



# REPORTS

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State of California

## MEMORANDUM

To Board of Directors

Date: August 23, 2005



From: Bruce D. Gilbertson, Director of Financing  
CALIFORNIA HOUSING FINANCE AGENCY

Subject: REPORT OF BOND SALE AND INTEREST RATE SWAP AGREEMENTS  
HOME MORTGAGE REVENUE BONDS 2005 SERIES EF

On July 28<sup>th</sup>, we delivered the Agency's Home Mortgage Revenue Bonds 2005 Series E and Series F bonds to Citigroup. The bonds totaled \$200 million and were issued in both tax-exempt fixed rate and tax-exempt variable rate form. Liquidity for the variable rate bonds was provided by Lloyds Bank. The transaction proceeds will be used to fund approximately 880 new loans with rates expected to range from 4.65% to 5.25%. With the proceeds of this financing we expect to purchase approximately \$145 million of *interest only*.PLUS<sup>SM</sup> loans (35 year loans), with the remaining funds being used to purchase our standard 30 year mortgage loan product. CalHFA is currently taking reservations which are approximately 35% ioP loans and 65% standard 30 year loan.

The debt structure is comprised of \$20 million of serial bonds, \$160 million of variable rate bonds swapped to a fixed-rate utilizing two interest rate swaps, and an additional \$20 million of variable rate bonds which were left unhedged. Having callable serial bonds and unhedged variable rate debt allowed us to reduce the amount of call options purchased on the interest rate swaps, thus lowering our cost of funds. The issuance of new unhedged variable rate debt also maintains the overall level of unhedged debt, which had been reduced due to August 1, 2005 redemptions.

We determined the rates for the interest rate swaps on July 7, 2005, with the effective date of the swaps occurring on the bond closing date of July 28, 2005.

A table summarizing the terms of the bonds and swaps appears on page 2.

SERIES	E	F	F	F
\$ Amount	\$20,000,000	\$86,685,000	\$73,315,000	\$20,000,000
Type of Bonds	Fixed Rate Serial Bonds	VRDO	VRDO	VRDO
Tax Treatment	Non-AMT	AMT	AMT	AMT
Maturities	8/1/2006 – 2/1/2011	2/1/2037	2/1/2038	2/1/2040
Average Life	N/A	22 yrs	10 yrs	2.5 yrs
Interest Rates	2.60% - 3.35%	Variable	Variable	Variable
Reset Frequency	N/A	Weekly	Weekly	Weekly
Floating Rate Swap Formula	N/A	60% of LIBOR + 26 bps	60% of LIBOR + 26 bps	N/A
Swap Rates	N/A	3.386%	3.22%	N/A
Swap Start Date	N/A	7/28/05	7/28/05	N/A
Bond Credit Rating	Aa2/AA-	Aa2/AA-	Aa2/AA-	Aa2/AA-
Swap Counterparty	N/A	Morgan Stanly Capital Services	Citigroup Financial Products Inc.	N/A
Bond Insurer	N/A	N/A	N/A	N/A

State of California

**MEMORANDUM****To:** Board of Directors**Date:** August 23, 2005


**From:** Bruce D. Gilbertson, Director of Financing  
**CALIFORNIA HOUSING FINANCE AGENCY**

**Subject:** DRAW DOWN BONDS

On August 1, 2005 the Agency completed a drawing on the 2005 A Draw Down Bonds to preserve \$5.37 million of refunding authority associated with the August 1, 2005 bond redemptions. This drawing increases the balance of authority available in this draw down bond to \$69,895,000. A future issuance of Home Mortgage Revenue Bonds will refund this authority.

The draw down bond program is one of several available mechanisms for preserving tax-exempt bond authority for future use. Draw down bonds are issued in variable rate form and have interest rate resets based on an index. The bonds are privately placed with an investment subsidiary of one of our underwriters and are not rated or insured. Private placement greatly reduces transaction costs and provides useful flexibility, allowing us to easily add additional amounts and to redeem on short notice.

The following table reflects draw down bond program balances at 8/1/05.

