CalHFA

REPORTS

2000

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State of California

2002

MEMORANDUM

To: Board of Directors

Date: February 26, 2004

Ken Carlson, Director of Financing

From: **CALIFORNIA HOUSING FINANCE AGENCY**

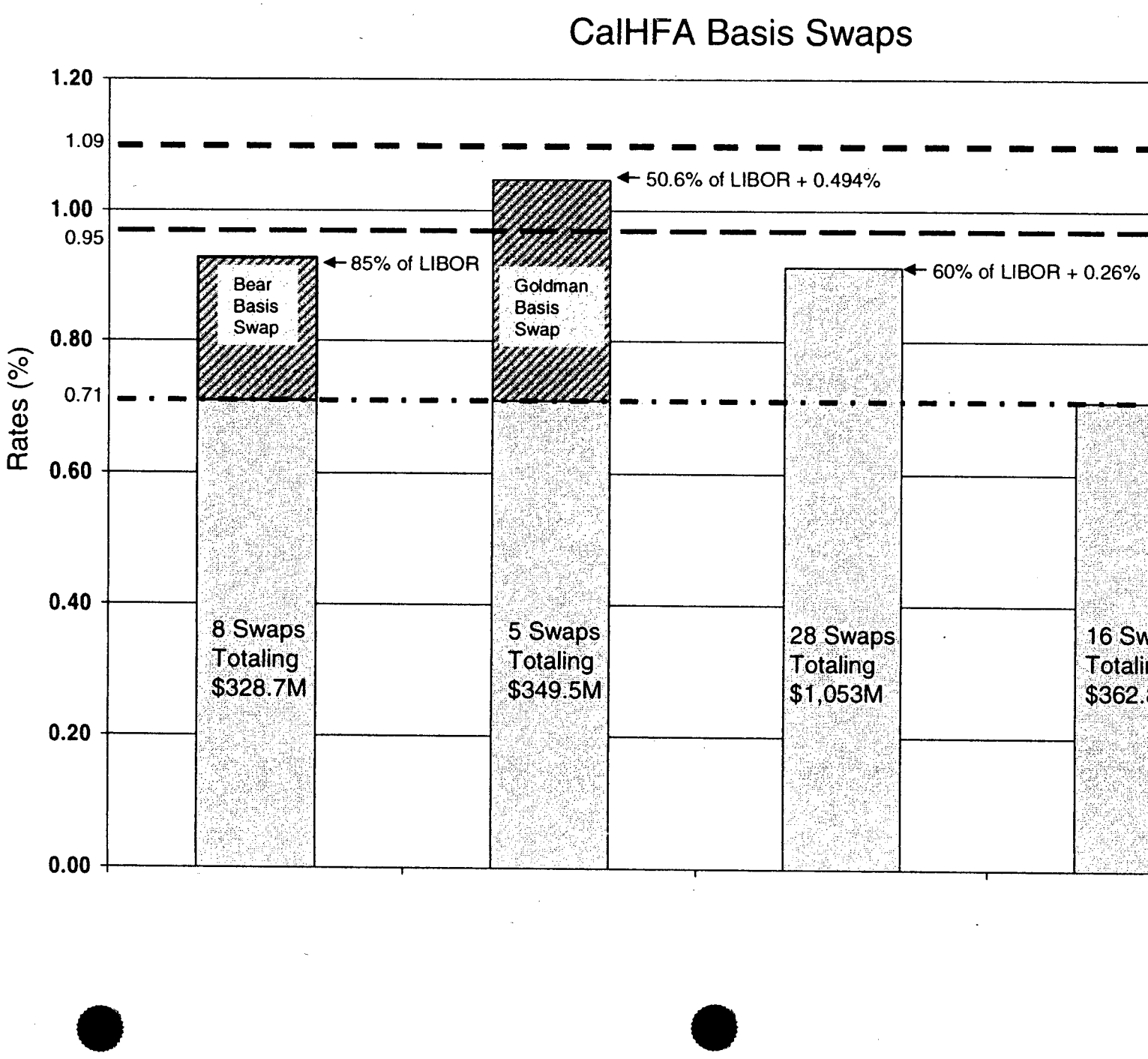
Subject: REPORT OF BASIS SWAP AGREEMENTS

On January 30th we agreed to terms with two of our swap counterparties for a total of 13 basis swaps designed to increase the variable rate payment to us when interest rates are low. These 13 basis swaps are layered onto 13 of our older fixed-payer interest rate swaps which are paying us a flat percentage (65%) of the one-month LIBOR index for $678.2 million of associated variable rate bonds. These basis swaps in effect convert the formula by which our floating rate swap receipts are calculated. By changing the formula, we will receive, if short-term rates stay at their current low levels for one year, almost $2 million of additional moneys to offset the variable rate payments owed to our bondholders. On the other hand, if interest rates rise above certain levels, we will not receive as much as we would have at the flat 65% of LIBOR calculation.

