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MEMORANDUM

To: Board of Directors

Date: June 27, 2000

Ken Carlson

Ken Carlson, Director of Financing

From: **CALIFORNIA HOUSING FINANCE AGENCY**

Subject: Update on Variable Rate Bonds and Interest Rate Swaps

Visit to Ratine Anencies

I am pleased to report that our recent visit to the rating agencies in New York went very well. On June 22, Tem Parker and I, together with our investment bankers and interest rate swap advisors, made presentations both to Moody's and to Standard & Poor's regarding CHFA's plans for implementing the goals of the newly-updated business plan. An important portion of this presentation was devoted to our current strategy of employing variable rate financing and (for a portion of such financing) interest rate swaps in order to achieve savings in interest costs. The quantitative analysis behind the presentation was done by our bankers, utilizing state-of-the-art cashflow modeling techniques.

What this cashflow modeling shows is that our massive Home Mortgage Revenue Bond indenture, which contains most of our variable rate bonds, can readily absorb the financial consequences of much higher interest rates. As an example, for the residual value of the HMRB indenture to fall as much as 50% would require the extremely unlikely scenario where the interest rates for all our variable rate bonds, taxable and tax-exempt, immediately rise to 9% and stay at that level for their life. This scenario requires not only higher interest rates generally but also fundamental change in State and federal tax law so that the tax exemptions on our bonds would be meaningless. However, in such a scenario this apparent loss of wealth would more than be offset by increased investment earnings on other CHFA moneys held in the State's investment pool.

Current Variable Rate Exposure

As of August 1, we expect that the total amount of CHFA variable rate debt outstanding will be approximately $1.45 billion, of which only $504 million should be considered as "net" variable rate exposure, an amount $14 million less than reported at the May meeting. Taking into account bonds to be issued in July as well as bonds maturing or being redeemed on August 1, this net amount is now only 7.4% (down from 8% reported in May) of our anticipated $6.8 billion of August 1 indebtedness. The net amount of variable rate bonds is that amount that is not backed by complementary variable rate loans or not swapped to fixed rates.

2003

As discussed at the rating agency meetings, our $504 million of net exposure provides the Agency with a useful internal hedge against a low interest rate scenario, where we would otherwise suffer financially from low short-term investment rates and fast loan prepayments. On the other hand, if interest rates rise, high short-term investment rates and slow prepayments will provide a hedge against our higher variable rate bond costs, as quantified by our bankers for the rating agency presentations.

The table below summarizes our anticipated August 1 risk position.

NET VARIABLE RATE DEBT

	Tax-Exempt	Taxable	Totals
Short average life	$266 million	$104 million	$370 million
Long average life	$ 14 million	$120 million	$134 million
TOTALS	$280 million	$224 million	$504 million

Attached is a new table showing how the $435 million of variable rate bonds that have been issued over the past three years to refinance 10-year-old loan portfolios has already been paid down to $370 million. Note especially that the oldest of these economic refunding bonds, 1997 Series G, has already declined in outstanding amount by 43% (from $53 million to $30 million) in only three years. This relatively fast actual reduction in the amount of bonds outstanding supports our strategy of issuing variable rate bonds for economic refundings and simply accepting the inherent interest rate risk rather than swapping to a fixed rate.

Interest Rate Swaps

As described in bond sale reports to be distributed at the Board meeting, in July we anticipate issuing another $265 million of variable rate bonds, including $100 million for multifamily and $165 million for single family, and swapping all of it to fixed rates. As a result, as of the date of the Board meeting we expect to have arranged a total of 13 fixed-payor interest rate swaps, totaling approximately $874 million of "notional amount".

These interest rate swaps generate significant debt service savings in comparison to our alternative of issuing fixed-rate bonds. This savings will help us continue to offer exceptionally low interest rates to homebuyers and multifamily sponsors. The overall rate savings for our single family transactions, with their blend of fixed and variable, tax-exempt and taxable bonds has been approximately 0.60%. The rate savings in multifamily is expected to be twice as great, given that all the bonds will be tax-exempt and variable rate.

2004

The table below provides a summary of our swap transactions, including those expected to be arranged late in June and early in July.

