



# REPORTS

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2002

State of California

MEMORANDUM

To: Board of Directors

Date: October 25, 2001



Ken Carlson, Director of Financing

From: CALIFORNIA HOUSING FINANCE AGENCY

Subject: UPDATE ON VARIABLE RATE BONDS AND INTEREST RATE SWAPS

The following report is based on our estimated bond and swap positions as of November 15, 2001, the scheduled closing date for our next multifamily bond issue.

Variable Rate Exposure

The total amount of CHFA variable rate debt estimated to be outstanding by November 15 is approximately \$2.72 billion, some 35% of our \$7.7 billion of total indebtedness. As shown in the table below, our "net" variable rate exposure will be \$672 million, approximately 8.9% of our indebtedness. The report submitted for the previous Board meeting showed \$2.62 billion of variable rate bonds and \$643 million of net exposure. 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.

**VARIABLE RATE DEBT**  
*(\$ in millions)*

	Tied Directly to Variable Rate	Swapped to <u>Fixed Rate</u>	Not Swapped or Tied to Variable Rate <u>Loans</u>	Total Variable <u>Rate Debt</u>
Single Family	\$24	\$1,662	\$602	\$2,288
Multifamily	<u>16</u>	<u>349</u>	<u>70</u>	<u>435</u>
Total	<b>\$40</b>	\$2,011	\$672	\$2,723

As discussed previously, our **\$672** million of net exposure provides the Agency with a useful internal hedge against today's low interest rate scenario, where we are experiencing low short-term investment rates and fast loan prepayments. **As** examples, we expect that new bond proceeds will have to be invested at an interest rate **as** low as **2.5%**, and we have seen the monthly incidence of single family loan prepayments increasing from a \$30 million average to an average of **\$68** million over the last eight months. At the same time, we hope to offset the economic consequences of these effects with debt service savings on our unswapped variable rate bonds. As an example, the interest rates on our **\$375** million of unswapped taxable variable rate bonds have dropped to levels as low **as** 2.6% as a result of the Federal Reserve's rate cuts.

The table below summarizes this current risk position.

**NET VARIABLE RATE DEBT**  
(*\$ in millions*)

	<u>Tax-Exempt</u>	<u>Taxable</u>	<u>Totals</u>
Short average life	\$238	\$226	\$464
Long average life	<u>59</u>	<u>149</u>	
TOTALS	\$297	\$375	\$672

**Interest Rate Swaps**

As of November 15, we expect to have **41** swaps with four or five different counterparties for a combined notional amount exceeding **\$2** billion. 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 multifamily sponsors and to serve a great many additional homebuyers.

The table below provides a summary of our estimated notional swap amounts as of November 15.

**INTEREST RATE SWAPS**  
(*\$ in millions*)

	<u>Tax-Exempt</u>	<u>Taxable</u>	<u>Totals</u>
Single family	\$508	\$1,154	\$1,662
Multi family	<u>340</u>	<u>9</u>	<u>349</u>
TOTALS	\$848	\$1,163	\$2,011

The table below shows the diversification of **our** swaps (as of October 25) among the four firms acting as **our** swap counterparties. Note that **our** swaps with Lehman Brothers and Bear Steams are with structured triple-A subsidiaries that are special purpose vehicles used only for derivative products. We have chosen to use these subsidiaries because the senior credit of those firms is not as strong as that of Merrill Lynch or of Salomon Smith Barney.

In connection with **our** \$108.6 million multifamily transaction scheduled for bond delivery on November 15, we plan to enter into three swaps totaling \$94.6 million. The counterparties for these new swaps will be determined through a competitive bid process, and we hope to receive bids from as many as five additional highly-rated financial institutions. Bidding out a portion of **our** swaps should enable us to obtain further diversification of counterparty risk.

### SWAP COUNTERPARTIES

<u>SWAP COUNTERPARTY</u>	<u>CREDIT RATINGS MOODYS S &amp; P</u>	<u>NOTIONAL AMOUNTS SWAPPED (\$ In Millions)</u>	<u>NUMBER OF SWAPS</u>
Merrill Lynch Capital Services Inc.	Aa3 AA-	\$ 686.1	13
Lehman Brothers Derivative Products Inc.	Aaa AAA	545.5	13
Salomon Brothers Holding Company Inc.	Aa3 A	412.4	8
Bear Steams Financial Products Inc.	Aaa AAA	286.3	4
		\$1,930.3	38

Note that, with interest rate swaps, the “notional amount” (equal to the principal amount of the swapped bonds) itself is not at risk. Instead, the risk is that a counterparty would default and, because of market changes, the terms of the original swap could not be replicated without additional cost.