As discussed in previous "Update on Variable Rate Bonds and Interest Rate Swaps" reports to the Board, we ceased entering into flat percentage of LIBOR swaps in late 2002, when we realized that our variable rate bonds were trading at much higher percentages of LIBOR when the LIBOR index was very low. Today the one-month LIBOR index is at 1.09%, but we are paying 0.95% on our weekly-reset variable rate bonds. This 0.95% rate we are paying is 87% of LIBOR (not 65% of LIBOR), and, without the basis swaps, we would be 0.24% short of matching our swap receipts to our interest rate payments, a mismatch that would cost us $1.6 million per year.

Attachment 1 is a bar chart showing the layering of the basis swaps on top of the underlying 65% of LIBOR fixed-payer swaps and the resulting performance of these combined swaps in comparison to today's actual interest rates. Note also the bar showing the payment level we are receiving on our post-2002 swaps with their formula of 60% of LIBOR plus 0.26%. While this formula is expected to provide us with a good match through the full range of interest rate levels, the basis swap combinations will provide us with an even better match at low rates.

Attachment 2 describes the rate calculation formulas for the two forms of basis swaps. Both of these formulas (as well as our usual recent formula of 60% of LIBOR plus 0.26%) were developed as a result of studies of actual performance of California tax-exempt variable rate bonds in comparison to the taxable LIBOR index. Having more than one kind of calculation method may prove to be useful diversification, given that the matching of interest rates between our tax-exempt variable rate bonds and the taxable LIBOR index is subject to many complex factors. As further diversification, we have left $362.8 million of fixed-payer swaps at a flat percentage (64% or 65%) of LIBOR, partly as a hedge against high short-term rates when (as history has shown) our variable rate bonds may trade at levels as low as 60% of LIBOR.


CalHFA Basis Swaps
Rates (%)
1.20
1.09
1.00
0.95
0.80
0.71
0.60
0.40
0.20
0.00
50.6% of LIBOR + 0.494%
85% of LIBOR
60% of LIBOR + 0.26%
Bear Basis Swap
Goldman Basis Swap
8 Swaps Totaling $328.7M
5 Swaps Totaling $349.5M
28 Swaps Totaling $1,053M
16 Sw
Totali
$362.

ATTACHMENT 2

Swap Counterparties	Bear Stearns Financial Products, Inc.	Goldman Sachs Mitsui Marine Derivative Products Inc.
Aggregate Notional Amount	$328,690,000	$349,525,000
Swap Start Date	2/1/2004	2/1/2004
No. of Swaps	8	5
Type of Bonds	all Single Family	3 - Single Family; 2 - Multifamily
Floating Rate Formula	Stepped Percentage of LIBOR	Enhanced LIBOR
Calculation Base	if LIBOR is: / % of LIBOR Less than 1.25% — 85.0% 1.25% to 2.25% — 80.0% 2.25% to 3.25% — 70.0% 3.25% to 4.25% — 66.0% 4.25% to 5.75% — 64.0% 5.57% to 6.75% — 62.0% Greater than 6.75% — 60.0%	The Enhanced LIBOR formula is 50.6% of LIBOR plus 0.494%, with the proviso that the result can never be lower than 61.5% of LIBOR nor greater than 100% of LIBOR.

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State of California

2006

MEMORANDUM

To: Board of Directors **Date:** February 26, 2004

Ken Carlson, Director of Financing

From: **CALIFORNIA HOUSING FINANCE AGENCY**

Subject: DRAWDOWN BONDS FOR MULTIFAMILY

On December 17 we received $21,555,000 of private activity bond volume cap from the California Debt Limit Allocation Committee for the following three multifamily projects:

Murphy Ranch II	$ 7,235,000
Newport Senior	8,570,000
Oak Village	5,750,000
Total	$21,555,000

Per the CDLAC resolution that awarded the allocation, we are required to issue bonds pursuant to this authority by March 16. Issuing our normal form of bonds in such a relatively small amount is not a cost-effective use of staff resources or Agency money. Alternatively, we can issue what are called "drawdown bonds" to preserve the authority for later use, when we can take advantage of the economies of scale associated with larger bond issuances. Accordingly, we plan to issue drawdown bonds, in the amount of $21,555,000, on March 10.