INTEREST RATE SWAPS

	Tax-Exempt	Taxable	Totals
Short average life	$ 10 million	$530 million	$540 million
Long average life	$334 million	$ 0	$334 million
TOTALS	**$344** million	**$530** million	**$874** million

It should be noted that, for the $344 million of tax-exempt bonds swapped to a fixed rate, CHFA remains exposed to certain tax-related risks. In return for significantly higher savings (approximately 0.75% per year), CHFA has chosen through these interest rate swaps to retain exposure to the risk of changes in tax laws that would lessen the advantage of tax-exempt bonds in comparison to taxable securities. This is the same risk that investors take every time they purchase our fixed-rate tax-exempt bonds.

Multifamily Plans

On July 12 we expect to issue $100 million of tax-exempt variable rate bonds, all of which will be swapped to fixed rates. These bonds are being issued primarily to provide financing for six new loans for projects recently approved by the Board and for which private activity bond allocation was granted late in April. In addition, a small portion of the bonds is being issued to refund certain bonds issued in 1985.

In addition, as noted in other material provided for the July 13 Board meeting, acquisition of Fannie Mae's Section 236 loan portfolio is now anticipated to be accomplished without direct interest rate risk to CHFA. Instead of having to issue commercial paper or variable rate bonds, we plan to issue pass-through securities to be privately placed to Fannie Mae and backed by the loan portfolio that we will purchase from them.

Single Family Plans

As mentioned above, we expect to be issuing more single family bonds in July, to include an estimated $165 million of variable rate bonds to be swapped to fixed rates. The anticipated debt service savings resulting from accessing the swap market is one of the factors that enables us to continue to offer low mortgage rates to new borrowers in spite of our aggressive use of taxable bonds to increase our lending resources.

Attachment

CALIFORNIA HOUSING FINANCE AGENCY

Single Family Variable Rate Economic Refunding Bonds

Bond Issue	Amounts Outstanding at Semi-annual Period						
	8/1/97	2/1/98	8/1/98	2/1/99	8/1/99	2/1/00	8/1/00
HMRB 1997 Series G	$ 53,045,000	$ 49,560,000	$ 45,955,000	$ 40,865,000	$ 35,540,000	$ 32,525,000	$ 30,335,000
HMRB 1998 Series M			66,470,000	53,665,000	51,960,000	43,350,000	42,405,000
HMRB 1999 Series H					35,265,000	32,290,000	31,200,000
HMRB 1999 Series I					22,460,000	22,025,000	21,585,000
HMBR 1999 Series J					105,250,000	96,355,000	92,790,000
HMRB 1999 Series P						25,135,000	24,540,000
HMRB 1999 Series Q						26,485,000	26,255,000
HMRB 2000 Series L							35,685,000
HMRB 2000 Series M							65,265,000
Totals	$ 53,045,000	$ 49,560,000	$ 112,425,000	$ 94,530,000	$ 250,475,000	$ 278,165,000	$ 370,060,000

MEMORANDUM

To: CHFA Board of Directors

From: Di Richardson
Director of State Legislation

Date: 26 June 2000

Re: State Legislative Report

It's that time of year again in Sacramento. The Legislature is in high gear, moving bills and Budget in anticipation of the month long Summer Recess and the final month of the two year session. Things seem to be moving fast and furious, but there is still a lot of work to do in the few remaining weeks, as witnessed by the list below.

SPONSORED BILLS

AB 2008 **(Committee on Housing and Community Development)** **Amended: 06/12/2000 - SENATE HOUSING AND COMMUNITY DEVELOPMENT COMMITTEE**

This is the Assembly Housing Committee's "omnibus" bill – which contains a number of technical, noncontroversial changes that relate to housing and housing finance.

AB 2157 **(Lowenthal)** **Amended: 03/28/2000 - SENATE APPROPRIATIONS COMMITTEE.**

This bill clarifies CHFA's authority to do bridge and gap fmancing and to secure repayment on subordinate loans.

SB 1505 (Alarcon) Amended: 06/14/2000 - ASSEMBLY **EDUCATION** COMMITTEE.

