initially, the Agency Executive Director established an interfund credit agreement in the amount of $100,000,000 in which the Fund may borrow from CHFF as needed for the purpose of paying claims arising out of policies of mortgage guarantee insurance and costs and expenses related to the payment of such claims. The amount by which the fund may borrow was reduced to $10,000,000 from $100,000,000 during 2009. Interest rates and repayment terms are determined upon receipt of a request to draw on this credit facility. Pursuant to the terms of the Board Resolution and the interfund credit agreement, the credit line is no longer legally available to the Fund. The credit agreement stipulates that the amount of credit is determined to be an amount necessary to maintain or improve the claims paying rating of the Fund, which at the time was "A+", and such amount shall not impair or adversely affect the Agency credit rating or any CHFF bond credit rating. The claims paying rating of the Fund was "A+" until July 2009 when it was lowered to "BBB" and subsequently fell as low as "CCC-" during 2010. In September 2010, management of the Fund decided to withdraw the rating. Consequently, there is no credit line currently available under the interfund agreement as there is no rating to support and the $10 million would not resurrect the "CCC-" claims paying rating back to "A+".

7. PENSION PLAN AND POST RETIREMENT BENEFITS

The Fund contributes to the Public Employees' Retirement Fund (PERF) as part of the State of California, the primary government. The PERF is a cost-sharing multiple-employer defined benefit pension plan administered by the California Public Employment Retirement System (CalPERS). CalPERS provides retirement, death, disability, and postretirement health care benefits to members as established by state statute. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for the Public Employees' Retirement Fund. A copy of that report may be obtained from CalPERS via the internet at www.calpers.ca.gov.

For the CalPERS fiscal years ended June 30, 2012, 2011, and 2010, the employer contribution rates were as follows:

	Jun-12	**Dec-11**	**Jun-11**	**Dec-10**
State Miscellaneous Member First Tier	18.175 %	18.175 %	17.528 %	19.922 %
State Miscellaneous Member Second Tier	17.025	17.025	16.442	19.622

The Fund's contributions to the PERF for the years ended December 31, 2012, 2011, and 2010, were $335,203, $189,984, and $136,045, respectively, equal to the required contributions for each year.

Required contributions are determined by actuarial valuation using the individual entry age normal cost method. The most recent actuarial valuation available is as of June 30, 2011, which actuarial assumptions included (a) 7.5% investment rate of return compounded annually, (b) projected salary increases that vary by duration of service, and (c) overall payroll growth factor of 3% annually. The overall payroll growth factor included an new price inflation component of 2.75% and a 0.25% per annum real wage inflation assumption.

The most recent actuarial valuation of the PERF indicated that there was an unfunded actuarial accrued liability. The amount of the underfunded liability applicable to each Agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due, are presented in the June 30, 2012, CalPERS CAFR.

GASB Statement 45 requires states and local governments to publicly disclose the future dollar amount of their obligations to pay for Other Postemployment Benefits (OPEB), like healthcare, that are provided to retired employees, including retired public employees. The OPEB is a cost-sharing multiple-employer defined benefit healthcare plan administered by CalPERS. State Controller's Office sets the employer contribution rate based on the annual required contribution of the employers (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. The Fund's estimated unfunded OPEB cost were $595,000 and $309,440 for the years ended December 31, 2012 and 2011, respectively, and this liability was added to Personal Services in the respective year. CalPERS issues a publicly available CAFR that includes financial statements and required supplementary information for the OPEB.

8. LITIGATION

On June 14, 2002, the Agency filed a complaint in the case of California Housing Finance Agency (CalHFA) v. Hanover California Management and Accounting Center Inc., (HC) et al, Orange County Superior court #02CC10634 (Action). The trial in this matter has concluded and the Agency prevailed on all causes of action. The jury awarded $6.7 million in damages, prejudgment interest of $1 million, and finally the jury found that the defendants acted with malice, and awarded total punitive damages of $1.5 million. The defendants appealed the judgment and the Court of Appeal issued a decision affirming the judgment in full. The decision is now final.

The amounts received from the defendants were $900 and $3,750 during the years ended December 31, 2012 and 2011, respectively which is recorded as other revenue in the accompanying Statements of Revenues, Expenses, and Changes in Net Position. To date, the Agency has received approximately $2.8 million. It is highly unlikely that any additional amounts will be received and as such no gain contingency has been recorded.