The drawdown bond program is a private placement program that provides a low-cost, flexible means to vest private activity bond allocation for later use. We frequently use this program for single family, where we have issued $1.1 billion of drawdown bonds since the program's inception in 2002. Previously we used the drawdown bond program for multifamily only once, in 2002, and also to avoid a small regular issuance. These drawdown bonds will bear interest at a variable rate, with monthly resets based on an index. The proceeds will be invested in an investment agreement that bears interest at an indexed rate higher than the bonds. The bonds are unrated, uninsured and secured solely by their proceeds.

We intend to refund these drawdown bonds in June 2004. Including the refunding of the drawdown bonds, we expect to issue an aggregate amount of approximately $116 million of multifamily bonds in June, comprised of various refunding bonds and the $67 million of new money allocation that we have requested and expect to receive from CDLAC at its meeting scheduled for April 21.

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2008

MEMORANDUM

To: Board of Directors **Date:** February 26, 2004

Ken Carlson, Director of Financing

From: **CALIFORNIA HOUSING FINANCE AGENCY**

Subject: UPDATE ON VARIABLE RATE BONDS AND INTEREST RATE SWAPS

Although we began issuing some variable rate bonds in 1995, it was not until 2000 that we began using variable rate debt as our primary issuance strategy with most of our interest rate exposure hedged in the swap market, as further described in this report. This strategy has enabled us to achieve a significantly lower cost of funds and a better match between assets and liabilities, all as described in detail in this report. These benefits are especially important in today's interest rate market, where short-term rates are extremely low and the usual rate advantage of tax-exempt financing is greatly reduced.

The following report describes our variable rate bond and swap positions. The report is divided into sections as follows:

- Variable Rate Debt Exposure
- Fixed-Payer Interest Rate Swaps
- Basis Risk and Basis Swaps
- Risk of Changes to Tax Law
- Amortization Risk
- Termination Risk
- Types of Variable Rate Debt
- Liquidity Providers
- Bond and Swap Terminology

2009

VARIABLE RATE DEBT EXPOSURE

The total amount of CalHFA variable rate debt (not including our warehouse lines) is $5.4 billion, 74% of our estimated $7.4 billion of total indebtedness as of March 10, 2004. As shown in the table below, our "net" variable rate exposure is $1.1 billion , 15% of our indebtedness. The net amount of variable rate bonds is the amount that is neither swapped to fixed rates nor directly backed by complementary variable rate loans or investments.

VARIABLE RATE DEBT
($ in millions)

	Tied Directly to Variable Rate Assets	Swapped to Fixed Rate	Not Swapped or Tied to Variable Rate Assets	Total Variable Rate Debt
Single Family	$543	$3,155	$926	$4,624
Multifamily	0	648	190	838
Total	$543	$3,803	$1,116	$5,462

Our net exposure has been adjusted to recognize that, of the $682 million of proceeds of variable rate taxable notes currently outstanding, $266 million is invested at a fixed rate. The remaining $416 million of proceeds is invested at a floating rate. One year ago our net exposure was $688 million and 8.9% of our indebtedness. Two years ago it was $697 million and 9.2 % of our indebtedness; three years ago it was $517 million and 7.0%.

As discussed in each previous report, our $1.1 billion of net exposure provides a useful internal hedge against today's low interest rate environment, where we are experiencing low short-term investment rates and fast loan prepayments. For example, interest rates for the State Treasurer's investment pool, where we invest much of our bond proceeds, have now fallen to 1.49%. In addition, the high incidence of single family loan prepayments since early in 2001 has caused our loan portfolio to contract in spite of our $1.3 billion pace of annual new single family and multifamily production. However, debt service savings on our unswapped variable rate bonds helps to offset the economic consequences of low investment rates and high prepayments. As an example, the interest rates on our unswapped taxable variable rate bonds have been running at just over one percent since the last time the Federal Reserve lowered overnight rates.

The table below summarizes this risk position.

NET VARIABLE RATE DEBT
($ in millions)

	Tax-Exempt	Taxable	Totals
Short average life	$104	$715	$819
Long average life	120	177	297
TOTALS	$224	$892	$1,116

2010

FIXED-PAYER INTEREST RATE SWAPS

Currently, we have arranged (or expect to arrange early in March) a total of 93 "fixed-payer" swaps with nine different counterparties for a combined notional amount of $3.92 billion. Included in this total is $107 million of anticipatory swaps for multifamily bonds that are expected to be issued later this year and in 2005. All of these fixed-payer swaps are intended to establish synthetic fixed rate debt by converting our variable rate payment obligations to fixed rates. 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 first-time homebuyers. The table below provides a summary of our notional swap amounts.