Because all of **our** swaps have been entered into to establish “synthetic” fixed rates for **our** variable rate bonds, we receive floating rate payments from our counterparties in exchange for a fixed rate obligation on **our** part. In today’s market, with very low short-term rates, the net periodic payment owed under **our** swap agreements is from us to **our** counterparties. As an example, on August 1 the net payment from us to them was equal to \$13.4 million. Conversely, if short-term rates were to rise above the fixed rates of our swap agreements, then the net payment would run in the opposite direction, and we would be on the receiving end.

**Risk of Changes to Tax Law**

It should be noted that, for an estimated **\$644** million of the **\$848** 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), we have 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. In addition, we bear this same risk for \$321 million of our tax-exempt variable rate bonds which we have not swapped to a fixed rate. Together, these two categories of variable rate bonds total \$965 million, less than 12.5% of our \$7.7 billion of bonds outstanding. This risk of tax law changes is the same risk that investors take every time they purchase our fixed-rate tax-exempt bonds.

**Types of Variable Rate Debt**

The table below shows the estimated amount of variable rate debt to be outstanding as of November 15, sorted by type, i.e., whether it is auction rate, indexed rate, or variable rate demand obligations (VRDOs). Auction and indexed rate securities cannot be "put" back to us by investors; hence they typically bear higher rates of interest than do "put-able" bonds such as VRDOs.

**TYPES OF VARIABLE RATE DEBT**  
*(\$ in millions)*

	<u>Auction Rate Bonds</u>	<u>Indexed Rate Bonds</u>	<u>Variable Rate Demand Obligations</u>	<u>Total Variable Rate Debt</u>
Single Family	<b>\$87</b>	\$797	<b>\$1,404</b>	\$2,288
Multifamily	<u>0</u>	<u>0</u>	<u>435</u>	<u>435</u>
Total	\$87	\$797	\$1,839	\$2,723

Since September of 2000 we have been able to sell all of our taxable single family variable rate bonds to the Federal Home Loan Bank of San Francisco. These bonds are designed as indexed rate securities and have no put feature. For the seven transactions completed to date, the FHLB has purchased approximately \$781 million of these indexed rate bonds.

**Liquidity Providers**

The following table shows the financial institutions providing CHFA with liquidity in the form of standby bond purchase agreements for **our** VRDOs. Under these agreements, if our variable rate bonds are put back to us and cannot be remarketed, these institutions are obligated to buy the bonds from our remarketing agents. We plan to solicit these and other financial institutions later this month to provide liquidity for our single family VRDOs to be issued in **2002**, and we have asked Fannie Mae to continue to provide liquidity for next year's multifamily VRDOs.

**LIQUIDITY PROVIDERS**  
*(\$ in millions)*

<b><u>Financial Institution</u></b>	<b><u>\$ Amount of Bonds</u></b>	<b><u>Type of Bonds</u></b>
Commerzbank	<b>\$3 16.5</b>	<b>SF</b>
CalSTRS	<b>274.3</b>	SF/MF
Westdeutsche Landesbank	<b>2 10.2</b>	SF/MF
Landesbank Hessen-Thuringen	<b>187.1</b>	MF
Fannie Mae	<b>186.3</b>	MF
<b>KBC</b>	<b>157.0</b>	SF
Bayerische Landesbank	<b>145.3</b>	SF
Lloyds TSB	<b>120.6</b>	<b>SF</b>
Bank of America	<b>89.6</b>	SF
State Street	<b>50.9</b>	SF
Morgan Guaranty	<b>45.0</b>	SF/MF
Bank of New York	<u><b>38.6</b></u>	SF
Total	<b>\$1.821.4*</b>	

\* The total amount of CHFA variable rate demand obligations (shown on the previous page) is slightly higher because of a small multifamily variable rate transaction with liquidity provided by a different means.

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# MEMORANDUM

To: CHFA Board of Directors

Date: 18 October 2001

From:  Di Richardson, Director of State Legislation  
CALIFORNIA HOUSING FINANCE AGENCY

Subject: Final State Legislative Report 2001

Below you will find the final legislative report for 2001. This report includes not only those bills that made it to the Governor's desk, but several of those that didn't. Looking over the list you should easily be able to see which bills were completed this year, and which will be back before us next year. As tempting as it was to categorize them as the good, the bad, and the ugly, I restrained myself.

For those of you interested in trivia, this year the Legislature presented the Governor with 1149 bills. 979 were signed, and 170 (just under 15%) were vetoed.

As always, if you have any questions, thoughts, or comments, please don't hesitate to call me.