Certain other lawsuits and claims arising in the ordinary course of business have been filed or are pending against the Fund. Based upon information available to the Agency, its review of such lawsuits and claims and consultation with counsel, the Agency believes the liability relating to these actions, if any, would not have a material adverse effect on the Fund's financial statements.

9. SUBSEQUENT EVENTS

In January 2013, Moody's lowered the ratings on Genworth from "Ba1" to "Ba2".

Last year, the Governor introduced a wide-ranging government reorganization plan in order to improve efficiencies in state government. As part of the Governor's Reorganization plan, the Agency will transfer into the Department of Housing and Community Development and will be under the umbrella of the newly created Business, Consumer Services and Housing Agency effective July 1, 2013. It is not anticipated that the proposed changes will affect the Agency's statutory independence.

Management has evaluated subsequent events during the period from December 31, 2012 to April 25, 2013, the date the financial statements were available to be issued.

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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
California Housing Finance Agency
Sacramento, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency (the Agency), as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated .

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Baltimore, Maryland
April 25, 2013

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Audit Committee
California Housing Finance Agency
Sacramento, California

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency (the Agency) for the year ended December 31, 2012, and have issued our report thereon dated April 25, 2013. We have previously communicated to you information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. Professional standards also require that we communicate to you the following information related to our audit.

Significant audit findings

Qualitative aspects of accounting practices

Accounting policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Fund are described in Note 1 to the financial statements.

No new accounting policies were adopted and the application of existing policies was not changed during 2012.

We noted no transactions entered into by the Fund during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements were:

- Management evaluates the reserves for unpaid losses and loss adjustment expense on an annual basis based on changes in nature and volume of insurance portfolio, historical analysis of delinquent loans and anticipated economic conditions that may affect the borrower's ability to pay. Management of the Fund has provided us with details regarding the process used in formulating these estimates.

- Computations performed by independent outside specialists, including actuarial assumptions of future paid losses, future expenses necessary to run-off existing business and future renewal premium, were relied upon to establish the premium deficiency reserve.

Financial statement disclosures

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. There were no particularly sensitive financial statement disclosures.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties encountered in performing the audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Uncorrected misstatements

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management did not identify and we did not notify them of any uncorrected financial statement misstatements.

Corrected misstatements

None of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditors' report. No such disagreements arose during our audit.

Management representations

We have requested certain representations from management that are included in the attached management representation letter dated April 25, 2013.

Management consultations with other independent accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the entity's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Significant issues discussed with management prior to engagement

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to engagement as the Fund's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our engagement.

The Fund's ability to continue as a going concern

The following conditions and events, when considered in the aggregate and after considering management's plans, caused us to conclude that substantial doubt about the Fund's ability to continue as a going concern for a reasonable time remains:

- The Fund has experienced recurring losses, and Management of the Fund has concluded that there is substantial doubt as to the Fund's ability to continue as a going concern.

These conditions and events and management's plans for addressing them are disclosed in Note 2 to the financial statements. We concluded the disclosures are adequate. The outcome of these uncertainties could result in the realizability of assets and the settlement of liabilities at amounts materially different than their carrying values in the financial statements which were prepared on a going concern basis.

Because we concluded there is substantial doubt about the Fund's ability to continue as a going concern, we included an emphasis-of-matter paragraph in our auditors' report reflecting that conclusion. The paragraph states:

The accompanying financial statements have been prepared assuming that the Fund will continue as a going concern. As discussed in Note 2 to the financial statements, the Fund has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Other information in documents containing audited financial statements

With respect to the required supplementary information (RSI) accompanying the financial statements, we made certain inquiries of management about the methods of preparing the RSI, including whether the RSI has been measured and presented in accordance with prescribed guidelines, whether the methods of measurement and preparation have been changed from the prior period and the reasons for any such changes, and whether there were any significant assumptions or interpretations underlying the measurement or presentation of the RSI. We compared the RSI for consistency with management's responses to the foregoing inquiries, the basic financial statements, and other knowledge obtained during the audit of the basic financial statements. Because these limited procedures do not provide sufficient evidence, we did not express an opinion or provide any assurance on the RSI.