**Draw Down Bond Program Balances**

Single Family Draw Down Bonds	Tax Status	Bonds Outstanding at 8/01/05
2004 A	Non-AMT	\$ 0
2004 B1	AMT	\$ 475,000,000
2004 B2	AMT	\$ 266,425,000
2005 A	Non-AMT	\$ 67,236,000
2005 B	AMT	\$ 0
<b>Totals</b>		<b>\$ 808,661,000</b>

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State of California

**MEMORANDUM****To:** Board of Directors**Date:** August 23, 2005**From:** Bruce D. Gilbertson, Director of Financing  
**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

**VARIABLE RATE DEBT EXPOSURE**

This report describes the variable rate bonds and notes of CalHFA and is organized programmatically by indenture as follows: HMRB (Home Mortgage Revenue Bonds--CalHFA's largest single family indenture), MHRB (Multifamily Housing Revenue Bonds III--CalHFA's largest multifamily indenture), HPB (Housing Program Bonds--CalHFA's newest indenture, used to finance the Agency's downpayment assistance loans), and DDB (Draw Down Bonds used to preserve tax-exempt authority.) The total amount of CalHFA variable rate debt is \$6.3 billion, 87% of our \$7.2 billion of total indebtedness as of August 1, 2005. As shown in the table below, our "net" variable rate exposure is \$893 million, 12.4% 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 ( <i>\$ in millions</i> )			
	Tied Directly to Variable Rate <u>Assets</u>	Swapped to <u>Fixed Rate</u>	Not Swapped or Tied to Variable Rate <u>Assets</u>	Total Variable <u>Rate Debt</u>
HMRB	\$4	\$3,677	\$593	\$4,274
MHRB	45	813	285	1,143
HPB	0	35	15	50
DDB	<u>808</u>	<u>0</u>	<u>0</u>	<u>808</u>
Total	\$897	\$4,490	\$893	\$6,275

One year ago our net exposure was \$1.2 billion and 16% of our indebtedness. Two years ago it was \$806 million and 10.3% of our indebtedness; three years ago it was \$666 million and 8.5%.

As discussed in each previous report, our \$893 million 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, the interest earnings rate for the State Treasurer's investment pool, where we invest much of our bond proceeds, is currently at 3.14%. 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 resetting at approximately 3.55%.

**VARIABLE RATE DEBT EXPOSURE**

This report describes the variable rate bonds and notes of CalHFA and is organized programmatically by indenture as follows: HMRB (Home Mortgage Revenue Bonds--CalHFA's largest single family indenture), MHRB (Multifamily Housing Revenue Bonds III--CalHFA's largest multifamily indenture), HPB (Housing Program Bonds--CalHFA's newest indenture, used to finance the Agency's downpayment assistance loans), and DDB (Draw Down Bonds used to preserve tax-exempt authority.) The total amount of CalHFA variable rate debt is \$6.3 billion, 87% of our \$7.2 billion of total indebtedness as of August 1, 2005. As shown in the table below, our "net" variable rate exposure is \$893 million, 12.4% 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 <u>Assets</u>	Swapped to Fixed Rate	Not Swapped or Tied to Variable Rate <u>Assets</u>	Total Variable Rate Debt
HMRB	\$4	\$3,677	\$593	\$4,274
MHRB	45	813	285	1,143
HPB	0	35	15	50
DDB	<u>808</u>	<u>0</u>	<u>0</u>	<u>808</u>
Total	\$857	\$4,525	\$893	\$6,275

One year ago our net exposure was \$1.2 billion and 16% of our indebtedness. Two years ago it was \$806 million and 10.3 % of our indebtedness; three years ago it was \$666 million and 8.5%.

As discussed in each previous report, our \$893 million 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, the interest earnings rate for the State Treasurer's investment pool, where we invest much of our bond proceeds, is currently at 3.14%. 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 resetting at approximately 3.55%.



The table below summarizes this risk position.

