STATE OF CALIFORNIA

CALIFORNIA HOUSING FINANCE AGENCY

BOARD OF DIRECTORS

PUBLIC MEETING

Hyatt Regency Sacramento
1209 L Street
Sacramento, California

Thursday, March 26, 2009
9:43 a.m. to 3:26 p.m.

Minutes approved by the Board of Directors at its meeting held:
May 21, 2009
Attest:

Reported by: DANIEL P. FELDHAUS, CSR #6949, RDR, CRR

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A P P E A R A N C E S

Board of Directors Present

PETER N. CAREY
(Acting Board Chair)
President/CEO
Self-Help Enterprises

KATIE CARROLL
for BILL LOCKYER
State Treasurer
State of California

LYNN L. JACOBS
Director
Department of Housing and Community Development
State of California

CARLA I. JAVITS
President
REDF
(formerly Roberts Enterprise Development Fund)

HEATHER PETERS
for DALE E. BONNER, Secretary
Business, Transportation, and Housing Agency
State of California

TOM SHEEHY
for MICHAEL C. GENEST, Director
Department of Finance
State of California

JACK SHINE
Chairman
American Beauty Development Co.

RUBEN A. SMITH
Partner
Adorno Yoss Alvarado & Smith
A Professional Corporation

A P P E A R A N C E S

Board of Directors Present
Continued

L. STEVEN SPEARS
Acting Executive Director
California Housing Finance Agency
State of California

BROOKS TAYLOR
for Cynthia Bryant, Director
Office of Planning and Research
State of California

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Participating CalHFA Staff:

ROBERT L. DEANER II
Director of Multifamily Programs

BRUCE D. GILBERTSON
Director of Financing

THOMAS C. HUGHES
General Counsel

CHARLES K. McMANUS
Director, Mortgage Insurance Services

JOJO OJIMA
Office of the General Counsel

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BE IT REMEMBERED that on Thursday, March 26, 2009, commencing at the hour of 9:43 a.m., at Hyatt Regency Sacramento, 1209 L Street, Sacramento, California, before me, DANIEL P. FELDHAUS, CSR #6949, RDR and CRR, the following proceedings were held:

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CHAIR CAREY: I would like to welcome everyone to the March 26th meeting of the California Housing Finance Agency Board of Directors.

Our first order of business will be roll call.

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Item 1. Roll Call

MS. OJIMA: Thank you.

Ms. Peters for Mr. Bonner?

MS. PETERS: Here.

MS. OJIMA: Ms. Gay?

(No response.)

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Here.

MS. OJIMA: Ms. Javits?

MS. JAVITS: Here.

MS. OJIMA: Ms. Carroll for Mr. Lockyer?

MS. CARROLL: Here.

MS. OJIMA: Mr. Shine?

MR. SHINE: Here.

MS. OJIMA: Mr. Smith?

MR. SMITH: Here.

MS. OJIMA: Mr. Taylor for Ms. Bryant?

MR. TAYLOR: Here.

MS. OJIMA: Mr. Sheehy for Mr. Genest?

MR. SHEEHY: Here.

MS. OJIMA: Mr. Spears?

MR. SPEARS: Here.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Here.

MS. OJIMA: We have a quorum.

CHAIR CAREY: Thank you.

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Item 2. Approval of Minutes

CHAIR CAREY: Our second order of business is approval of the minutes of January 22nd.

MS. JACOBS: Move approval.

MS. PETERS: Second.

CHAIR CAREY: Moved and seconded.

Roll call?

MS. OJIMA: Thank you.

Ms. Peters?

MS. PETERS: Yes.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Yes.

MS. OJIMA: Ms. Javits?

MS. JAVITS: Yes.

MS. OJIMA: Ms. Carroll?

MS. CARROLL: Yes.

MS. OJIMA: Mr. Shine?

MR. SHINE: Yes.

MS. OJIMA: Mr. Smith?

MR. SMITH: Yes.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Yes.

MS. OJIMA: The minutes have been approved.

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Item 3. Chairman/Executive Director Comments

CHAIR CAREY: A couple of housekeeping items. For Board members, we have made arrangements for lunch, for the orders to be made for us. Downstairs, we're on our own. But if you can make a decision on the menu and we'll get them to JoJo, then she'll place the orders before we break so that we can move the day along and not wait in the restaurant.

For everybody, the restrooms are off to the side here, so you just have to walk through the side of the room. Don't be shy about walking into the space up here.

It feels like a different world out there. And

I do want to be assured that you're going to be watching the same thing that we are on the screen and not *American Idol* or something like that.

A couple of personal notes.

I think everybody has heard the news, and we have copies of the press release, that our member, Carol Galante, has been appointed as HUD Deputy Assistant Secretary for Multifamily Housing. And that is an exciting moment for those of us who care about multifamily housing, who care about the future of HUD. And she will be a great voice nationally but with a phenomenal California perspective, which is critical at this time, and joining a secretary who has a terrific reputation. So we wish Carol great success -- and that she comes home frequently.

The second departure is hard for me to mention because I've come to appreciate Carla Javits so much and her time on the Board. Carla has a national reputation, and certainly I've known of her work for many years. But it wasn't until she joined the Board here that I really got the chance to appreciate her sense of public service, her commitment to housing, her unfailing good judgment, and the qualities that I think we are all going to miss on the Board. But, more importantly, we want to take an opportunity to thank her for sharing those qualities with us during her term on the Board, which is ending at the end of this month.

And so, Carla, on behalf of the Board, I would like to present you a gift from the Agency.

MS. JAVITS: Oh, that's very nice of you. Thank you so much. Thank you.

Maybe I can just say, you know, it's been an honor to serve here and to get to know every single person on this board. I've learned a lot. I have tremendous respect for you, Peter, for everybody on the Board.

And I also wanted to say about the staff here at CalHFA, first under Terri Parker's leadership, now under Steve Spears' leadership, I just think it's a tremendously impressive agency. I think the professionalism, the dedication, the commitment of the people here on the staff is really impressive and really extraordinary. So it's been an honor, it's been a privilege. I'm very sorry in many ways to be stepping down, but I look forward to continuing to follow what's happening with CalHFA.

And I have to say, on a personal note, the Mental Health Services Act is something that's been near and dear to my heart. And I understand we've begun to close some loans and move forward with that program. So even though we have a lot of daunting challenges and we've had to slow down in some respects, it's great to see that we're continuing in that regard.

So thank you.

(Applause)

CHAIR CAREY: And I'd like to follow up on something Carla said. I think that we all recognize that these are -- to say these are challenging times is an understatement. But as an agency, it's up to the challenges. And I know that these are challenges at every level in the Agency. And it's not necessarily unique to CalHFA. Many agencies are facing challenges, particularly those involved in housing across the nation. But I know that there's lots of staff here, and many staff back at their desks down the street at the other offices, and recognize the concern and this board's commitment to you and the Agency.

With that, I'm going to turn to Steve.

MR. SPEARS: Thank you, Mr. Chairman.

This is a very, very important Board meeting, and probably more evidence than anything that we have a number of employees here today of CalHFA. And so a lot of eyes on us.

What I thought I'd do first, though, is to tell you about a couple of developments, a really positive development we heard from Standard & Poor's since we last met, that they have affirmed our 'AA-' rating. And that announcement is here on your desk. And they are concerned. They have us on outlook, negative outlook, which I think is probably fair, given all of our challenges. And I think it's an excellent, positive statement about the Agency.

I wish we were so lucky so far as to convince Moody's of the same thing, and perhaps we will be. That would be great. But the Moody's folks have not come out with a decision yet. Bruce was on the phone with them as late as just a few minutes ago this morning. They don't think that they'll have an announcement in the next week or so. We're not really sure what their timing is. They are still analyzing everything.

But one thing they did do was come out yesterday with announcements about three other state HFAs that they're concerned about -- Wisconsin, Illinois, and South Carolina -- and put them in the same status as us. So one of their major concerns is the exposure to private mortgage-insurance companies and their downgrades.

So a lot of unknown. And so I think what you'll hear today is that we're working very hard on a number of solutions; but there are things that we don't know yet and that we will know a lot more about in a few weeks. But that is where we are. And we're just not sitting around and feeling sorry for ourselves. We're trying to be proactive and get out there.