This communication is intended solely for the information and use of the [Identify the body or individual(s) charged with governance] and management of California Housing Loan Insurance Fund and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP
Baltimore, Maryland
April 25, 2013

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Cal HFA California Housing Finance Agency

April 25, 2013

CliftonLarsonAllen LLP
9515 Deereco Road, Suite 500
Timonium, MD 21093

This representation letter is provided in connection with your audits of the financial statements of California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency, as of December 31, 2012 and 2011, and the respective changes in financial position and cash flows for the years then ended, and the related notes to the financial statements, for the purpose of expressing opinions on whether the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, as of April 25, 2013 the following representations made to you during your audit.

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter dated January 3, 2013, for the preparation and fair presentation of the financial statements in accordance with U.S. GAAP. The financial statements include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.

- We acknowledge and have fulfilled our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

- We have identified all accounting estimates that could be material to the financial statements, including the key factors and significant assumptions used in making those estimates, and we believe the estimates and the significant assumptions used in making those accounting estimates are reasonable.

- Significant estimates have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP. Significant estimates are estimates at the financial statement date that could change materially within the next year.

- Related party relationships and transactions, including, but not limited to, revenues, expenditures/expenses, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP.

- No events, including instances of noncompliance, have occurred subsequent to the financial statement date and through the date of this letter that would require adjustment to, or disclosure in, the financial statements.

- We have not identified or been notified of any uncorrected financial statement misstatements.

- The effects of all known actual or possible litigation, claims, and assessments have been accounted for and disclosed in accordance with U.S. GAAP.

- Guarantees, whether written or oral, under which the entity is contingently liable, if any, have been properly recorded or disclosed in accordance with U.S. GAAP.

- We have no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or equity.

- Regarding the entity's ability to continue as a going concern for a reasonable period of time:

    - Our plans to continue to operate and monitor the Fund are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

    - We believe those plans have been implemented and are assessed on an ongoing basis and consider the impact of changing operational and economic conditions.

    - Note 2 to the financial statements discloses all of the matters of which we are aware that are relevant to the entity's ability to continue as a going concern, including principal conditions and events and management's plans.

- We have no intention of terminating our participation in the Public Employees Retirement Fund, administered by CalPERS as part of the State of California as the primary government or taking any other action that could result in an effective termination or reportable event for the plan. We are not aware of any occurrences that could result in the termination of our pension plan to which we contribute. The Fund has no liability for pension costs or benefits other than the normal annual required contributions as determined by CalPERS. As such required contributions have been remitted.

- We believe that the actuarial assumptions and methods used to measure pension and other postemployment benefits (OPEB) liabilities and costs for financial accounting purposes are appropriate in the circumstances.

- We agree with the findings of the specialist in evaluating the unpaid claim liabilities and analysis of the reinsurance program quota share, which is 75% of the 35% coverage, and have adequately considered the qualifications of the specialist in determining amounts and disclosures used in the financial statements and underlying accounting records. We did not give any instructions, nor cause any instructions to be given, to the specialist with respect to values or amounts derived in an attempt to bias their work, and we are not aware of any matters that have affected the independence or objectivity of the specialist.

- The reserves for unpaid losses and loss adjustment expense, including amounts for incurred but not reported claims, net of the quota share arrangement and net of salvage and subrogation recoverable, has been determined using appropriate historical and expected frequency and loss severity, estimated ultimate costs of settling the claims (including the effects of inflation and other societal and economic factors), using past experience and are the most appropriate under the circumstances. The Fund's reinsurance agreement provides for a recovery of a proportionate level of claim expenses from the reinsurer. The Fund remains liable to its policyholders if the reinsurer is unable to satisfy their obligations under the reinsurance agreement. Management has assessed that financial strength of Genworth and does not believe that the Fund is exposed to any significant credit or counterparty risk other than has been disclosed to you and is included in the financial statements.

- The Fund entered into a reinsurance treaty and administrative services agreement with Genworth (formally known as General Electric Mortgage Insurance Corporation) effective March 1, 2003. This agreement ceded to Genworth 75% quota share of the insurance risk for 96% of loans insured by the Fund at December 31, 2012. The remaining 4% of loans insured by the Fund do not have reinsurance coverage from Genworth as of December 31, 2012.