## BONDS

SB 1227

**Burton** Housing Bond Act of 2002  
Status: 09/13/2001 ASM HOUSING AND COMMUNITY  
**DEVELOPMENT**

This bill would enact the Housing Bond Act of 2002

Comments: current amendments specify \$980 million bond, allocated as follows:  
**\$450m for MHP**; \$100m for EHAP; \$50m for supportive housing; \$100m for Farmworker Housing Grants; **\$100m** for HCD's Self-Help; \$10m for Code Enforcement; and \$170m for **CHDAP**.

**CHFA MISC**

- AB 4415**    **Cardenas**    School Facilities Fee Assistance Fund  
Status:    07/30/2001    Chaptered# 114  
This bill would delete that appropriation to the School Facilities Fee Assistance Fund currently scheduled for the 2002-03 fiscal year; would prohibit CHFA from honoring reservations received for that program on or after January 1, 2002; and would require any unobligated amounts in the Fund as of that date be transferred to the General Fund, except as specified. The bill would delete the January 1, 2003, repeal date for those provisions, and would make the provisions inoperative on and after January 1, 2002, except with respect to any repayment obligation or regulatory agreement imposed as a condition of assistance.  
Comments: Enacted as a Budget trailer bill - non-urgency.
- AB 999**    **Keeley**    California Housing Loan insurance Fund  
Status:    05/31/2001    ASM APPROPRIATIONS In committee: Set second hearing. Held under submission.  
This bill would move CaHLIF out of CHFA, establishing it as a separate entity governed by a newly created and separate board.  
Sponsor - California Association of Realtors.
- AB 1044**    **Migden**    California Housing Finance Agency: bonds  
Status:    08/17/2001    Chaptered# 202  
The bill would increase the amount of bond debt CHFA may have outstanding by \$2.2 billion.
- SB 519**    **Vincent**    Military base conversion: housing  
Status:    04/11/2001    SEN HOUSING AND COMMUNITY DEVELOPMENT  
This bill would establish the California Temporary Military Affordable Housing Authority within the California Housing and Finance Agency to, among other things, examine and select housing units on a decommissioned military base for renovation and leasing as affordable senior housing.  
Sponsor - Commission on Aging. Author's staff has indicated that CHFA was included only as a "placeholder" and will be replaced with a more appropriate entity once one is identified.

**2010**HCD

AB404

**Diar** New neighborhoods program  
 Status: 05/31/2001 ASM APPROPRIATIONS In committee: Set second hearing. Held under submission.

This bill would enact provisions to be known as the New Neighborhoods Program that would provide at least 7 planning grants of not more than \$250,000 each to counties, cities, or cities and counties to study the availability of multifamily affordable housing sites defined as 'new neighborhoods'. The bill would require that the studies be completed by January 1, 2003. The bill would create the New Neighborhoods Multifamily Affordable Housing Fund. All money in the fund would be continuously appropriated to the Department of Housing and Community Development for matching grants to cities and counties to conduct these studies.

AB490

**Diaz** Housing trust funds  
 Status: 05/31/2001 ASM APPROPRIATIONS In committee: Set second hearing. Held under submission.

This bill would require the Department of Housing and Community Development to establish a program to make matching grants, from money appropriated by the Legislature for that purpose from the California Housing Trust Fund, to local agencies that establish housing trust funds, to provide financing for affordable housing to be occupied primarily by low-income persons and families.

**HOME BUYER ASSISTANCE**

AB 820

**Shelley** California State University Housing Finance Pilot Program  
 Status: 04/18/2001 ASM HOUSING AND COMMUNITY DEVELOPMENT

This bill would enact the California State University Housing Finance Pilot Program, which would be administered by the California Housing Finance Agency to provide home loan assistance through the CSU system to recruit and retain newly hired professors and faculty at CSU campuses where they  
 Comments: The author's staff has indicated that this bill is a work in progress, and may not move in its current form.

AB905

**Cohn** Housing: down payment assistance: public safety officers  
 Status: 05/31/2001 ASM APPROPRIATIONS In committee: Set second hearing. Held under submission.

This bill would create the Public Safety Downpayment Assistance Program, administered by CHFA, to provide downpayment assistance to public safety officers, as defined, employed by a city.  
 Sponsor - State Controller