This bill, sponsored by the Adminstration, contains a number of incentives related to the recruitment and retention of teachers. As originally introduced, this bill contained **a** forgivable loan program for teachers agreeing to work in low performing schools for **a** certain period of **time** that would have been administered by CHFA. These provisions were recently amended, **and** the bill **now** provides for **a** competitive block grant program for school districts **to use as** they **deem** appropriate. Housing is specifically listed **as an authorized use** of those funds, but the program would not be administered by **CHFA.** Because **this** billl no longer affects CHFA directly, it will not appear on future reports.

SB 2197 **(Soto)** Amended: 05/11/2000 - ASSEMBLY HOUSING **AND** COMMUNITY **DEVELOPMENT**

This bill would make a number of changes to facilitate the administration of the Home Purchase Assistance Program, administered CHFA. Specifically, this bill would repeal the requirements that the amount of home purchase assistance not exceed the amount necessary to make the total debt financing affordable to eligible households, and that the principal and interest that is due **be** reduced if the proceeds of a sale are insufficient to reimburse the original downpayment. This bill would also recast **as** intent a current requirement that not more than ***50%*** of the assistance **be** provided for homes not previously occupied.

BUDGET

AB 2864 (Torlakson) Enrolled: **06/15/2000** Enrolled

Existing law requires the Department of Housing and Community Development to prepare a guidebook for use by governmental agencies in planning and developing a housing supply **to** meet the need **created by** employment growth. Existing law requires a city or county to include **a** housing element in its general plan, and, for that purpose, **prescribes** criteria for determining the city or county share of the regional housing needs, including a requirement that the distribution of regional housing needs **take** into account, **among** other things, market demand for housing and employment opportunities. This **bill** would **create the** Inter-Regional Partnership State Pilot Project to Improve the Balance of **Jobs** and Housing, which would **be** monitored by **the** Department of Housing and Community Development, to test and evaluate policies and incentives, **as** specified, **to** mitigate current and future imbalances of jobs and housing in specified counties. The bill would make these provisions inoperative **on** July 31, 2004, and would repeal them **as** of January 1, 2005. The Budget proposed by the Governor contained ***$5*** million for the Inter-Regional Partnership Program. The Budget approved by the Legislature also contains ***$5*** million for **this** program.

AB 2865 **(Alquist)** Enrolled: **06/22/2000** Enrolled

Existing law requires CHFA to administer various housing programs to meet the needs of persons and families of low- and moderate-income households. This bill would create the California Homebuyer's Downpayment Assistance Program, administered by CHFA, to provide downpayment assistance to first-time homebuyers. The Budget proposed by the Governor contained $100 million for this program. The Budget approved by the Legislature contains $50 million.

AB 2866 **(Migden)** Enrolled: **06/16/2000** Enrolled

This is a budget trailer bill which encompasses a number of non-controversial, general government provisions. As it relates to CHFA, this bill would make changes to the School Facility Fee Program to ensure that it will be an effective tool to stimulate the affordable homeownership market. These changes will increase not only the number of homes that will now be eligible to be purchased under this program, but the number of homebuyers. There are no new dollars allocated by either the Governor or the Legislature for this program.

AB 2867 **(Lowenthal)** Enrolled: **06/15/2000** Enrolled

Existing law contains various provisions relating to building standards and code enforcement. This bill would establish the Code Enforcement Incentive Program pursuant to which the Department of Housing and Community Development would make funds, upon appropriation by the Legislature, available as matching grants to cities, counties, and cities and counties to increase staffing dedicated to local building code enforcement efforts. The bill would require the department to award the grants on a competitive basis, as specified, and would exempt the grants from provisions of the Administrative Procedure Act. The Budget proposed by the Governor contained no funding earmarked for code enforcement. The Budget adopted by the Legislature contained $5 million.

AB 2870 **(Cedillo)** Enrolled: **06/15/2000** Enrolled

Existing law contains various provisions administered by the Department of Housing and Community Development relating to the rehabilitation of housing. This bill would require the department to make grants and loans for specified downtown rebound projects and related planning from funds appropriated in a specified item of the Budget Act of 2000. The Budget proposed by the Governor contained $21.4 million for the Downtown Rebound Program. The Budget adopted by the Legislature contains $25 million.