- The reinsurer must assume significant insurance risk under the reinsured portions of the underlying contract; and it is reasonably possible that the reinsurer could realize a significant loss. Both of these conditions were met as of December 31, 2012. The reinsurance agreement with Genworth provides 75% loss coverage (which represents significant insurance risk) and it is reasonably possible that Genworth will realize a significant loss, as such probability is greater than remote (meeting the FASB ASC 944 standard for reasonable possibility). In addition, the amounts and disclosures used in the financial statements and underlying accounting records related to the reinsurance contract with Genworth are adequate.

- With respect to the Fund's reserves for claim and claim judgment expenses:

    a. For the year ended December 31, 2012, we have processed claims received by the Fund in a manner and timing consistent with prior years.

    b. We have considered all information that, in our judgment, is necessary to adequately estimate the claim and claim adjustment expense reserves at the balance-sheet date, including, among other things:

    - Anticipated and historical claims experience of the Fund

    - Anticipated and historical claims experience of the mortgage insurance industry

    - Expected impact of inflation and other economic or social factors on future payments of losses incurred at the balance-sheet date

    - Lines and geographical locations of the business written and assumed by the Fund

- The Fund's underwriting and claims policies and procedures
- The timeliness and reliability of reports from reinsurer
- Estimates of claim recoveries, exclusive of reinsurance recoveries.

c. The Fund has considered and properly disclosed in the financial statements all the information with respect to claim and claim adjustment expense reserves and related claim recoveries, which in our judgment, is necessary to adequately identify and understand the nature of reserving estimates and underlying coverage issues, including the potential volatility, complexity, and uncertainty of such estimates and the possibility that the ultimate liability may vary significantly from the recorded reserve and related recovery amounts.

d. The reserve for unpaid claims and claim adjustment expenses for the Fund at December 31, 2012 is management's best estimate and makes a reasonable provision for all reported and unreported claims incurred as of December 31, 2012 based upon the consideration of all information available at the date those financial statements were prepared, including actuarial indications and other factors.

- Unearned premiums are fairly stated at December 31, 2012 and the calculations of such are consistent with those of the preceding year. Business expired and reinsurance ceded has been excluded from premiums in force and unearned.
- The premium deficiency reserve has been determined using appropriate historical data, estimated future losses and expenses and related premium revenue on unexpired business. Management believes this reserve is adequate based on an independent third party actuarial report.

Information Provided

- We have provided you with:
  - Access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters.
  - Additional information that you have requested from us for the purpose of the audit.
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
  - Complete minutes of the meetings of the governing board and related committees, or summaries of actions of recent meetings for which minutes have not yet been prepared.
- All material transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We have no knowledge of any fraud or suspected fraud that affects the entity and involves:

- Management;
- Employees who have significant roles in internal control; or
- Others when the fraud could have a material effect on the financial statements.

- We have no knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, regulators, or others.
- We have no knowledge of any instances of noncompliance or suspected noncompliance with laws and regulations and provisions of contracts and grant agreements, or abuse whose effects should be considered when preparing financial statements.
- We are not aware of any pending or threatened litigation, claims, or assessments, or unasserted claims or assessments, that are required to be accrued or disclosed in the financial statements in accordance with U.S. GAAP, and we have not consulted a lawyer concerning litigation, claims, or assessments.
- There are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed in accordance with U.S. GAAP.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- The insurance in-force files properly reflect all policies and contracts in force as of and for the year ended December 31, 2012.
- Management has disclosed all communications from the Fund's third-party service organization (Genworth) relating to any noncompliance with the Fund's operations at that service organization.
- We have a process to track the status of audit findings and recommendations.
- We have identified to you any previous audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.
- We are responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to the Fund, including tax or debt limits and debt contracts; and we have identified and disclosed to you all laws, regulations, and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.
- There are no violations or possible violations of budget ordinances, laws and regulations (including those pertaining to adopting, approving, and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or for reporting on noncompliance.

- The entity has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

- We have followed all applicable laws and regulations in adopting, approving, and amending budgets.

- All funds that meet the quantitative criteria in GASB Statement Nos. 34 and 37 for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.