FIXED PAYER INTEREST RATE SWAPS
(notional amounts)
($ in millions)

	Tax-Exempt	Taxable	Totals
Single family	$1,876	$1,291	$3,167
Multifamily	756	0	756
TOTALS	$2,632	$1,291	$3,923

The following table shows the diversification of our fixed payer swaps among the nine firms acting as our swap counterparties. Note that our swaps with Lehman Brothers, Bear Stearns, and Goldman Sachs are with highly-rated structured 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 the others. Note also that with our most recent swaps with Merrill Lynch we are benefiting from the credit of their triple-A structured subsidiary.

2011

SWAP COUNTERPARTIES

Swap Counterparty	Credit Ratings Moody's	S & P	Fitch	Notional Amounts Swapped *($ in millions)*	Number of Swaps
Merrill Lynch Capital Services Inc.					
Guaranteed by:					
Merrill Lynch & Co.	Aa3	A+	AA-	$ 862.7	18
MLDP, AG	Aaa	AAA	AAA	303.6	8
Citigroup Financial Products Inc.	Aa1	AA-	AA+	683.9	15
Bear Stearns Financial Products Inc.	Aaa	AAA	NR	678.6	11
Lehman Brothers Derivative Products Inc.	Aaa	AAA	NR	599.4	18
AIG Financial Products Corp.	Aaa	AAA	AAA	260.1	8
Goldman Sachs Mitsui Marine Derivative Products, L.P.	Aaa	AA+	NR	167.1	4
JP Morgan Chase Bank	Aa3	AA-	AA-	146.2	5
Bank of America, N.A.	Aa1	AA-	AA+	129.0	4
UBS AG (Union Bank of Switzerland AG)	Aa2	AA+	AA+	91.6	2
				$3,922.2	93

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.

For all of our fixed-payer swaps, 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 these swap agreements is from us to our counterparties. As an example, on our February 1, 2004 semiannual debt service payment date we made a total of $61.6 million of net payments to our counterparties. 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.

BASIS RISK AND BASIS SWAPS

All of our swaps contain an element of what is referred to as "basis risk" – the risk that the floating rate component of the swap will not match the floating rate of the underlying bonds. This risk arises because our swap floating rates are based on indexes, which consist of market-wide averages, while our bond floating rates are specific to our individual bond issues.

Periodically, the divergence between the two floating rates widens, as market conditions change. Some periodic divergence was expected when we entered into the swaps. However, in today's very-low-rate market, we have encountered one such divergence that is worth noting as it pertains to our LIBOR-based swaps used in conjunction with the Agency's tax-exempt variable rate bonds. Based on a conservative reading of historic relationships between short-term tax-exempt and taxable rates, we chose to enter into many swaps at a ratio of 65% of LIBOR. LIBOR, the London Inter-Bank Offered Rate, is the market benchmark taxable floating rate index. These percentage-of-LIBOR swaps have afforded us with excellent liquidity and great savings compared with other alternatives.

With short-term rates at historic lows and with an increased market supply of tax-exempt variable rate bonds, the historic relationship between tax-exempt and taxable rates has not been maintained. For example, the average BMA/LIBOR ratio was 77% in 2002, 84.3% in 2003, and is currently at 85.1%. The BMA (Bond Market Association) index is the market benchmark index for tax-exempt variable rates.

When the BMA/LIBOR ratio is very high the swap payment we receive falls short of our bond payment, and the all-in rate we experience is somewhat higher. The converse is true when the percentage is low. In response, we and our advisors looked for a better formula than a flat 65% of LIBOR. After considerable study of California tax-exempt variable rate history, we settled on a new formula (60% of LIBOR plus 0.26%) that results in comparable fixed-rate economics but performs better when short-term rates are low and the BMA/LIBOR percentage is high. Since December of 2002 we have amassed approximately $1.1 million of new LIBOR-based swaps using this new formula, and we expect to continue to use this formula for new swaps in 2004.

While we have dealt with this problem for new swaps, we still had approximately $1 billion of older swaps for which we received a flat percentage (64% or 65%) of LIBOR. On February 1, we entered into basis swaps with two of our counterparties covering $678 million of the older 65% of LIBOR swaps. Under the terms of these basis swaps, we have exchanged our 65% of LIBOR floating rate obligation for alternative formulas that provide us with better economics in low-rate environments. In one case, covering eight older swaps, our new payment obligation will be calculated based on a stepped-rate formula that provides a higher percentage of LIBOR in low- rate conditions. In the other case, for five older swaps, our new payment obligation will be a lower percentage of LIBOR plus a "spread". In both cases we expect to greatly alleviate the effects of the current high BMA/LIBOR ratio. Together these basis swaps are expected to save us almost $2 million per year if short-term interest rates stay low.