SB 1656 (Alarcon) Enrolled: 06/15/2000 Enrolled

Existing law contains various programs relating to housing assistance, including the Senior Citizens' Shared Housing Program, the California Self-Help Housing Program, and specified federal programs. This bill would establish the CalHome Program, to be administered by the Department of Housing and Community Development, to provide funds to local public agencies or nonprofit corporations as either *grants* for programs that assist individual households or loans that assist multiunit development projects. This bill would also repeal the Senior Citizens' Shared Housing Program and state the intent that the CalHome Program take the place of the Senior Citizens' Shared Housing Program. The Budget proposed by the Governor contained $SO million for the CalHome Program. The Budget adopted by the Legislature contains *$40* million.

MISCELLANEOUS

AB 905 **(Dutra)** Chaptered: 04/06/2000 Chaptered # 10

The Mortgage Guaranty Insurance Act provides for the regulation of mortgage guaranty insurance, as defined. Under these provisions, mortgage guaranty insurance may be written only to insure loans secured by first or junior liens on authorized real estate securities in an amount not to exceed *97* percent of the fair market value of the securities. This bill would increase the allowable total indebtedness on which this insurance may be written in this circumstance to 100% of the fair market value of the real estate securities.

AB 2054 **(Torlakson)** Amended: 05/26/2000 - SENATE HOUSING AND COMMUNITY DEVELOPMENT COMMITTEE

Existing law requires the Department of Housing and Community Development to prepare a guidebook for use by governmental agencies in planning and developing a housing supply to meet the need created by employment growth. This bill would create the Inter-Regional Partnership (IRP) State Pilot Project to Improve the Balance of Jobs and Housing, which would be monitored by the Department of Housing and Community Development, to test and evaluate policies and incentives, as specified, to mitigate current and future imbalances of jobs and housing in specified counties. The bill would make these provisions inoperative on July 31, 2004, and would repeal them as of January 1, 2005.

AB 2359 **(Keeley)** Amended: 05/09/2000 - SENATE HOUSING AND COMMUNITY DEVELOPMENT COMMITTEE

Existing law prescribes the powers and duties of the Treasurer, and contains various provisions relating to housing and community development. This bill would enact the Community Investment Act, which would establish the Community Development Investment Guarantee Fund . The fund would be administered by the Treasurer who would have prescribed powers and duties relating to stimulating private sector lending and investment and encouraging community development lending and investment in very low, low-, and moderate-income communities that would not otherwise be served and who would be required to submit an annual written report to the Legislature, beginning December 31,2001, on the performances of the fund, as specified.

SB 510 **(Alarcon)** Amended: 06/06/2000 - ASSEMBLY HOUSING AND COMMUNITY DEVELOPMENT COMMITTEE.

Existing law creates the California Housing Trust Fund for deposit of certain bond proceeds and other revenues, and provides that the money in the fund is to be used for housing programs, as specified. Not less than 20% of the revenue deposited annually in the fund is required to be expended in a rural area, which is defined to mean any open country or any place, town, village, or city that meets certain population requirements . This bill would continuously appropriate money in the fund for investment in a manner calculated to deliver the greatest rate of return consistent with the requirements of specified securities that are eligible for investment of surplus state moneys. It would provide that all interest or other increment resulting from investment may only be expended, upon appropriation, for housing programs that serve lower or very low income households . It would revise the definition of rural area for the purpose described above. It would require any interest or other increment not appropriated for housing programs in the budget year succeeding its accrual to be deposited in the fund and to be no longer deemed interest or other increment for these purposes.

SB 1572 (Alarcon) Amended: 06/21/2000 - ASSEMBLY **HOUSING AND** COMMUNITY DEVELOPMENT COMMITTEE

Existing law, known as Section 8 of the United States Housing Act of 1937, and other provisions of federal law, provide for housing assistance payments pursuant to contract to aid low-income families, and authorize loans, insurance, and interest reduction payments to assist in the provision of housing. Section 8 requires the owner of an assisted dwelling unit to notify the tenant not less than 90 days prior to the termination of the assistance contract. Existing law also generally prescribes the notice to be given by a landlord or tenant to terminate a tenancy. Existing law requires until January 1,2002, at least 9 months advance notice, as specified, to tenants, to the city or county and public housing authority, and to the Department of Housing and Community Development when the abovedescribed forms of federal financial assistance are to be terminated or prepaid with respect to a multifamily rental housing development. This bill, instead of the 9-month notice period, would require specified notices at least 12 months and at least 6 months in advance of the termination to be sent to the tenant and affected public entities, as defined. The bill would revise various conditions that must be met regarding offers to purchase an assisted housing development.