	NET VARIABLE RATE DEBT		
	(\$ in millions)		
	<u>Tax-Exempt</u>	<u>Taxable</u>	<u>Totals</u>
Short average life *	\$139	\$412	\$551
Long average life	<u>216</u>	<u>126</u>	<u>342</u>
<b>TOTALS</b>	<b>\$355</b>	<b>\$538</b>	<b>\$893</b>

\* Bonds with an expected average life of 10 years or less.

#### **FIXED-PAYER INTEREST RATE SWAPS**

Currently, we have a total of 118 "fixed-payer" swaps with eleven different counterparties for a combined notional amount of \$4.6 billion. Included in this total is \$34 million of anticipatory swaps for multifamily bonds that are expected to be issued later this year. 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)		
	<u>Tax-Exempt</u>	<u>Taxable</u>	<u>Totals</u>
HMRB	\$2,731	\$1,010	\$3,741
MHRB	847	0	847
HPB	<u>35</u>	<u>0</u>	<u>35</u>
<b>TOTALS</b>	<b>\$3,613</b>	<b>\$1,010</b>	<b>\$4,623</b>

The following table shows the diversification of our fixed payer swaps among the eleven 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 other firms. Note also that our most recent swaps with Merrill Lynch are either with their highly-rated structural subsidiary or we are benefiting from the credit of this triple-A structured subsidiary through a guarantee.

## SWAP COUNTERPARTIES

<u>Swap Counterparty</u>	<u>Credit Ratings</u>			<u>Notional Amounts Swapped</u> <i>(\$ in millions)</i>	<u>Number of Swaps</u>
	<u>Moody's</u>	<u>S &amp; P</u>	<u>Fitch</u>		
Merrill Lynch Capital Services Inc.					
Guaranteed by:					
Merrill Lynch & Co.	Aa3	A+	AA-	\$ 781.1	18
MLDP, AG	Aaa	AAA	AAA	317.5	12
Merrill Lynch					
Derivative Products Inc.	Aaa	AAA	AAA	105.9	5
Citigroup Financial					
Products Inc.	Aa1	AA-	AA+	846.4	21
Bear Stearns					
Financial Products Inc.	Aaa	AAA	NR	808.3	11
				319.4 *	8 *
Lehman Brothers					
Derivative Products Inc.	Aaa	AAA <sup>t</sup>	NR	565.5	21
Goldman Sachs Mitsui Marine					
Derivative Products, L.P.	Aaa	AA+	NR	316.3	6
				340.2 *	5 *
AIG Financial Products Corp.	Aa1	AA+	NR	246.0	8
Bank of America, N.A.	Aa1	AA	AA	230.1	5
JP Morgan Chase Bank	Aa2	AA-	AA-	143.2	6
BNP Paribas	Aa2	AA	AA	99.9	2
Morgan Stanley					
Capital Services Inc	Aa3	A+	AA-	86.7	1
UBS AG (Union Bank of Switzerland AG)	Aa2	AA+	AA+	<u>76.0</u>	<u>2</u>
				\$4,622.7	118

\* Basis Swaps (not included in totals)

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 low short-term rates, the net periodic payment owed under these swap agreements is from us to our counterparties. As an example, on our August 1, 2005 semiannual debt service payment date we made a total of \$41.7 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. In the past we entered into swaps at a ratio of 65% of LIBOR, the London Inter-Bank Offered Rate which is the index used to benchmark taxable floating rate debt. These percentage-of-LIBOR swaps have afforded us with excellent liquidity and great savings when the average BMA/LIBOR ratio was steady at 65%. But 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, 81.5% in 2004, and is currently at 74.2%. The BMA (Bond Market Association) index is the index used to benchmark 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 \$2.1 billion of new LIBOR-based swaps using this new formula, and we expect to continue to use this formula.

In addition, we currently have basis swaps for \$659 million of the older 65% of LIBOR swaps. The basis swaps provide us with better economics in low-rate environments by exchanging the 65% of LIBOR formula for alternative formulas that would alleviate the effects of the current high BMA/LIBOR ratio. As an example, we saved \$1.5 million on our swap payments since entering into the basis swaps. The following table shows the diversification of variable rate formulas used for determining the payments received from our interest rate swap counterparties.