2013

BASIS SWAP COUNTERPARTIES

Swap Counterparts	Notional Amount Swapped ($ in Millions)	Number of Swaps
Bear Stearns Financial Products Inc.	$328.7	8
Goldman Sachs Mitsui Marine Derivative Products, L.P.	349.5	5
Lehman Brothers Derivative Products Inc.	12.9 *	1
TOTALS	$691.1	14

* This small swap executed in 2000 converted a portion of a LIBOR-based swap to a BMA basis, thus reducing tax risk.

RISK OF CHANGES TO TAX LAW

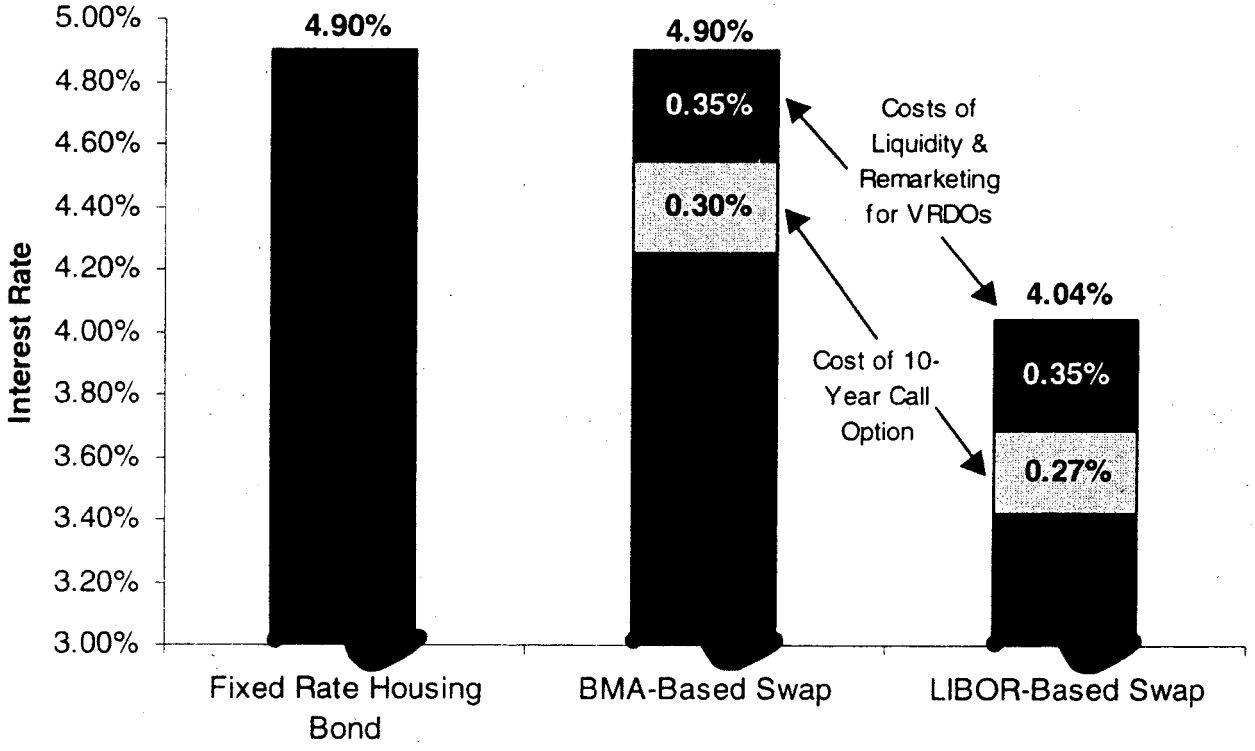
For an estimated $2.1 billion of the $2.5 billion of tax-exempt bonds swapped to a fixed rate, we remain exposed to certain tax-related risks, another form of basis risk. In return for significantly higher savings, we have chosen through these interest rate swaps to retain exposure to the risk of changes in tax laws that would lessen the advantage of tax-exempt bonds in comparison to taxable securities. In these cases, if a tax law change were to result in tax-exempt rates being more comparable to taxable rates, the swap provider's payment to us would be less than the rate we would be paying on our bonds, again resulting in our all-in rate being higher.

We bear this same risk for $351 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 $2.5 billion, 31.9% of our $7.4 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.