- Components of net assets (net investment in capital assets; restricted; and unrestricted) and equity amounts are properly classified and, if applicable, approved.

- We have appropriately disclosed the entity's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available and have determined that net assets were properly recognized under the policy.

- We acknowledge our responsibility for the required supplementary information (RSI). The RSI is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.

Signature: ______________________ Title: EXECUTIVE DIRECTOR

Signature: ______________________ Title: DEPUTY COMPTROLLER

California Housing Loan Insurance Fund

Results of December 31, 2012

Financial Statement Audit
May 9, 2013

Audit Team

- J. Michael Stephens — CliftonLarsonAllen Partner
- Mandy Heagy — CliftonLarsonAllen Sr. Manager
- Mike Brannan — CliftonLarsonAllen Manager
- Staff — CliftonlarsonAllen Associates

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Agenda

- Audit Approach
- Audit Results
- Required Communications

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Our Audit Approach

- CliftonLarsonAllen Professionals with Reliance on Specialists
- Integrated Teams
  - Auditors
  - Insurance Specialists
  - IT Specialist
- Approach – Risk-Based, Assessment of internal controls and substantive testing
- Communication – Frequent, including status meetings and informal communications
- Implementation of Clarity Standards in Current Year

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Audit Results

- **Auditors' Opinion on Financial Statements**
  – Going Concern Opinion – Consistent with Prior Years
  – Report Revisions to Comply with Clarity Standards and GASB 63

- **Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards**
  – No Findings Reported

Audit Results (cont.)

- There were no audit adjustments or unrecorded passed adjustments related to 2012

- Implementation of GASB 63 for the year ended 12/31/12. Changes in terminology but no other changes required applicable to the Fund

Management Letter (Statement on Auditing Standard 117)

- No Separate Management Letter Comments

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Required Communications

- The AICPA Statement on Auditing Standards No. 114 requires independent public accountants to communicate certain matters to those who have responsibility for oversight of the financial reporting process. We have summarized the results of our audit of the Loan Insurance Fund for the year ended December 31, 2012 by addressing each of these required communications.

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Required Communications

- **Auditor’s Responsibility Under Generally Accepted Auditing Standards (GAAS):**
  - The financial statements are the responsibility of management. Our audit was performed for the purpose of forming an opinion as to whether the financial statements have been prepared in accordance with Generally Accepted Accounting Principles (GAAP).

- **Significant Issues Discussed With Management Prior to Retention:**
  - There were no significant issues discussed with management prior to retention as the auditors.

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Required Communications (cont.)

- **Consultations With Other Accountants:**
  - We were informed by management that they made no consultations on the application of GAAP and GAAS.

- **Qualitative Aspects of Accounting Practices:**
  - Management is responsible for the selection and use of appropriate accounting policies. Significant accounting policies are disclosed in the Summary of Significant Accounting Policies in Note 1 of the financial statements. There were no new accounting policies or pronouncements in the current year that had an impact on the financial statements.

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Required Communications (cont.)

- The preparation of the financial statements requires that certain estimates and judgments be made by management. These judgments and estimates include:
  - ◊ Reserves for Unpaid Losses and Loss Adjustment Expense
  - ◊ Actuarial Assumptions Performed by Outside Specialists for Premium Deficiency Reserve
- We concluded that management has a reasonable basis for significant judgments and estimates that impact the financial statements.
- Sensitive financial statement disclosures included the disclosure of the above contingent losses and liabilities and going concern.

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Required Communications (cont.)

- **Difficulties Encountered in Performing the Audit:**
  - We encountered no significant difficulties in dealing with management during the audit.
- **Misstatements:**
  - There were no corrected misstatements or uncorrected misstatements (discussed previously).
- **Representations from Management:**
  - The representation letter was signed by management and is attached to the SAS 114 letter.

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Required Communications (cont.)

- **Disagreements with Management:**
  - There were no disagreements with management on financial accounting and reporting matters, auditing procedures, or other matters.
- **The Fund's Ability to Continue As a Going Concern:**
  - The Fund has incurred recurring losses and has limited cash available to meet its obligations over the next 12 months. In addition, the availability to borrow or obtain additional capital is significantly limited.
- **Other Significant Issues:**

  - Sufficiency of Management Response to Going Concern

Open Discussions / Questions