So I want to add my congratulations, but sad congratulations, to Carla.

Carla and I visited last Thursday or Friday in my office for a couple hours. Had a great conversation. And all I hope is that we have time in the future for more housing conversations, more conversations about politics and life and that sort of thing.

So as long as she promises that --

MS. JAVITS: Absolutely.

MR. SPEARS: -- we'll give her our best wishes.

But the other thing is, I wanted to recognize Dennis Meidinger. Dennis is going to be retiring.

Dennis, please stand and be recognized.

(Mr. Meidinger stood up.)

MR. SPEARS: Thank you.

(Applause)

MR. SPEARS: Dennis has given 35 years of service to the people of the state of California in a number of different roles.

We think that the other roles that he served before he got to CalHFA were just preparing him to get here. He's served what is now the Department of Financial Institutions. He was at EDD. He was in various places -- Department of Finance, and finally he found his true home here at CalHFA. And he has been serving as the comptroller since Terri appointed him there in the fall of 2004, I believe.

So we give him our best wishes. He is our resident, unofficial golf champion, fitness advocate. I think he is the Fiscal Services Division team captain for the softball trophy at the picnic.

So we're going to miss Dennis's energy and his smile and his service, and we wish him the best. So just please congratulate Dennis sometime when you have a chance today.

So just a couple of other things, and we'll get right to what we're here for.

This is a really important mission that we have at CalHFA. Di and I testified at Assembly Housing not too long ago, and we gave them our bio. And I think it's important to remind the Board of that. We have, since inception, provided 152,000 first-time home-buyer mortgages, 34,000 rental units. We've loaned almost $200 million to locals for development, and as Carla mentioned, started the MHSA program. We've got $400 million that is funded and on our books and ready to go.

And we have now closed how many, Kathy?

MS. WEREMIUK: Three tomorrow.

MR. SPEARS: Okay, as of tomorrow, we've already closed three MHSA projects, which is great.

We have good borrowers. We have good business practices, sound business practices. While everybody else was doing subprime loans, we were doing fully documented loans to good borrowers.

And, unfortunately, the home-price declines that our borrowers are seeing today are not the result of anything that we've done. They are the result of things that have gone on in the rest of the world, and that's unfortunate.

So the things that we're going to talk about today are challenges. We're going to talk about what we're trying to do about them.

President Obama said in his speech in January, I believe, that his plan -- part of it is to bolster state HFAs and help them get back in the game. We're going to hold him to his word, and they're working on that right now. And the details are being worked on by the president of our national association. She has asked some of us, including CalHFA, to participate in that process, and let them know what we need. And we've been very vocal about that.

So I think probably the best thing to do is to get right at it and go to the first slide.

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Item 4. Discussion and possible action regarding the mid-year financial review and the components of the Agency's financial strategies and action plan for the remainder of the 2008-2009 Fiscal Year

MR. SPEARS: Bruce, Item 4 of the agenda. Actually, the next slide.

MS. PETERS: He took you literally.

MR. SPEARS: Yes.

We'll talk about the flow. The flow of this session today is based on the Board's comments and desires from last time.

I think I've read the transcript from the last Board meeting at least a half a dozen times. And it was very clear the Board wanted to pick up where they left off; so we are. We're going to start with the financial statements because I believe that's a pretty clear picture of where we are financially and where our risks are embedded. There are financial statements in the report section, a summary of those.

Then another question that came up under

Item 2, and that is, what level of capital do we need to have on hand to do our mission? That's a great question.

Carol asked it, I think Lynn and Carla joined in and said that, "We'd love to know this." It's not a simple answer, but we've put that in as a major discussion.

The third thing is, what are we doing to maintain that level of financial stability.

But when we get to Item 4, I think we're going to all agree that we're operating in a different environment because of the risk we have, because of the world we live in, that we live in a different environment for CalHFA, and we're going to have to recap and identify that.

But the last item here is, how does CalHFA do business in that new environment? We have talked about this a great deal at two off-sites with senior staff, we've put a lot of thought into this presentation; and we'd like to show the Board how we think we can keep going and deliver our products, tried-and-true products in this new environment, and maintain our stability.

So that's the presentation outline.

And if there are no questions about that, we can move to the next slide and get right to the point where we left off. And that's our financial situation.

This balance sheet has a lot in it, and there are many details. We're an $11.1 billion financial institution. And there are a number of things that you could ask questions about, but we'd like to focus on two areas of risk that Moody's and others have focused on. One is in the "loans receivable" area and one is in the "bonds payable" area.

So what we're going to do is give you a couple of summary slides here and then come back to the balance sheet and talk about it in more detail.

But, Bruce, if you can move to the next slide -- which you've already done. Thank you very much.

I'd like to introduce my assistant, Bruce Gilbertson, at the computer there.

The real-estate risk that we're managing is mainly in the single-family loan receivable side of things. We're the epicenter. I mean, everybody realizes that. Lynn has argued that when she's been talking about NSP money for the state. The Governor has mentioned it. We're the poster child. This is where things are not going well.

We've got a major loss in home-price values, and we're going to show you where those hot-spots are. The concern that we have, where we have a large decrease in home-price values and we have a large number of loans.

I think you'll be surprised at some of the things you see; but we wanted to emphasize that the impact of the recession, the job loss is of concern to us. And, of course, a major concern is Genworth's downgrade. They are a major business partner of ours. Moody's downgraded all the PMIs recently. But Genworth, they downgraded five notches, and that's been a concern.

We have increased our loan-loss reserves to deal with this. That's had an impact on our net income, we'll get to that. But the other risk is something that we've talked more about. And Bruce has given you a report. We're going to give you another update on our variable-rate bond situation. It's on the liability side of the balance sheet.

Moody's is concerned about the strength of our counterparties, our swap providers, our liquidity providers.

On a going-forward basis, a lot of those liquidity agreements, the standby bond purchase agreements come due over the next year, two years. And we will talk to you about that. But, of course, one of the main concerns is the mismatch that we've talked about between what our swap providers are paying us and what we're having to pay bondholders in basis mismatch. And that's also had an impact on net income.

So the next slide, Bruce.

Here again, just to go into a little more detail, what we're going to talk about is in our delinquency statistics, we are now up to a total delinquency of 10.87 percent. Now, that's for FHA and conventional. And, of course, as you know, FHA is federally insured. The "conventional" part is what we'll emphasize.

The biggest concern besides our loss of home-price value is the growing state jobless rate. It is 10½ percent now. It's expected to go up. And that's a concern. But the latest report that Chuck McManus shared with me here recently from our consultant, is a 52 percent decline in market value in that lowest quartile of homes. And that's what we track.

We're going to, again, show you a map that shows our hot spots with the largest drop in value and the highest number of CalHFA loans. Those are the areas that we're concerned about.

This all translates into more folks mailing us the keys, more foreclosures, higher REO inventory. We have increased staff there to help Chuck manage the REO inventory. And that's taking up more and more staff time.

So I think at this point, why don't we go to the -- right there, the loans receivable.

This is what makes up the $8.6 billion. You can see the largest chunk is single-family mortgages. Our multifamily portfolio is performing well. That's not the major concern of Moody's. It's not our major concern. We are taking real-estate risk there. But the single-family mortgage line is what we're concerned about.

What we're going to do is talk about this and then come back and show you a slide or two about what we have set aside in resources to deal with loan losses for single-family mortgages.

Let's see -- why don't we go to -- I'm sorry, Lynn?

MS. JACOBS: Could I ask a question?

MR. SPEARS: Of course.

MS. JACOBS: When you said that the delinquency rate is about 10 percent, do you know how that compares with our --

AUDIENCE: We can't hear.

MS. JACOBS: When you said -- can you hear now? When you said the delinquency rate is 10 percent, do we know how that compares with the industry?

MR. SPEARS: We do.

Chuck, do you want to speak to the MBA comparison?

MR. McMANUS: These are close. We're a little under the MBA prime delinquency curves but following them. We're approaching them. So I would say we're just slightly below them in performance.

MS. JACOBS: Okay, thank you.