The bar chart shows clearly that our ability to assume the risk of changes to tax laws is the "engine" that makes our interest rate swap strategy effective in today's market. If the Agency was unable or unwilling to take this risk, our cost of funds would be significantly higher. In fact, the chart shows that a BMA-based swap strategy, where we would avoid taking tax risk, would not produce an all-in cost of funds any different than that of a fixed-rate bond strategy.

2014

Comparative Costs of Funds for Fixed-Rate Bonds and Synthetic Fixed-Rate Bonds (Variable Rate Bonds Swapped to Fixed)



AMORTIZATION RISK

Our bonds are generally paid down (redeemed or paid at maturity) as our loans are prepaid. Our interest rate swaps amortize over their lives based on assumptions about the receipt of prepayments, and the single family transactions which include swapped bonds have been designed to accommodate prepayment rates between two and three times the "normal" rate. In other words, our interest rate swaps generally have had fixed amortization schedules that can be met under what we have believed were sufficiently wide ranges of prepayment speeds. Unfortunately, when market rates fell to unprecedented levels, we started receiving more prepayments than we ever expected.

Since January 1, 2002, we have received over $3.4 billion of prepayments, including over $2.1 billion in 2003. Of this amount, approximately $600 million is "excess" to swapped transactions we entered into between 2000 and 2002. In other words, our current loan portfolios for these 2000 through 2002 bond transactions have shrunk to amounts that are $600 million less than the current "notional" amounts of the interest rate swaps.

Also of interest is our first instance (as of February 1, 2004) of a small $11.8 million forced mismatch between the notional amount of certain of our swaps and the outstanding amount of the related bonds. These five small mismatches have occurred as a result of the interplay between our phenomenally high incidence of prepayments and the "10-year rule" of federal tax law. Under this rule, prepayments received 10 or more years beyond the date of the original issuance of bonds cannot be recycled into new loans and must be used to redeem bonds. In the case of these recent bond issues, a portion of the authority to issue them on a tax-exempt basis was related to older bonds.

While this small mismatch has occurred (and will show up in the tables of this report), the small semiannual cost of the mismatch will be more than offset by the large interest cost savings from our $1.1 billion of "net" variable rate debt. In other words, while some of our bonds are "over-swapped", there are significantly more than enough unswapped variable rate bonds to compensate for the mismatch.

There are several strategies for dealing with these excess prepayments: they may be reinvested, used for the redemption of other (unswapped) bonds, or recycled directly into new loans. Alternatively, we could make termination payments to our counterparties to reduce the notional amounts of the swaps, but this alternative appears to be the least attractive economically.

Currently we are investing the bulk of the excess prepayments with the financial institutions that originally provided us, for each transaction, with fixed-rate "float" agreements at what seem like high rates today. Many of these agreements, however, were written to limit the amount of time that we could leave moneys on deposit; in these cases the investment of the excess is an interim step until we implement longer-term strategies.

We believe that the best long-term strategy will be to recycle the excess prepayments into new CalHFA loans. Of course, this means that we will be bearing the economic consequences of replacing old 7% to 8% loans that have paid off with new loans at the rates that will be current at the time we recycle. With our March 1 transfer of loans from our warehouse line we will have recycled a total of $385 million of excess prepayment moneys. Each month going forward we expect to continue high levels of recycling. This practice will likely result in reduced issuance activity in 2004.

TERMINATION RISK

Termination risk is the risk that, for some reason, our interest rate swaps must be terminated prior to their scheduled maturity. Our swaps have a market value that depends on current interest rates. When current fixed rates are higher than the fixed rate of the swap, our swaps have a positive value to us (assuming, as is the case on all of our swaps, that we are the payer of the fixed swap rate), and termination would result in a payment from the provider of the swap (our swap "counterparty") to us. Conversely, when current fixed rates are lower than the fixed rate of the swap, our swaps have a negative value to us, and termination would result in a payment from us to our counterparty.

Our swap documents allow for a number of termination "events", i.e., circumstances under which our swaps may be terminated early, or (to use the industry phrase) "unwound". One circumstance that would cause termination would be a payment default on the part of either counterparty. Another circumstance would be a sharp drop in either counterparty's credit ratings and, with it, an inability (or failure) of the troubled counterparty to post sufficient collateral to offset its credit problem. It should be noted that, if termination is required under the swap documents, the market determines the amount of the termination payment and who owes it to whom. Depending on the market, it may be that the party who has caused the termination is owed the termination payment.