**BASIS FOR VARIABLE RATE PAYMENTS  
RECEIVED FROM SWAP COUNTERPARTIES**  
(notional amounts)  
(\$ in millions)

	<u>Tax-Exempt</u>	<u>Taxable</u>	<u>Totals</u>
60% of LIBOR + 26bps	\$2,062	\$0	\$2,062
3 mo. LIBOR + spread	0	642	642
BMA – 15bps	494	0	494
Enhanced LIBOR <sup>1</sup>	340	0	340
1 mo. LIBOR	0	301	301
Stepped % of LIBOR <sup>2</sup>	319	0	319
65% of LIBOR	302	0	302
6 mo. LIBOR	0	67	67
64% of LIBOR	36	0	36
BMA – 20bps	36	0	36
60% of LIBOR + 21bps	<u>23</u>	<u>0</u>	<u>23</u>
<b>TOTALS</b>	<b>\$3,612</b>	<b>\$1,010</b>	<b>\$4,622</b>

<sup>1</sup> Enhanced LIBOR – This formula is 50.6% of LIBOR plus 0.494% with the proviso that the end result can never be lower than 61.5% of LIBOR nor greater than 100% of LIBOR.

<sup>2</sup> Stepped % of LIBOR – This formula has seven incremental steps where at the low end of the spectrum the swap counterparty would pay us 85% of LIBOR if rates should fall below 1.25% and at the high end, they would pay 60% of LIBOR if rates are greater than 6.75%.

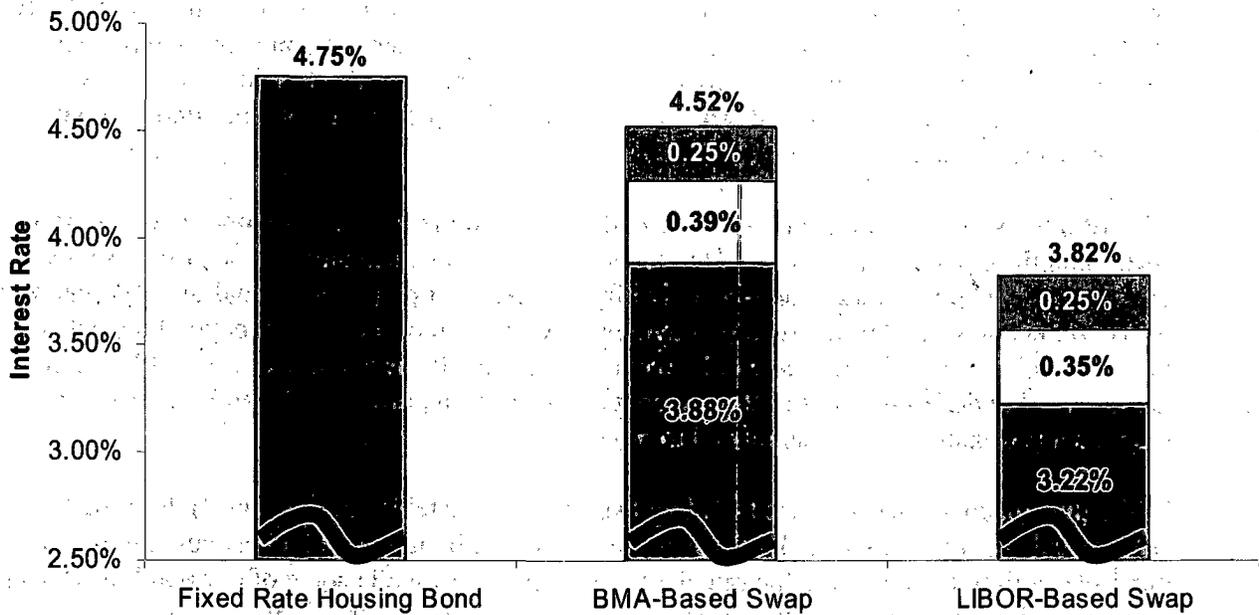
**RISK OF CHANGES TO TAX LAW**

For an estimated \$3.0 billion of the \$3.5 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 \$409 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 \$3.4 billion, 46.6% of our \$7.2 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 following 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.