MR. SPEARS: The major concern, again, is on the single-family side and decrease in home-price values. So we have developed a map here.

If we can go to that, Bruce.

What we might want to do is -- there we go. Let's go to the map itself.

MR. GILBERTSON: We're working on it here.

MR. SPEARS: Okay. It's thinking?

MR. GILBERTSON: There we go.

MR. SPEARS: They're going to have to make that window bigger.

What we've done is take this, and turn it into a heat map, if you will, where the darker red colors there show where the higher drop in value is. And not surprisingly, Riverside County, San Joaquin -- counties we've talked about before -- San Diego County are where you're seeing the highest amount of loan losses -- I'm sorry, where we're seeing the highest drop in value.

So what we've done is for each county -- why don't you bring up San Diego County, Bruce?

This is the county that we feel is the highest interest to us as CalHFA, where we have a fairly high change in price decline of 42 percent, but we have a high number of loans there. Many of them condominiums, I believe -- if that's correct, Chuck?

MR. McMANUS: Yes, over 50 percent.

MR. SPEARS: But we've also shown the number of delinquent loans there and also the number of REOs.

So San Diego County is of high interest to us.

So we've done that for various counties. One of them I wanted to point out -- Bruce, if you can go to San Joaquin Valley or San Joaquin County, and slide over to the right a little bit.

This is interesting. A very high drop in values; but we don't have very many CalHFA loans, relatively speaking. We have a number of REOs -- ten, which is high, compared to the loans we have there, not surprisingly because of the loss in value. But we don't have a lot of loans there. Unfortunately, I believe a lot of the folks there went with the competition and went with the subprime products. And that's unfortunate.

But we've identified -- if we can go back to the main map, Bruce -- we've identified the top ten counties for loan servicing to focus on, because these are the counties that have the largest number of conventional loans -- not FHA because those are not of concern to us on the loan-loss side.

And you can see where they are bunched in Southern California, and then around Contra Costa -- I can't see the other counties, but in the Bay Area, a couple there.

Any questions about this?

(No response.)

MR. SPEARS: It's pretty straightforward. These are where folks are simply deciding, "I am so far underwater. I'm a first-time home buyer. I was going to keep this house for five or six years. I don't see getting back to even with my mortgage, and so I'm just going to choose to walk away."

Bruce, I think we have a slide there for delinquencies. Just take a look at that detail.

You might want to start with -- yes.

So FHA has a much higher delinquency rate. But here again, our concern is with the conventional loans, down below. And so we have, overall, the 10.83 in the bottom right-hand corner is our overall rate. And then the conventional side of the house is what we focus on.

You might want to go to the byproduct slide.

MS. JAVITS: Steve?

MR. SPEARS: I'm sorry?

MS. JAVITS: What's happening now with, like, the 30-day delinquencies? What are we doing?

MR. SPEARS: For the ones that we are servicing -- remember, we service about a third of the -- well, a third to 40 percent, I believe, of our own loans; but 60 percent are outside.

We are doing what we've always done, and that is, before someone gets in trouble, we're calling them earlier. And one of the things that you're going to see us present this afternoon is, we're going to change -- restructure our loan-servicing department with the goal of servicing all of our loans in the future because we do a better job all the way across the board. If we go to servicers eventually here -- not right now, Bruce.

But if you look at servicers, we do a better job than almost every single one of our servicers. We are calling folks, we're trying to make accommodations to the greatest extent we can. So I think Rhonda Barrow and her crew internally do a much better job than outside services do.

MS. JAVITS: I mean just over time, it might be interesting to see how many you're able to flip from 30-day delinquent, back in, I mean, just as a way to see are we having any impact.

MR. SPEARS: Right.

Do we have it by servicer? Is that it?

MR. GILBERTSON: Yes, that's the servicer chart.

CHAIR CAREY: Steve, to what would you attribute the vast differences in delinquencies between the different servicers?

MR. SPEARS: The number-one -- I mean, it's anecdotal. Chuck and his folks in loss mitigation work with our outside servicers. But the bottom line is, they get paid a fee every month. And they're contract servicers. So we don't know what their competing interests are, we don't know where this winds up on their priority list as to what they service. But I know this: That the folks on the first floor in loan servicing are mission-based, and the other folks are for-profit servicers who don't have that same motivation.

I'm assuming that it has a great deal to do with the difference. I don't think they work the loans as much as we do. I think they'll let somebody go delinquent and not contact them until much later in the process than we do. And that, right there, is probably the main reason.

CHAIR CAREY: So you would say then that those servicers with the highest delinquency rates are not servicing our borrowers as well as the others?

MR. SPEARS: Yes.

I've not collected mortgages, but early in life, collected bills. And the one thing that you do is, you try to get in touch with the borrowers and make contact and do something. If you don't say anything, you won't get a response. You're not going to cure a loan. That's just all there is to it.

So the thing that I know for sure about our operations is that we're on the phone, we're getting in contact, we're talking to people and trying to work things out. And just no response is not an option for us. Our folks actually do everything they can to contact personally each borrower that gets into trouble.

MS. PETERS: Steve, I have a question.

MR. SPEARS: Yes?

MS. PETERS: With the outside servicers, do we have any contractual ability to reach out to them, get metrics on what they're doing, when they're doing it, what their experiences with our borrowers are, what their number of files per employee are? Do we have any way to hold them accountable and find out what exactly they're doing that's making them perform?

MR. SPEARS: We do. Every one of them has a servicer agreement with us, a master agreement that they have to sign to be approved. And that's part of what Chuck's group is doing, is working with these -- I mean, these numbers have gone up dramatically in the last two months, even.

MS. PETERS: Do we have an ability to take any of that back in-house, if they're not performing?

MR. SPEARS: That, I've asked; and I don't have a clear answer yet on that, but it's something that we're considering.

But to do that is -- I mean, they kept those. We had the option of buying that servicing up-front and we didn't, and elected to pay them a servicing fee. So we could buy the servicing from them at this point and pay them some fee and take it in-house. But it would be a business transaction. We don't have the right to just take them over.

MS. PETERS: So we're actually monitoring some sort of metrics on their performance?

MR. SPEARS: Yes, yes.

MS. PETERS: Thanks.

MR. SPEARS: They're required to report to us.

So they're required to post statistics with us. And we're not prepared at this point to take them back because we don't have the staff to do that. But what we're heading for is a new paradigm, if you will, where we're servicing all the loans here.

MR. SMITH: Steve, just a question. Is there any correlation between -- is it really the servicing or was it the work that was done in giving the loan in the first place? Because if you look at the numbers, I mean, some of them are -- Countrywide is pretty high and WaMu is pretty low. I don't know if that's due to what they do in the servicing side.

I mean, do you know what they're doing that others are not? Is Countrywide not doing any of the calls that you're talking about?

MR. SPEARS: I don't think they do as many. I don't think they work the accounts as hard as we do -- I really don't -- and as hard as, obviously, some other folks do.

I do not think it was review of the files early on, because all the files, when they walk in the door, we don't treat them differently, if it's Countrywide or if it's WaMu or anyone else.

On the conventional side and on the FHA side, they all went through Chuck's shop, they got underwritten, then they go to Gary's shop, they get reviewed for compliance with program. And so they're all treated the same.

So when we get to this point, then you'd think that the servicing would be the same. So the only explanation is, you know, how much they work the accounts. And it's the only explanation that I have.

MR. SMITH: Right.

MS. JACOBS: I can't find that chart in my packet. Do we have that chart in our packet?

MR. SPEARS: This one?

MS. JACOBS: Yes.

MR. SPEARS: Not this one.

MS. JACOBS: Could I get a copy?

MR. SPEARS: Absolutely.

MS. JACOBS: Could I have a copy of that and the map?

MR. SPEARS: Yes.

MS. JACOBS: That's a very cool map. I mean, it's saying bad things, but it's a cool map.

MR. SPEARS: Yes, I understand.

We're going to keep this little arrangement, because we have a number of presentations that we're going to be giving to folks over the next few weeks and months. And so we'll -- the problem was, number one is we're trying to put in the latest, latest data for you guys. But the other was, if we sent this out in this kind of -- it was going to be kind of hard to follow if you weren't switching around. But we'll be happy to provide that.