SB 1621 (Alarcon) Amended: 06/21/2000 - ASSEMBLY **HOUSING AND** COMMUNITY DEVELOPMENT COMMITTEE

Existing law places prescribed limits on the adoption of an interim zoning ordinance by a local legislative body. This bill would make those provisions inapplicable to any development for which an application has been submitted, as specified, prior to the adoption of an interim ordinance.

TAX CREDITS

AB 1626 (Torlakson) Chaptered: 02/23/2000 Chaptered # 3

Existing insurance tax law and the Personal Income Tax Law and the Bank and Corporation Tax Law authorize, for so long as corresponding provisions of federal law are in effect, a credit against the taxes imposed by those state laws for certain amounts with respect to the provision of specified low-income housing. Those laws generally provide, subject to the addition of certain other amounts, that the maximum aggregate dollar amount of the credits allowed in each calendar year may not exceed $35,000,000, but increase this limit to $50,000,000 for the 1998 and 1999 calendar years only. This bill would, for purposes of existing low-income housing tax credits, provide a $50,000,000 maximum aggregate dollar amount for the 1999 calendar year and each calendar year thereafter.

AB 1903 **(Lowenthal)** Amended: 05/02/2000 - SENATE HOUSING AND COMMUNITY DEVELOPMENT COMMITTEE

Existing insurance tax law and the Personal Income Tax Law and the Bank and Corporation Tax Law authorize, for so long as corresponding provisions of federal law are in effect, a credit against the taxes imposed by those state laws for certain amounts with respect to the provision of specified low-income housing. Those laws generally provide, subject to the addition of certain other amounts, that the maximum aggregate dollar amount of the credits allowed in each calendar year may not exceed $35,000,000, but increase this limit to $50,000,000 for the 1998 and 1999 calendar years and each calendar year thereafter. This bill would provide that the state low-income housing tax credits may be transferred, sold, or assigned separately from federal low-income housing tax credits.

SB 2198 **(Soto)** Amended: 05/08/2000 SEN REVENUE AND TAXATION Set first hearing. Testimony taken. Further hearing to be set.

Existing law designates the California Tax Credit Allocation Committee as the state's housing credit agency for purposes of allocating federal housing tax credits. The Bank and Corporation Tax Law authorizes various credits against the taxes imposed by that law. This bill would authorize a homeownership tax credit, as specified, against those taxes for each income year beginning on or after January 1, 2000, for qualified lenders, as defined. The bill would also authorize the committee to allocate housing tax credits to lenders that make qualified 2nd mortgage loans to qualified low-income homebuyers.

TEACHERS

AB 2060 **(Steinberg)** Amended: 06/15/2000 - SENATE HOUSING AND COMMUNITY DEVELOPMENT COMMITTEE

Existing law sets forth various findings and declarations of the Legislature in respect to the substantial public benefit served by assistance for housing for lower income families and individuals. Existing law also establishes the California Debt Limit Allocation Committee for the purpose of implementing the unified volume limit for the state on private activity bonds established pursuant to federal law. This bill would further declare that a substantial public benefit is served by providing federal tax credits or reduced interest rate mortgages to assist teachers who are willing to serve in low performing schools to purchase a home. The bill would authorize the California Debt Limit Allocation Committee to establish tbe Extra Credit Teacher Home Purchase Program to provide federal mortgage credit certificates and reduced interest rate loans funded by mortgage revenue bonds to eligible teachers, principals, and assistant principals who agree to teach or provide administration in a low performing school.

AB 2070 (Shelley) Amended: 05/02/2000 - SENATE HOUSING AND COMMUNITY DEVELOPMENT COMMITTEE

Existing law creates the California Housing Finance Agency with specified powers and duties relating to meeting the housing needs of persons and families of law or moderate income. Existing law also contains provisions for assisting members of the State Teachers' Retirement System to obtain home loans. This bill would enact the Teachers Homebuyer Assistance Program, which would be administered by the California Housing Finance Agency to provide home loan assistance for teachers employed in low performing challenge schools.