**Costs of Funds for Fixed-Rate Bonds and Synthetic Fixed-Rate Bonds  
(Variable Rate Bonds Swapped to Fixed)  
(All Rates as of August 18, 2005)**



BMA-Based Swap: BMA Index – 15 bps  
LIBOR-Based Swap: 60% LIBOR + 26 bps

**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 generally 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 \$5.4 billion of prepayments, including over \$1.4 billion in 2004 and \$748 million to date in calendar year 2005. Of this amount, approximately \$1.6 billion is "excess" to swapped transactions we entered into between 2000 and 2004. We have since recycled \$963 million of the \$1.6 billion excess into new loans and have used \$166 million to cross-call high interest rate bonds.

With persistent high levels of prepayments, we are planning to modify the structuring of new swaps by widening the band of expected prepayments speeds. The swap structure for the HMRB 2005 Series A bonds utilized a matched amortization swap so that the bonds outstanding and the swap notional amount remain equal under all mortgage prepayment scenarios. In other words, all prepayments will be used to call bonds, recycling is not permitted, and our bonds and swaps will amortize together.

Also of interest is a \$64 million forced mismatch between the notional amount of certain of our swaps and the outstanding amount of the related bonds. This mismatch has 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 tax-exempt 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 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 \$893 million 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 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 initially invest most 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.

In consultation with our financial advisors, we have determined that the best long-term strategy is 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 August 1, 2005 transfer of loans from our warehouse line we have recycled a total of \$963 million of excess prepayment moneys over the past year and a half. This practice has resulted in reduced issuance activity in 2004 and 2005.

### 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).

Monthly 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 have generally been falling. Growth in the portfolio combined with this 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.

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 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 for the last year.

#### TERMINATION VALUE HISTORY

<u>Date</u>	<u>Termination Value</u> <u>(\$ in millions)</u>
6/30/04	(\$187.2) <sup>1</sup>
7/31/04	(\$230.4)
8/31/04	(\$272.8)
9/30/04	(\$279.3)
10/31/04	(\$296.2)
11/30/04	(\$237.9)
12/31/04	(\$279.0)
1/31/05	(\$292.2)
2/28/05	(\$231.0)
3/31/05	(\$199.1)
4/30/05	(\$252.8)
5/31/05	(\$296.7)
6/30/05	(\$306.9)
7/31/05	(\$235.1)

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

<sup>1</sup> *As reported in our 2003/04 financial statements.*

**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 "puttable" bonds such as VRDOs.

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

	<u>Auction Rate &amp; Similar Securities</u>	<u>Indexed Rate Bonds</u>	<u>Variable Rate Demand Obligations</u>	<u>Total Variable Rate Debt</u>
HMRB	\$168	\$1,265	\$2,840	\$4,273
MHRB	500	0	643	1,143
HPB	0	0	50	50
DDB	<u>0</u>	<u>809</u>	<u>0</u>	<u>809</u>
Total	\$668	\$2,074	\$3,533	\$6,275

**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 November 2004 we requested proposals from our existing liquidity banks to provide standby bond purchase agreements for our VRDOs issued under the HMRB indenture during calendar year 2005. We received liquidity bids from nine banks or syndicates of banks totaling in excess of \$2.8 billion. We have selected four banks to provide liquidity for HMRB VRDOs with whom we plan to rotate throughout the coming year. Each of the four banks selected offered very attractive pricing for terms up to 12 years.

Likewise, in April 2005, we requested liquidity banks to identify new capacity for our MHRB indenture. We received liquidity bids from nine banks totaling in excess of \$1.7 billion, far exceeding our expectations. The newly identified liquidity capacity will allow financing of our multifamily program with variable rate demand obligations rather than auction rate securities as we had been doing since 2003.