MS. JACOBS: Absolutely. Thanks.

MR. SPEARS: Sure.

Any other questions?

MS. JAVITS: Well, I guess I just wonder, it looks like about 30, a third of the delinquent loans are Countrywide and Bank of America, together, which is essentially Bank of America; right?

MR. SPEARS: Yes.

MS. JAVITS: So, I mean, I guess my question is, maybe sort of along the lines of what Heather said, I mean, is there any kind of pressure, specific pressure -- I mean, at least to concentrate perhaps on one company that is responsible for a third of our delinquent loans?

MR. SPEARS: Right. We do have that ability, and that's the plan.

MS. JAVITS: Okay, thank you.

MR. SPEARS: They're taking our money every month, and we expect them to do a good job. So holding their feet to the fire is part of the plan going forward.

MS. JAVITS: Right.

MR. SPEARS: Okay, Bruce, why don't we backtrack, if we can, to -- I think we want to go all the way back to what the resources are.

MR. GILBERTSON: Yes.

MS. PETERS: Why did values drop in Modoc County? Not that that's of particular relevance, but it was an odd red. What happened in Modoc?

MR. SPEARS: All five houses up there lost value.

All right, so we're rolling through this. And, obviously, delinquencies are up, loan-loss reserves you're going to see are up a great deal in the first quarter, and even -- and, again, dramatically in the second quarter of this fiscal year.

So as Board members, I think it's important for you to know what the Agency has as far as resources to deal with the loan-loss reserves and losses on REOs.

So we're going to show you a table in just a second. But before we get there, we have primary mortgage insurance on conventional loans and FHA, both. The Mortgage Insurance Fund has a reserve for insurance losses. That's Chuck's side of the house. Chuck has a model he goes through on a loan-by-loan basis. They calculate delinquencies, they calculate how many of those they think will cure, they calculate it based on estimated values of homes, and they get a loss number. And they have been doing that on a constant basis for the past few months.

Genworth, again, is our reinsurance partner on the insurance fund housing side. They take 75 percent of the risk that's insured.

There's also FHA insurance on FHA loans, and we rely on the federal government for that. We hope that they're there for us, and I'm sure they will be.

The second thing is gap insurance. This is provided by the housing fund. It is indemnification for claims that are presented by the Mortgage Insurance Fund. Bondholders are guaranteed 50 percent of the unpaid balance as insurance. It's very deep coverage.

The primary mortgage insurance covers 35 percent. The difference between those two is covered by this gap-insurance policy. It is a policy based on an interagency agreement, or interfund agreement, between the MI Fund and the housing fund.

So we're covering that gap, which is the ugly brown color there in between the 50 percent -- anything over 50 percent, the bondholders and the bond indentures suffer that. Now, there are reserves in the indenture -- it's not as if they don't get paid their full debt service. There are reserves in the indenture that absorb these losses. But the gap policy hits the housing fund, and it reimburses the insurance fund for those losses.

Okay, let's back up one slide then to the schedule.

So folks were asking last time, "What do we have on hand? You know, what do we have to combat this?" So we have loan-loss reserves in the insurance fund of $18 million -- $18.3 million -- that was at the end of September. We've updated that to almost $26 million at the end of December. And when those financial statements come out, you're going to see numbers close to that.

Genworth is roughly three times that because it's a 25 percent to 75 percent relationship. So they're at $76 million. That's what they would anticipate that they would -- now, I have no idea if they have an account on the Genworth books that says, "Due to CalHFA, $75 million." But under our contract, that's what they would have to put up, based on what Chuck's analysis and Dennis Meidinger's analysis are for loan-loss reserves.

Then the gap insurance part, the ugly brown part that we showed you on the chart, we have $32 million set aside in the September financial statements. It will be, roughly, $44.5 million, an increase there of $12 million in just three months.

Then the loan-loss reserves on delinquent loans, this is the amount that the indentures would suffer, I believe -- is that right, Bruce?

MR. GILBERTSON: Yes, I think the fair way to say that is, these would be expected losses that are not covered by either the primary mortgage insurance coverage or the gap insurance coverage.

MR. SPEARS: Right.

And up to $10.5 million by the time we get to the September financial statements.

Then we have another category -- once we get through that process of settling claims on mortgage insurance, then we own that house. We have Real Estate Owned properties. And that, again, is in Chuck's shop, and they are managing that. That REO inventory is up to -- I think we're north of 200 now -- is that correct, Chuck?

MR. McMANUS: 270, I believe.

MR. SPEARS: So that's going up very rapidly. And those values change from time to time.

We would love to be able to turn around and sell them immediately and not suffer any market loss; but the truth is that if we hold that property and the market declines, we're going to suffer additional losses on that REO side. So that reserve is up to $5.6 million.

So as of December 2008, our estimate is that the reserves that we have set aside in the financial statement -- and these are all accounting entries, accounting reserves, and the one with Genworth is based on our view of our contract with them. This is not cash out the door because it takes a while for those claims to settle and process and go through. So accountingwise, though, this is what we've set aside and the resources that we have, almost $163 million at the end of December.

CHAIR CAREY: But, Steve, the Genworth is their reserve, though?

MR. SPEARS: It is, it is.

CHAIR CAREY: Okay.

MR. SPEARS: Any questions?

MR. SMITH: Yes. Steve, how comfortable are we in their financial stability -- Genworth and the gap coverage and all these other insurers -- how are they doing financially?

MR. SPEARS: Chuck, do you want to speak to that?

MR. SMITH: Are they going to be around to pay us?

MR. McMANUS: Genworth had their credit rating reduced down to 'Baa2,' which was a five-level downgrade. But they have, as far as I am concerned, proven they have the money to pay claims. And the rating agency did not deny they had the money today to pay the anticipated claims.

That rating is based on a stress test, where they take the existing book of business and stress it to depression-level foreclosures and losses. And it's under that scenario that they were downgraded to that level. But they, in their own write-up, believe that they can pay the claims currently. If things deteriorate for another 18 months, they'll revisit it.

They are the second-highest-rated mortgage insurer or reinsurer out there. The highest is CMG, which is the credit-union mortgage-insurance entity that's very small. That's out of Madison, Wisconsin. They're rated 'AA-.' But other than that, Genworth is rated as high as any other mortgage insurer. So they're the best of the alternatives we have today. I believe they'll make their payments and their claims. They're conserving capital. They're managing under the old GE, which is a very financial-management-oriented company. That's their heredity.

And it's not that we're not concerned about it, but in the short-term, we see no problem in getting their 75 percent of any claims we anticipate, at least for the next year or two. But we will watch it and we will look for backstops if the market continues to deteriorate.

MR. SPEARS: The other thing, Ruben, it's fairly widely known that the mortgage insurers believe that they're entitled to some of the TARP I, TARP II money, the assistance that's going out to all the financial -- and they're in discussions with the federal government right now about that. I don't know how that will turn out, but they believe that they're entitled to assistance as well.

MR. McMANUS: And they report to us that they're getting a favorable audience, because they are -- the private mortgage insurance industry is the key to low down-payment loans. And if you want to start housing sales again and first-time home buyers and so forth, you must have a viable private mortgage insurance industry.

And the president of Genworth USA is the president of the Mortgage Insurance Companies of America trade group, and he is the one negotiating on behalf of the mortgage insurers. So hopefully, it will be a program that works for Genworth, if there is a program.

MR. SMITH: And the gap insurance, is that a separate company?

MR. SPEARS: That's self-insurance.

MR. SMITH: That's us?

MR. SPEARS: Yes. The housing fund providing claims-paying ability to the insurance fund.

MR. SMITH: So if everything were to go into foreclosure that we have currently, that's delinquent, our exposure is $162 million, in terms of the current values that we project?

And I know we can't predict because we don't know what we're going to sell it for. But I'm just trying to get a sense of the worst-case scenario, what condition would we be in, let's say a year down the road.

MR. SPEARS: Right.

MR. GILBERTSON: I think, perhaps, is Mr. Smith asking the question, if all of the delinquent loans today went through foreclosure, what our likely loss would be?

MR. SMITH: Right.