As part of our strategy for protecting the agency when we entered the swap market in late 1999, we determined to choose only highly-creditworthy counterparties and to negotiate "asymmetrical" credit requirements in all of our swaps. These asymmetrical provisions impose higher credit standards on our counterparties than on the agency. For example, our counterparties may be required to collateralize their exposure to us when their credit ratings fall from double-A to the highest single-A category (A1/A+), whereas we need not collateralize until our ratings fall to the mid-single-A category (A2/A).

At least quarterly we monitor the termination value of our swap portfolio as it grows and as interest rates change. Over time, since we entered the swap market, interest rates largely fell, with a "bottom" in June of 2003. Growth in the portfolio combined with this steady downward trend in interest rates made our swap portfolio have a large negative value (to us), as shown in the table on the next page. This negative value was greatly reduced by the July rise in rates. However, falling rates this fall and winter caused the negative value to increase again, but not to the levels seen last May and June.

2017

Because termination is an unlikely event, the fact that our swap portfolio has a large negative value, while interesting, is not necessarily a matter of direct concern. We have no plans to terminate swaps early (except in cases where we negotiated "par" terminations when we entered into the swaps) and do not expect that credit events triggering termination will occur, either to us or to our counterparties.

The Government Accounting Standards Board does not require that our balance sheet be adjusted for the market value of our swaps, but, beginning last fiscal year, it does require that this value be disclosed in the notes to our financial statements.

The table below shows the history of the fluctuating negative value of our swap portfolio over the last three years.

TERMINATION VALUE HISTORY

Date	Termination Value ($ in millions)
6/30/01	($81.6)
9/30/01	($178.6)
12/31/01	($133.4)
3/31/02	($ 86.2)
6/30/02	($200.8)
9/30/02	($344.6)
12/31/02	($345.2)
3/31/03	($345.1)
5/31/03	($450.4)
6/30/03	($409.9)*
7/31/03	($208.4)
8/31/03	($212.9)
9/30/03	($322.9)
10/31/03	($255.4)
11/30/03	($254.3)
12/31/03	($274.5)
1/31/04	($297.6)

It should be noted that during this period, the notional amount of our fixed-payer swaps has been increasing to our current total of $3.9 billion. When viewing the termination value, one should consider both the change in market conditions and the increasing notional amount.

** As reported in our 2002/03 financial statements.*

2018

TYPES OF VARIABLE RATE DEBT

The table below shows our variable rate debt sorted by type, i.e., whether 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)

	Auction Rate & Similar Securities	Indexed Rate Bonds	Variable Rate Demand Obligations	Total Variable Rate Debt
Single Family	$140	$2,321	$2,142	$4,603
Multifamily	231	21	607	859
Total	$371	$2,342	$2,749	$5,462

Since September of 2000 we have been able to sell $2.4 billion of taxable single family variable rate bonds to the Federal Home Loan Banks. We also expect in April to convert an additional$47 million of existing taxable VRDOs to indexed-rate securities for purchase by the San Francisco FHLB. In addition, our $100 million of currently outstanding drawdown bonds are indexed-rate securities.

LIQUIDITY PROVIDERS

The table below shows the financial institutions providing liquidity in the form of standby bond purchase agreements for our VRDOs. Under these agreements, if our variable rate bonds are put back to our remarketing agents and cannot be remarketed, these institutions are obligated to buy the bonds. Dexia Credit Local, a highly-rated Belgian/French bank, is the largest provider of liquidity, followed closely by Fannie Mae

In 2003 we began financing our multifamily program with auction rate securities, for which no liquidity support is required. Use of auction rate securities for multifamily will enable us to target Fannie Mae's remaining liquidity capacity to single family deals. For instance, Fannie Mae recently provided liquidity for the first time to a single family bond issue that we did in partnership with the Southern California Home Financing Authority.

We are currently working toward obtaining liquidity for single family bond issues this year and next from eight different financial institutions. We expect to obtain additional capacity from some of our current providers (e.g. Fannie Mae, Bank of America, and JP Morgan Chase Bank) and hope to bring in as many as five new providers, including Freddie Mac.

Bank liquidity is more scarce today than in previous years for a couple of reasons. First, more and more issuers want to issue variable rate debt, and second, many banks apparently feel that, because of the State's budget crisis, this is not the time to increase exposure to California issuers.