LIQUIDITY PROVIDERS  
(\$ in millions)

<u>Financial Institution</u>	<u>\$ Amount of Bonds</u>	<u>Indenture</u>
Dexia Credit Local	\$658.7	HMRB
Lloyds TSB	486.6	HMRB
Fannie Mae	445.1	HMRB/MHRB
BNP Paribas	299.6	HMRB
Bank of Nova Scotia	247.8	HMRB
Bank of America	193.6	HMRB
Bayerische Landesbank	174.5	HMRB
Westdeutsche Landesbank	173.4	HMRB
JPMorgan Chase Bank	167.9	HMRB/MHRB
Landesbank Hessen-Thuringen	155.6	MHRB
KBC	120.6	HMRB
State Street Bank	98.1	HMRB
Bank of New York	94.8	HMRB
DEPFA Bank	94.4	MHRB
CalSTRS	72.0	HMRB/MHRB
Citigroup, N.A.	50.0	HPB
Total	\$3,532.7	

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.

**BOND AND SWAP TERMINOLOGY****BMA**

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

**COUNTERPARTY**

One of the participants in an interest rate swap

**DATED DATE**

Date from which first interest payment is calculated.

**DELAYED START SWAP**

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

**DELIVERY DATE, OR ISSUANCE DATE**

Date that bonds are actually delivered to the underwriters in exchange for the bond proceeds.

**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.

**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.

**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.

**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.

**MARK-TO-MARKET**

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

**MATURITY**

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

**NOTIONAL AMOUNT**

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

**OFFICIAL STATEMENT**

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

**PRICING DATE**

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

**REDEMPTION**

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

**REFUNDING**

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

**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.

**SALE DATE**

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

**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.

**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.

**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.

**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.

**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.

**VARIABLE RATE BOND**

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

State of California

**MEMORANDUM****To: CalHFA Board of Directors****Date: 23 August 2005**

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

**Subject: Legislative Report**

It has been an unusual year. For the first time in many years, the Legislature adopted a budget and actually got out of town for a few weeks this summer! Many of us had forgotten what it was like not to have them here during those weeks! But they are back, and working diligently to finish their work before they adjourn for the year on September 9. Other deadlines of note - all fiscal bills must be out of Appropriations by the August 26<sup>th</sup>, and no committees will be meeting at all after August 29 - Floor Session only.

Below is the status of several bills you may be interested in. As always, if you have any questions, feel free to give me a call.

**Budget****AB 139****(Committee on Budget) State government. (C-07/20/2005)****Status: 07/19/2005-Chaptered by Secretary of State - Chapter No. 74, Statutes of 2005****Summary:**

This was one of the budget trailer bills. It contained the language which allows funds originally allocated to CalHFA under Proposition 46 for preservation purposes to be used instead, in conjunction with funds from Proposition 63, to help build housing for the chronic homeless. This is part of the Governor's Initiative to Reduce Homelessness.

**CalHFA Sponsor****AB 1512****(Garcia) California Housing Finance Agency. (A-08/16/2005)****Status: Passed Appropriations 12-0; to Senate Floor.****Summary:**

This bill would authorize CalHFA's general counsel to designate someone else to act in his or her absence. More significantly, it would also authorize CalHFA to utilize unused funds originally allocated to the mortgage insurance program in Proposition 46 to be used to help finance the acquisition, development and construction of affordable residential ownership housing.

**AB 1754** (Committee on Housing and Community Development) Housing. (A-08/22/2005)

**Status:** Pending on the Senate Floor.

**Summary:**

Committee Omnibus Bill - contains provisions clarifying CalHFA's ability to issue bonds to make loans to local public entities to provide low and moderate income housing; and clarifies conflict of interest statutes affecting CalHFA Board members.

**CEQA**

**SB 326** (Dunn) Land use: housing elements. (A-08/15/2005)

**Status:** Assembly Floor.

**Current Location:** 08/15/2005-A THIRD READING

**Calendar Events:** 08/25/05 98 ASM THIRD READING FILE

**Summary:**

Would extend the exemption currently provided for multifamily housing (exempt from a CUP on any parcel zoned for housing) to any attached housing development containing two or more housing units (excludes converting existing units to condos).