- 2011**
- AB 920 Daucher** Live Near Your Work Program  
 Status: 03/27/2001 ASM HOUSING AND COMMUNITY  
 This bill would enact the Live Near Your Work Program administered by the Department of Housing and Community Development that would provide grants through local jurisdictions to assist individuals to buy or rent housing near their work. The bill would create the Live Near Your Work Fund and continuously appropriate any money deposited in the fund to the department for the purposes of the program.
- AB 930 Keeley** CalHome Program  
 Status: 06/21/2001 SEN HOUSING AND COMMUNITY DEVELOPMENT  
 This bill would exempt home rehabilitation funds from home price limits of HCD's CalHOME program, and would require the department to use its best efforts to ensure a reasonable geographic distribution of these funds .
- AB 1170 Firebaugh** Housing: downpayment assistance  
 Status: 05/31/2001 ASM APPROPRIATIONS In committee: Set second hearing. Held under submission.  
 This bill would create the Building Equity and Growth in Neighborhoods Fund and would continuously appropriate any money in the fund to the department for grants to cities, counties, and cities and counties for assistance for downpayment to qualifying new home buyers in those cities, counties, and cities and counties in specified areas that have taken prescribed actions to remove barriers to affordable housing.  
 Sponsor - California Building Industry Association
- AB 1359 Lowenthal** Housing: Predevelopment Loan Fund  
 Status: 10/01/2001 Chaptered # 395  
 This bill would consolidate and streamline several of HCD's predevelopment loan programs.
- SB 401 Soto** Tax credits: second mortgages  
 Status: 04/25/2001 SEN REVENUE AND TAXATION Set first hearing. Testimony taken. Further hearing to be set.  
 This bill would authorize a homeownership tax credit, as specified, against those taxes for each taxable year beginning on or after January 1, 2002, 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.  
 Comments: Sponsor: California Building Industry Association

**SB 429**     **Soto**     Housing: assistance  
Status:     07/30/2001     Chaptered # 117

**2012**

This bill would clarify an ambiguity in current law regarding termination notices by creating a clear exemption for bona fide preservation transactions (current notice requirements are only intended to apply if the development is at risk of converting to market rate - not if the sale would preserve the affordability). The language of this bill represents a consensus that was negotiated by a group that included tenant advocates, property owners and management organizations.

### **LOCAL LAND USE**

**SB 1098**     **Alarcon**     Planning and zoning: housing  
Status:     10/14/2001     Chaptered # 939

This bill would prohibit the extension of an interim ordinance denying needed approvals for projects with a significant component of multifamily housing unless the legislative body identifies the adverse impact of continued approval of the development and makes other specified findings. It would provide that these provisions apply to a county, city, including a charter city, and city and county.

### **MISC**

**AB 1090**     **Hertzberg**     Real property  
Status:     10/07/2001     Chaptered # 560

This bill would amend those portions of the Civil Code defining the timely recording of a Deed of Reconveyance on a paid in full loan. The time frames would be defined, rather than ambiguous. The fees charged to consumers would be reduced, and penalties for noncompliance would be increased. This bill was introduced to abrogate Bartold v. Glendale Federal Bank.

**SB 975**     **Alarcon**     Prevailing Wage  
Status:     10/14/2001     Chaptered # 938

This bill would dramatically expand the number and types of public works projects subject to prevailing wage requirements.

Comments: Expect to see clean up legislation next year. Affordable housing advocates have been soliciting authors, and the Governor's Office has indicated that the sponsors of this bill (the State Building and Construction Trades Council) and Senator Alarcon have committed to clean up legislation to exempt below market rate loans. Senator Alarcon also indicated on the Senate Floor he would address the impacts on Self Help Housing.

**PRESERVATION**

**SB 372**     **Dunn**     Preservation Interim Loan Programs  
Status:     05/31/2001     SEN APPROPRIATIONS Set first hearing. Held in  
committee and under submission.

**2013**

This bill would establish preservation interim loan programs known as the Preservation Opportunity Program and the Interim Repositioning Program, and require the HCD to contract with CHFA to make loans on prescribed terms to preserve and maintain the affordability of assisted housing developments pursuant to those programs .

Sponsors: Housing California and NHC

**SPECIAL NEEDS**

**SB 442**     **Vasconcellos**     Housing: special needs population  
Status:     10/07/2001     Chaptered # 577

This bill would require the housing strategy in the California Statewide Housing Plan to include the provision of housing assistance for various specific population groups. For that purpose, the bill would require the Department of Housing and Community Development to consider certain information and to consult with various state departments that have information relevant to the housing needs of those population groups.

Sponsor: California Association of Homes and Services for the Aging

**TAX CREDITS**

**SB 73**     **Dunn**     Taxation: low-income housing  
Status:     10/10/2001     Chaptered # 668

This bill would increase the State Low Income Housing Tax Credit from \$50,000,000 to \$70,000,000 for the 2001 calendar year, and provides an inflation adjuster beginning in 2002 calendar year. This bill would require the California Tax Credit Allocation Committee to review and evaluate the geographic apportionment methodology of the low-income housing tax credit program, as provided, and to report back to the Legislature no later than June 30, 2002.

Sponsors: State Treasurer, California Rural Legal Assistance Foundation and the Western Center on Law and Poverty.