MR. GILBERTSON: I don't know, do you have a sense of that, Chuck? I mean, remember that all of these loans are secured by the underlying real estate and improvements on that, so there will be some value.

MR. SMITH: Right.

MR. GILBERTSON: I don't know the total of the amount of delinquent loans.

MR. McMANUS: If I can, I'd like to address what's on that, those reserves, and then you can judge whether it's adequate or not adequate.

The rating agencies judge, our actuary judges, and our accounting auditor judges. The gap-loss reserve, which our actuary and I propose and is booked by our accounting department, but we're the ones responsible for valuing the inventory and anticipated losses. And I can tell you that -- and we have an opinion, I have a draft opinion from our outside actuary that goes through all sorts of tests and peer review and so forth. And we were in the upper half of their range. I mean, we're probably at about the 75^{th} percentile. So our reserves are based on a percentage of 60-day delinquent, 90-day delinquent, 120+, going to foreclosure. And our valuations are based on our actual experience. And if we see a deterioration, we can actually make it more severe.

And we have 60 percent of the 60-day; 90, I believe, of the 90-day -- I'm sorry, 70 percent of the 90-day and 90 percent of the 120+ going to full claim. And we are booking the entire maximum claim. No saving of selling or short sales or other things. So that's why we finished in the upper half of where the actuaries were.

But we're in the toughest market -- or one of the toughest markets in the United States. So they are conservative reserves, but we cannot tell the future. So we're looking at where we are today -- and we're taking a pretty dim view of any quick recovery.

Will we increase reserves next quarter? Quite possibly, but then we're probably going to be taking them down in a year from now.

So we think that -- we really believe they're adequate, and our actuary believes they're adequate, and I'm sure that our auditor will find with all those opinions that we are conservative in our reserves.

We don't anticipate everything going to claim, but 90 percent is a pretty high number. That used to be 40. You know, there were people selling their houses for more than they owed and coming out. And today, we're just assuming it's lost. And, of course, we want to get into some way of keeping people in their houses, and we'll be working on that.

MR. GILBERTSON: Let me just add some numbers to that.

CHAIR CAREY: Bruce, first, Jack had a question.

MR. GILBERTSON: Sure.

MR. SHINE: With respect to the Real Estate Owned and the delinquent loans, what is the total of the outstanding loans on those properties now?

MR. GILBERTSON: I'm going to give you the loan balance of delinquent loans insured on a conventionally insured basis.

Again, we feel there's little to no risk if it's an FHA-insured loan. We believe the federal government will honor their commitment and make those claim payments when they are due if the borrower defaults.

So as of December 31st, the loan balance of conventionally insured loans that have a primary mortgage insurance policy underwritten by our insurance fund was $265 million if the borrower had missed two payments, 60 or more days past due.

The direct loss reserve calculation that Chuck was walking us through totaled almost $93 million. Three-quarters of that risk then is reinsured by Genworth, assuming Genworth honors their claims-paying responsibilities.

MR. SHINE: Three-quarters of the $265 million?

MR. GILBERTSON: Three-quarters of the expected loss amount of $93 million.

MR. SHINE: And what is the value of the Real Estate Owned?

MR. GILBERTSON: The loan balance -- again, I don't know what you have -- on the REOs, I have a balance as of the end of January -- I believe this report that I'm referring to now is in the back of the Board binder. All of the REOs -- the loan balance upon foreclosure was $72 million. Fourteen, almost fifteen million dollars of those properties have an FHA insurance policy on them.

So we believe the exposure is on the conventionally insured loans, which is $57 million.

MR. SHINE: So you have $57 million on the REOs, and you have $265 million.

Is that the total of all the loans or just the 60-day paper?

MR. GILBERTSON: The 60-days+ conventionally insured loans.

MR. SHINE: Everything over 60 days is $265 million?

MR. GILBERTSON: Correct.

MR. SHINE: And of the reserves -- and there are reserves, whether it's ours or Genworth's or anyone else's -- of about 93-some-odd-million dollars; is that it?

MR. GILBERTSON: Well, it's actually this 162, as of the end of December, the estimated amount for December.

MR. SHINE: Including Genworth?

FHA is not on there, though; is it? I don't see FHA.

MR. McMANUS: That's conventional only. We take zero loss on FHA. They're repurchased.

MR. SHINE: I just want to make sure -- I understand. That's right. I just want to make sure I'm not missing something.

So we have $162 million in reserves for about $140 million of maximum disaster potential losses, as you've calculated it; is that correct?

MR. GILBERTSON: It's about 320, 320. The REOs, we had 57, and we had $265 million of delinquent loans.

MR. SHINE: But you assume that -- the loss reserve that I heard you say, I think, was that the reserve for about 265 is ninety-and-some-odd-million? $93 million?

MR. GILBERTSON: That's true, correct.

MR. SHINE: So you have a $93-million loss reserve for the 265. And the $72 million of REO, you've got a $50-million reserve after the other money coming in. So that's -- add 95 -- is $140 million; right?

MR. GILBERTSON: I think a better comparison, Mr. Shine, would be to take the $162 million that's shown here, and compare that to a total of 265, plus the 57. Because we do have responsibilities for this gap insurance as well. Remember, the gap coverage is supplemental coverage for deep losses.

MR. SHINE: Well, I think the answer is, we're not really in horrible shape right now if the world doesn't collapse tomorrow morning.

MR. SMITH: Right.

MR. GILBERTSON: I would conclude that what is visible today is not the problem; it's the stress tests that Chuck referred to earlier. We'll talk more about that from a bond-indenture perspective when we deal with the rating agencies.

MR. SHINE: Thank you. That clears it up in my mind.

MR. SMITH: What's the average interest rate on the loans that we have out? Do you have a general idea?

MR. GILBERTSON: Approximately, I don't know, about 5.4 or 5.5 percent.

MR. SMITH: Do you expect the current rates that are out there -- I mean, I'm assuming they're lower than that now?

MR. GILBERTSON: Clearly. We're up in the upper 4 percent range as of the last week or two.

MR. SMITH: But someone who is in our loan and has the decline in the value, it's been pretty tough for them to qualify, I'm assuming, for refinance?

MR. GILBERTSON: Yes, they don't have equity in the property.

MR. SPEARS: Without equity, they have a very difficult time.

Other questions?

(No response.)

MR. SPEARS: I think we're going to go to the other side of the balance sheet now and let Bruce talk about -- thank you, Chuck -- and let Bruce talk about the variable-rate bond and give us an update on that.

MR. GILBERTSON: Thanks, Steve.

Over the last six months, many of these Board members have heard me talk way, way too often, I think, and for much too much time. But we spent a lot of time talking about our bond portfolio and what kind of bonds we have. We've simplified it dramatically today. Certainly, we want to respond to any questions you have.

What we've focused on today is what are the poorly performing bonds and what are some of the near-term risks that the Agency has. And that is centered around the variable-rate demand obligations that we have. We have about $4 billion of those. To the extent that investors no longer have an interest in them, they can become bank bonds.

And then we have another situation that we're facing, and that is that we have liquidity providers. These are standby bond purchase agreements with commercial banks. Many of them are set to expire in the next six to seven months.

So with that, I'm going to go back to our other

Excel spreadsheet here. Bear with me for one moment.

I hope you can all see this. You've seen this chart before at prior board meetings. It's updated. We can predict the future now. We can predict how many bonds will be outstanding as of April 1st. That's because we know we won't be issuing any and there are no additional redemptions.

But let's just work through this. It is color-coded. And, of course, that's supposed to be dark red. It looks almost black on the screen. But I'm going to start at the top and work our way down.

This is laid out to show where we have credit enhancements, so we have bond insurance from AMBAC, FGIC, MBIA. We consider them in a lower category than we might consider FSA that also has insured some of our bonds. And then the bulk of our issuance has been on an uninsured basis because of the high credit ratings of the Agency and its indentures. And you simply have a total column, total bonds outstanding is a little over $8 billion.

Starting at the top then, the two red numbers -- they kind of look red up there -- under the auction-rate security model. Remember, it was a little over a year ago that we had our first failed auctions. We still have $191 million of auction-rate securities.