LIQUIDITY PROVIDERS
($ in millions)

Financial Institution	$ Amount of Bonds	Type of Bonds
Dexia Credit Local	$504.0	SF
Fannie Mae	484.1	SF/MF
Lloyds TSB	327.1	SF
Bank of Nova Scotia	278.7	SF
Bank of America	191.7	SF
Landesbank Hessen-Thuringen	178.7	MF
KBC	143.1	SF
Westdeutsche Landesbank	142.2	SF
Bayerische Landesbank	120.7	SF
CalSTRS	105.3	SF/MF
Bank of New York	99.8	SF
State Street Bank	75.0	SF
JP Morgan Chase Bank	51.4	SF/MF
Commerzbank	47.2	SF
Total	$2,749.0	

Unlike our interest rate swap agreements, our liquidity agreements do not run for the life of the related bonds. Instead, they are seldom offered for terms in excess of five years, and a portion of our agreements require annual renewal. We expect all renewals to take place as a matter of course; however, changes in credit ratings or pricing may result in substitutions of one bank for another from time to time. In addition, we have begun to switch some of our VRDOs to auction rate in order to free up liquidity capacity of some current providers.

As a further matter, by April of this year we will have entirely eliminated our bondholders' exposure to Commerzbank, whose credit ratings were lowered in 2002. VRDOs backed by Commerzbank are being converted either to indexed rates (for purchase by the San Francisco FHLB) or to auction rates.

BOND AND SWAP TERMINOLOGY

REVENUE BOND (OR SPECIAL OBLIGATION BOND) (OR LIMITED OBLIGATION BOND)
A type of security which is evidence of a debt secured by revenues from certain assets (loans) pledged to the payment of the debt.

GENERAL OBLIGATION BOND
A type of security which is evidence of a debt secured by all revenues and assets of an organization.

INDENTURE
The legal instrument that describes the bonds and the pledge of assets and revenues to investors. The indenture often consists of a general indenture plus separate series indentures describing each issuance of bonds.

OFFICIAL STATEMENT
The "prospectus" or disclosure document describing the bonds being offered to investors and the assets securing the bonds.

SERIES OF BONDS
An issuance of bonds under a general indenture with similar characteristics, such as delivery date or tax treatment. Example: "Name of Bonds", 1993 Series A. Each series of Bonds has its own series indenture.

MATURITY
Date on which the principal amount of a bond is scheduled to be repaid.

REDEMPTION
Early repayment of the principal amount of the bond. Types of redemption: "special", "optional", and "sinking fund installment".

SERIAL BOND
A bond with its entire principal amount due on a certain date, without scheduled sinking fund installment redemptions. Usually serial bonds are sold for any principal amounts to be repaid in early (10 or 15) years.

TERM BOND
A bond with a stated maturity, but which may be subject to redemption from sinking fund installments. Usually of longer maturity than serial bonds.

DATED DATE
Date from which first interest payment is calculated.

PRICING DATE
Date on which issuer agrees (orally) to sell the bonds to the underwriters at certain rates and terms.

SALE DATE
Date on which purchase contract is executed evidencing the oral agreement made on the pricing date.

DELIVERY DATE, OR ISSUANCE DATE
Date that bonds are actually delivered to the underwriters in exchange for the bond proceeds.

REFUNDING

Use of the proceeds of one bond issue to pay for the redemption or maturity of principal of another bond issue.

VARIABLE RATE BOND

A bond with periodic resets in its interest rate. Opposite of fixed rate bond.

INTEREST RATE SWAP

An exchange between two parties of interest rate exposures from floating to fixed rate or vice versa. A fixed-payer swap converts floating rate exposure to a fixed rate.

NOTIONAL AMOUNT

The principal amount on which the exchanged swap interest payments are based.

COUNTERPARTY

One of the participants in an interest rate swap.

LIBOR

London Interbank Offered Rate. The interest rate highly rated international banks charge each other for borrowing U.S. dollars outside of the U.S. Taxable swaps often use LIBOR as a rate reference index. LIBOR swaps associated with tax-exempt bonds will use a percentage of LIBOR as a proxy for tax-exempt rates.

BMA

Bond Market Association. A weekly index of short-term tax-exempt rates.

MARK-TO-MARKET

Valuation of securities or swaps to reflect the market values as of a certain date. Represents liquidation or termination value.

DELAYED START SWAP

A swap which delays the commencement of the exchange of interest rate payments until a later date.

SWAP CALL OPTION

The right (but not the obligation) to terminate a predetermined amount of swap notional amount, occurring or starting at a specific future date.

INTEREST RATE CAP

A financial instrument which pays the holder when market rates exceed the cap rate. The holder is paid the difference in rate between the cap rate and the market rate. Used to limit the interest rate exposure on variable rate debt.

SYNTHETIC FIXED RATE DEBT

Converting variable rate debt into a fixed rate obligation through the use of fixed-payer interest rate swaps.

SYNTHETIC FLOATING RATE DEBT

Converting fixed rate debt into a floating rate obligation through the use of fixed-receiver interest rate swaps.