**SB 832** (Perata) CEQA: infill development. (A-05/04/2005)

**Status:** Assembly Floor.

**Summary:**

As currently written, would exempt residential developments of between 200 - 300 units on 10 acres or less in urban areas from CEQA, if the site is located in a city with a population of more than 200,000 persons and the city council determines the acreage and units by council resolution. There has been a great deal of discussion surrounding this bill, as it may be amended to be a companion to an infrastructure bond bill also being carried by this author (SB 1024). It is not yet clear whether those amendments will be proposed this year, or the bill will be made a two year bill and those provisions discussed next year.

**Housing Element**

**AB 712** (Canciamilla) Land use: density. (A-06/27/2005)

**Status:** Senate Judiciary Committee

**Summary:**

This bill would redefine the base residential densities from which local governments may not downzone without upzoning other properties or making specific findings. The bill would also delete the sunset on the

requirement that a court award attorney fees and costs to a successful plaintiff, except under extraordinary circumstances.

**SB 1087** (Florez) Housing elements: services. (A-07/12/2005)

**Status:** Assembly Appropriations Suspense File.

**Summary:**

This bill would require water and sewer providers to state how they plan to grant a priority for water and sewer capacity for lower-income housing. Final amendments are currently pending which are expected to remove all opposition.

**Land Use**

**SB 365** (Ducheny) Affordable housing. (I-02/17/2005)

**Status:** Assembly Floor.

**Summary:**

Would specify that charter cities are subject to two laws: (1) that multifamily housing projects are a permitted use not subject to a conditional use permit on any parcel zoned for multifamily housing if it satisfies specified standards, and (2) the requirement that a local government transmit its housing element to the water providers, who must grant a priority for the provision of water to proposed housing developments that help meet the area's regional housing need for lower income households as identified in the housing element.

**SB 435** (Hollingsworth) Housing: density bonuses. (A-08/18/2005)

**Status:** Senate Floor for Concurrence.

**Summary:**

Would clarify provisions of the state density bonus law to make a number of technical, clarifying, and substantive amendments to density bonus law.

**Misc**

**AB 1433** (Emmerson) Public finance contracts. (A-05/23/2005)

**Status:** 07/14/2005-Re-referred to Com. on E.Q.

**Current Location:** 07/14/2005-S E.Q.

**Calendar Events:**

**Summary:**

This bill would provide that the approval, sale or issuance of bonds by a state or local government or the approval of a bond-financed project for federal tax purposes or for other unrelated purposes does not constitute an approval for the purposes of CEQA. It would further specify that a project funded in whole, or in part by bonds must comply with any law or

regulation otherwise pertaining to the approval, authorization, design, or construction of the project.

### **Prevailing Wage**

**SB 940**

**(Torlakson) Public works. (E-08/22/2005)**

**Status:** ENROLLED – Pending Governor's Action.

**Summary:**

Co-sponsored by Housing California and the Building Trades, this bill would require DIR to publish existing residential prevailing wage rates on the department's web site.

### **Redevelopment**

**SB 527**

**(Alquist) Redevelopment: senior housing.**

**Status:** Assembly Floor.

**Summary:**

Adjusts the calculation for determining redevelopment spending on low-income senior housing. Specifically, this bill requires redevelopment agencies to expend low-and moderate-income housing funds (L&M Fund) on housing for seniors, according to the proportion that low-income seniors are represented in the overall low-income population in that community.

### **Surplus Property**

**AB 54**

**(Negrete McLeod) Surplus state property. (A-07/12/2005)**

**Status:** Senate Appropriations Suspense File.

**Summary:**

Would authorize the Department of General Services (DGS) and Caltrans to sell, exchange, lease, or transfer, various state owned real properties that are deemed surplus to the operational needs of the state.

### **Tax Credits**

**SB 950**

**(Torlakson) Housing. (A-06/16/2005)**

**Status:** Assembly Floor.

**Summary:**

This bill is intended preserve the affordability of subsidized housing units when they become eligible for conversion to market rate and to make the statutes and rules governing the various entities that use bonds to finance those units consistent.