We've described to the Board the reason why we haven't been overly anxious about redeeming those. They happen to finance multifamily projects. We're very, very successful in the financing of some of our construction loans in that program, and we actually have excess mortgage yield.

That is rapidly eroding, of course, as we pay a slight penalty rate of interest on those securities. But we do have plans. We'll talk about that later today, to do a large securitization for the multifamily program, and that would relieve the pressure from the auction-rate securities.

The next subgroup is the variable-rate demand obligations. We've broken that down into six different categories, if you will. The first being, those variable-rate demand obligations that are insured by AMBAC or MBIA, $48 million of those.

We have Dexia. Dexia is providing liquidity support --

CHAIR CAREY: Excuse me, Bruce, just a second.

Lynn? I'm sorry.

MS. JACOBS: I take it, we don't have that in our packet, either. I would really appreciate a hard copy of these things.

MR. GILBERTSON: Absolutely.

MS. JACOBS: Because I'm a little old for reading that board.

MR. GILBERTSON: Yes, and I know that's kind of hard.

So the AMBAC insured and MBIA is $48 million. Dexia, Depfa, and Fortis are all commercial banks. They provide liquidity support to these facilities.

Remember, the bondholder has a right to put the bands back on either a daily or weekly basis. None of these bonds are trading exceptionally well considering the bank that's giving the short-term credit support.

Dexia is better than Depfa and Fortis, but we do have a large exposure. $768 million of bonds backed by Dexia.

Depfa bonds, nearly all of those bonds have been returned to Depfa. If it is held as a bank bond, there's two things that happen to the Agency: We pay a penalty rate of interest, and there's an accelerated amortization of the repayment of the obligation. In our case, typically, that's over a five-year period in ten semiannual installments.

Fortis is kind of a new situation. In the last four to six weeks, most of those bonds have gone back to the bank as well. Fortis is a European bank. There's a lot of talk about Fortis being acquired by another

European bank. Fortunately, the shareholders have denied that taking place twice. There's yet another attempt for Fortis to be acquired by BNP Paribas.

We have $36 million of bonds where the support, the short-term credit support has expired. In that case, the bonds become bank bonds. And the banks, interestingly enough, have to make a decision to either extend a short-term credit facility where they may have to buy the bonds, or they simply let it expire and then they absolutely own the bonds. They do go back to them. So we have $36 million that is in that kind of bucket.

There's an additional $2.7 billion of bonds, VRDOs, that are really performing quite well. We've color-coded 179 because the FSA insurance is on them. And if we had our druthers and if it was a perfect world, at this point we would probably drop the insurance on those bonds as well.

A billion dollars of index bonds. These are actually performing very, very well. To give you a sense of how well, quite honestly, in our homeownership program, we issued a lot of taxable index bonds to expand our program. These are a bond that traded in an index based off LIBOR, and we pay a very modest spread to LIBOR, sometimes ranging as low as 25 basis points above LIBOR. More recently, maybe 100 basis points above

LIBOR. LIBOR is below 1 percent. So we effectively have a cost of funds on a billion dollars that is somewhere less than 2 percent. We've financed mortgages that we believe our weighted average coupon is in the mid-fives.

So tremendously valuable to us. And it was kind of a component of our debt profile that we felt comfortable taking unhedged floating-rate risk in many cases.

We also have some fixed-rate bonds totaling $3 billion. The box at the bottom is really designed to show you how we view risk on our debt side.

Auction rates represent 2 percent of the total portfolio. The poorly performing VRDOs add another 12 percent. You finally get down to what we've color-coded green and black, and you realize that it's about 17 percent of the bonds. That if we had access, we had a perfect world, we would redeem the bonds, reissue them in another form.

I'm going to go back and show you two other slides regarding bonds. Here's the history of CalHFA's bank bonds starting in mid-September of last year, updated through last week. We never had a bank bond, as you well know, before mid-September of last year, when Lehman Brothers went into bankruptcy, and we had a lot of other things hit the marketplace.

This simply shows that the number of bank bonds exceeded $1.1 billion in early October, and it gradually fell off. So that on February 1st of this year, we had about $120 million of bank bonds. There's been a little bit of activity recently.

I don't know what color that looks like to you. The top bar --

MR. SHINE: Lavender.

MR. GILBERTSON: -- right here is light green on my screen, that represents the Fortis-backed bonds that came back, the $120 million.

The blue bars down here represent Depfa-backed VRDOs -- whoops, and I skipped ahead.

And then there's a couple, I would call them maroon or dark red. It looks like on your screen over here, which a few of the Dexia bonds have come back as well.

We thought we've handled this fairly well. Again, it would be great to get rid of all the bank bonds at this point.

But speaking of that, we face the additional challenge. We have renewal of $711 million of these standby bond purchase agreements coming due between April and December of 2009. The first one we'll face is in about two weeks, Calyon, $174 million of liquidity support for bonds. And you can see the other names as we go through the balance of the calendar year.

We have been talking to Calyon again recently, and we're trying to suggest to them, as Fannie Mae did and as KBC Bank has done, to give us a short-term extension because of the hope that the federal government is going to provide a source of liquidity to the HFA community.

If it were Fannie Mae, that is probably where the liquidity will come from once Treasury announces this. In February, they gave us a three-month extension in hopes that May would be a long enough time frame for these other things to kick in.

I'm going to stop there on the debt side and just see if there's any questions.

I think at this point, we're going to kind of go in and take a closer look at the operating results for the fiscal year first quarter, if there are no questions.

CHAIR CAREY: Questions?

MR. SPEARS: If none, the idea here was to take a look at the two biggest risks on the balance sheet, obviously reserving against those risks and the interest costs associated with basis mismatch and other things on the liability side; on the bonds side, hits our income statement.

So a comparison of final operating results for the first quarter of the fiscal year for 2008-09, the one that ended September 30, will show us how -- the increase in interest income was almost $10 million. We have 2,600 more loans now than we did a year ago for the first quarter. That's great news. Most of those, obviously, were added on in last fiscal year, in the very beginning of this fiscal year, before lending ground to a halt. But it is good news.

There is a decrease in investment income. And that's a little more complicated. We had a dramatic decrease in short-term interest rates. And the interest income, most of what we earned, comes from the State Treasurer's office. They invest in very short-term instruments, and so that results in a decrease in our investment income.

Interest costs associated with the bonds, associated with the things that Bruce was just talking about, year over year -- first quarter last year, first quarter this year -- a $14.4-million increase. The basis mismatch portion of that is $7.9 million in increase. So very significant impacts to the financial statement.

The next slide, Mr. Assistant.

Thank you.

The largest impact, though, is due to loan-loss-reserve increases, $29 million since the end of June. So just in the first quarter, from July 1st to September 30th, we've set aside an additional $29 million in the housing fund. This does not include the additional amount that Chuck has set aside in the insurance side of the house.

For gap claim payments, an extra $25.2 million. For indenture losses, an extra $3.8 million.

The sum total of all this is a net loss for the first quarter, due to these accounting entries for loss reserves, mainly, of $22 million. Just for a comparison, the first quarter of last year, an $11-million income. So quite a swing in performance.

You may ask what we're going to see at the end of December for the second quarter, for the first six months, and not completely clear, but you can see that the increase in loan-loss reserves just from the first quarter to the second quarter was at least $13 million, I believe. So we are continuing to make accounting entries for more losses.

And, again, these are accounting losses; these aren't necessarily cash-out-the-door losses because, again, it takes a while for those to settle.

And we're also calculating estimates based on what we think will happen with delinquencies and what we think will happen with settlement of claims and REO inventory.

Any questions on those?

(No response.)

MR. SPEARS: It might be a good time for a time-out.

CHAIR CAREY: I think what we'll do is we'll take a short break, give our reporter a break. And the rest of us, before we move into the capital-adequacy questions, I want to add a couple of things.

I neglected to welcome Tom Sheehy and Katie Carroll -- Katie Carroll representing the Treasurer and Tom representing the Department of Finance.

Thanks for joining us today.

And let me explain a bit about the agenda. We'll break for about ten minutes. We'll come back, we'll finish this part of the presentation. I'm hoping we'll wrap that by about noon.

At that point, we will break for lunch. For Board members who haven't given your lunch orders to JoJo, please do so that she can get them ordered.

Following lunch, which we'll try to keep fairly brief, we will be coming back. We will convene briefly. We will adjourn into closed session. There will be no business conducted before we go into closed session.

And then following the closed session, we will come back out.

There will be a bit of a logistics issue because, since we're in this room, what we'll do at the end of the closed session, I think we'll send someone down to the first floor and let folks know that we're about to go back into open session again, so that people don't have to keep coming up in the elevator to see if we're in open session or not.

With that, we will take a ten-minute break.

(Recess from 10:53 a.m. to 11:08 a.m.)

CHAIR CAREY: We're back in session.

And moving on with Bruce's presentation on capital adequacy.

MR. SPEARS: I wanted to set this up just for a second. The question that came up last time from -- I think it started, perhaps, with Carol but then was echoed by some other Board members -- was, how much capital does it take to do what we do best. And there was a little bit of discussion. Our balance sheet shows we have $1.8 billion in fund equity. And on a corporate balance sheet, that would be the capital that we have. This is not a measure of what capital that we have and not a measure of minimum capital that we need.

The number that you see, $1.8 billion, when you take a look at the balance sheet, is restricted by statute, a great deal of it, and by indenture. So we don't want you to think that $1.8 billion is just free to do whatever we want; it is restricted, a lot of it.

So the staff believes that the answer doesn't depend on a number; it depends on a status, a credit status. And staff believes that CalHFA is going to operate at an 'AA-/Aa3' level from Standard & Poor's and Moody's, or higher, to execute our mission. Because below that rating, we start to lose investors. A major category of investors are the money-market funds that invest in our variable-rate and short-term bonds.

Fewer investors means harder-to-find buyers, means higher costs. And once you start calculating our cost of capital at less than 'AA-,' then it's too costly to offer competitive loan products out in the marketplace. So it makes Gary's job harder, it makes Bob's job harder on the multifamily side, and we can't get to our mission. So what we've done is to show you what it takes to be at that level.

Let's go to the next slide, Bruce.

The definition is based on the rating agencies' definition, not ours. They each have their own. The definitions change from time to time. So we have to be all things to two different firms. And it is a bit of a moving target.

So what I've asked Bruce to do, is to show you what we know was done with S&P when they reaffirmed ours, and show you what they do and show you what they hit us with as far as capital charges.

So we know that S&P recently affirmed the ratings, they went through this methodology for their definition. That's what Bruce is going to show you.

What we don't know is what the Moody's analysis is going to look like when they take us off of watch for possible downgrade. So I'll turn it over to Bruce and let him go through this part.

I think what we're going to try to do is get right to, as soon as we can, the schedule that you have, the little -- the S&P chart. But just a couple of things. First, this is where we are, we're at 'AA-' now and 'Aa3' on the Moody's scale right now for our G.O. rating.

On the HMRB side we have a slightly higher rating on the Moody's side. So we're right there, operating at where we think is an optimal place. And we've been there for some time. But going down to A+ and A-1 or lower is problematic.

So, Bruce, why don't you take it from here?

MR. GILBERTSON: Okay, thanks, Steve.

The rating agencies start this capital-adequacy process by reviewing the combined-fund balance. You saw the combined-fund balance as of September 30th, 2008. They always want to use the audited basis. So they start at the end of the June 30th financial period.

Our financial, our audited financial statements typically are available in late October, first part of November. And that begins this annual process.

They're looking to earmark and reserve capital to support loan programs and financial commitments that the Agency has.

Just quickly, on the single-family programs. There's several different components of what is part of the capital adequacy. They want over-collateralization. They want more assets than debt for each of these bond credits, because we have -- 'AA' rating is a very high rating and so they need to have over-collateralization. Typically, it's in the 2 to 3 percent range.

They start the process by basically eliminating the allowance for loan losses that we've put on the financial statements, raising the capital base, because they want to stress the numbers. They determine their own losses. And they do this on a depression-basis type of scenario.

So what we see today -- we went through this because Jack had some great questions regarding what delinquencies are today and the REOs, and we got our arms around an a number. They're going to stress this and they're going to identify loans that they believe will default and end up in foreclosure that aren't even delinquent today. So they're doing models, and they've done this based off historical trends in the mortgage marketplace.

We also have to cover the gap-insurance risk because that's something owned by the Agency. And then, of course, if a primary mortgage insurer like Genworth failed to honor their claims -- and Moody's is in the middle of this -- they're going to make us own all of that risk as well.

Multifamily is a little different. I listed this chart -- we give them very detailed information on all of our loans in the multifamily space. We tell them the lien position, if it's insured by a mortgage insurer at all; if it has subsidy attached to it, what the debt service coverage ratio is, so on and so forth.

Certainly, what we've come to experience out of this process is construction, bridge, and subordinate permanent loans considered to have much more risk, require more capital than a fully amortizing first-lien mortgage.

Other programs that consume capital: Down-payment assistance programs, because they're simple interest, deferred payment, no ongoing payment, tend to make a home buyer, even in a higher loan-to-value situation, pretty significant capital charges for those.

The HELP loan program, our loans to localities, the same type of thing. Deferred repayment, simple-interest program.

And then, of course, the Bay Area Housing Plan loans. The rating agencies aren't very keen on that program, either, and have assessed a lot of charges there.

A couple other things on the financial side. I don't want to dwell on this too much, but there is collateral posting that goes on with some of our interest-rate swap contracts. We post collateral because of contractual agreements that we've entered into. Today, that is about $16 million. It's not significant at all.

The views of Standard & Poor's and Moody's differ on this point dramatically. Moody's is the one that is going to look at contingency amounts. If an event happens, like they downgrade us, how much would we have to post? And that's causing a lot of pain as we work through the capital-adequacy numbers with them.

I think I'll stop at this point on that. But I want Tom to spend a little bit of time with the Board, because many of the Board members weren't here in 2003, when this Board adopted a resolution supporting the loan insurance fund that we administer.

MR. HUGHES: Yes, thank you, Bruce.

Actually, the capital support of the insurance fund goes back well before 2003. And the first express decision that the Board made to provide capital support for the insurance fund was back in 1993.

The way the Agency is structured, the insurance fund and the Housing Finance Fund are two separate firewalled funds. Statutorily, the Housing Finance Fund is not liable for the obligations of the insurance fund. Those are confined to the amounts of money in the insurance fund. So they are two separate firewalled accounting funds.

However, in order to meet its mission and to provide a sufficient capital base for the insurance fund to actually operate at the levels that we're required, the Agency has decided historically, as I said, to provide some degree of defined capital support to the insurance fund.

So back in 1993, the Board enacted a resolution doing that. And that resolution was changed, updated, modified in 2003 by a subsequent resolution of the Board. And essentially, the 2003 resolution does two things: It allows the executive director of the Agency to create and structure two types of capital support.

The first is what we've talked about as the gap insurance, which was a decision to reduce the mortgage-insurance coverage from 50 percent, down to the 35 percent level, and to supplement that gap, if you will, with an insurance policy that was essentially supported by the Agency's Housing Finance Fund through an indemnification of any of those losses. And that actually provides a lower loan rate to the borrower because the premium for the mortgage insurance is reduced. But, in any event, that was the first of the two types of capital support.

The second one was an interfund credit agreement, whereby the insurance fund was permitted to borrow a defined amount of money from the Housing Finance Fund to provide capital support. And the amount of that credit commitment is variable. It changes, depending on what the executive director defines as the amount that's available. And the agreement has embedded within it certain standards in terms of what the effect that credit agreement would have on the Housing Finance Fund.

As it stands right now, the insurance fund has a $100-million line of credit from the Housing Finance Fund. So, obviously, if Chuck were in a stress situation and needed liquidity, needed capital, he could borrow it from the Housing Finance Fund up to the amount of the credit limit, as it may change from time to time.

So that is really the summary of the two relevant board resolutions that have created the structure for the capital support. But absent that, the two funds are separate, although the Housing Finance Fund has an embedded account within it that allows us to provide that capital support to the insurance fund. But that's sort of a brief summary of how we got here.

MR. GILBERTSON: Okay, then let's wrap up the topic, unless there are questions at this point on capital adequacy.

We prepared this chart. This is a summarized version of the capital-adequacy analysis that Standard & Poor's completed as a part of our annual review. The numbers here are based off the audited June 30th, 2008, financial statements.

The top line, "Credit Reserves," is the ending fund balance, June 2008, with their adjustments added back, start at a $1.5-billion number.

We talked earlier, when we were going through all the delinquency information and REOs, we kind of settled on a number, we thought maybe there was $140-million worth of risk in that single-family portfolio.

You can see this first grouping, or subgrouping, there's $546-million worth of risk in the eyes of Standard & Poor's. It's comprised of three numbers of what I would describe as single-family loss coverage, which is losses that the indenture would take to the extent that the primary mortgage insurer didn't pay; to the extent that losses were deeper than the mortgage-insurance coverage.

I wrote some notes to myself here. It consists of 35 percent market-value decline for base loans. "Base loans" are probably loans originated several years ago, 30-year fixed-rate mortgages. And they stress that -- and the market-value decline was up to 46 percent for certain loans. I would guess those would be loans originated in 2005, 2006, at the peak of the market, perhaps also including our *interest only*SM program.

They stress this at a 45 percent foreclosure frequency. So four and a half out of ten loans would go into foreclosure. And they gave us credit for 92 percent recovery for mortgage insurance.

We've heard earlier that the Moody's model, which isn't complete yet, they're giving us 25 cents on the dollar for Genworth coverage. So a pretty significant difference between the two firms.

Down-payment assistance, just as a point, I think we have about $100 million of down-payment assistance loans on our books, $43 million of charges to support that. That basically is one way of saying they think 43 percent of those loans or borrowers will never repay.

Multifamily, we have two haircuts, permanent loans of $135 million. Construction/bridge loans, the rating agencies aren't keen on those loans, and so it's $54 million.

Some of the other deferred-payment programs that we have -- HELP, the Bay Area Housing Plan -- they get very sizable charges. Typically, 50 cents on the dollar, or 50 percent of the loan balance.

Both rating agencies have their own unique peculiarities. Standard & Poor's has two things that they put on every year. They have an earthquake self-insurance reserve. The history behind this is to support single-family loans made in condominiums. The fear is that there is a massive earthquake in a very urban area in the state and that we lose a number of units. So it's a formula base thing. I think it's

1 percent of loan balance or something like that.

They have picked up on what we write in our business plan. I guess this is a good thing, because they read it. And we've identified in there that we have an asset-management reserve. We talk openly about it in the business plan, and they have put that on as a capital adequacy, that we set aside $3 million in case any one of our multifamily projects were to get into some trouble, we at least have $3 million available to assist them with an immediate repair.

And then the bottom part, "Financial Considerations," it's important to note that even though our audited financial statements have -- you know, what we showed you, $1.8 billion of equity now, there's a large component of that, that is money that was transferred to us from the state. We're administering programs under Proposition 46, Proposition 1C. We also have the Mental Health money that was transferred to us more recently. All of that, in the eyes of the rating agencies, is restricted because the Board -- none of us have the right to use it other than consistent with the legislation that created its purpose.

MR. SHEEHY: Question: What's the "Mental Health money" that you refer to, Bruce?

MR. GILBERTSON: This is money that actually was transferred -- it's counties' money, the Mental Health Services Act. It's derived from Prop. 63. And they have transferred, I believe -- help me, Steve -- $385 million, about, today?

We're going to do loan programs with that.

MR. SHEEHY: For what type of facilities?

MR. GILBERTSON: Apartments to house chronically mentally-ill homeless. And there's an additional component of that money that will be used for operating subsidies because typically homeless people don't pay rent.

MR. SHEEHY: Has that money already been transferred over to CalHFA?

MR. GILBERTSON: It was transferred last summer.

MR. SHEEHY: Okay.

MR. GILBERTSON: The other two things, we have -- it's ironic, Tom just gave you a comment or a tutorial on the $100-million backstop to the MI. I don't know exactly how Standard & Poor's arrived at this. It kind of showed up in the final form of their capital adequacy. They've identified it as $92 million. I won't quibble. It's helping us, so on we go.

Another significant part here, though, is swap collateral and termination payments that S&P is imposing on us, total $28 million. The number that Moody's has kind of got their arms around today is about $250 million. So it's a significant difference. And we'll share that with the Board once we get there.

The bottom line, $330 million of capital still available to the Agency to support G.O. obligations.

MR. SPEARS: The next part of the conversation should be then: So, staff, what are you doing to try to maintain this level?

And some of this is tied into what Moody's has expressed concern about and some of it's part of what we had planned already. But one thing I wanted to point out again, if we can back up to that previous slide, is a couple things.

One is, these are very big numbers again. Bruce emphasized that. I want to say it again. And the reason is, they really stress these. They're trying to be conservative. And we appreciate that, and I think that's reasonable. But the charges are for loans and real-estate risk that we have on our balance sheet. The charges on the financial-considerations side are for the type of bonds that we have and the structure that we have on the capital side. So in the future, what we're going to be talking about is, are there ways that we can deliver CalHFA products and keep lending without increasing these numbers? But as we make more loans, and the loan side of the balance sheet keeps going up, these charges will keep going up. So unless that top number that they start with gets bigger to match that, then we're going to start running into trouble.

So those are the issues that we face.

So let's go to the next slide again. And I'm going to let Bruce go into a little more detail. But specifically, the game plan to try to reduce some of the concerns about what we have on the balance sheet fall in this list here. And a resecuritization of multifamily loans which result in multifamily loans going less of a capital charge, plus we get cash out of that, that's a good result for us, if we can work through that.

The sale of the Bay Area Housing Plan bonds has been a long process. It has been up and down.

We are now moving forward. We think that we'll be able to do that in April -- is that correct, Bruce?

MR. GILBERTSON: Hopefully.

MR. SPEARS: And that will result in not the loans being off our books and not the bonds being off our books, onto somebody else's books, but the loans and the bonds will be exactly tied together. And for the rating agency's purposes, that makes that concern go away. The bond investors are the ones that will be taking the risk.

MS. CARROLL: And when do you think that's going to happen in April?

MR. GILBERTSON: We owe you a call, Katie, to give you an update. We received a rating from Standard & Poor's this week. It's a whopping 'BB'-rated bond.

We'll be scheduling several calls Monday. We hope to reach out to you to schedule or reschedule the financing, I would guess the second to third week in April, for a sale.

MS. CARROLL: And you will be bringing it back to the PMIB, the loan concept back to PMIB when they meet, I believe it's April 2nd?

MR. GILBERTSON: Yes, we've left that open with PMIB. And certainly, we'd be more than willing to postpone the bond sale if PMIB had sufficient cash to give us a short-term loan because maybe rates would be coming down.

I mean, these are still bond interest rates that we're expecting to be somewhere between 9 and 18 percent.

MS. CARROLL: Thank you.

MR. SPEARS: Fannie Mae has also talked to us about the transaction that they're able to do, that would actually replace the whole loans that we have on our balance sheet, that we're being charged for by the rating agencies. And rather than hold those loans on our balance sheet, we would hold mortgage-backed securities on our balance sheet. We would simply transfer loans to them, but they would guarantee them. We would pay a guarantee fee. They would package those loans up into mortgage-backed securities, and that's what we would get back.

So when that happens, then with a guarantee from Fannie Mae, the capital charges associated with those loans would go away because we don't own the loans anymore; Fannie Mae does. So that's the transaction there.

The other thing is, we have been talking to them -- Fannie Mae -- about a sale outright of some loans that they were interested in. We get cash for that, obviously, and those loans are owned by them, again. And that reduces the capital charge for Moody's.

The next to the last, working with Moody's on their review of the Agency's G.O. rating. Bruce is almost daily in contact with the analysts that are working on this, providing them with more detail, providing them with rationale for what we're doing, challenging them on their methodology.

And Bruce and I are planning on writing them a letter that documents our differences of opinion --

professionally, of course -- with their ideas about how we do business and their ideas about our risk.

The final item here is that we're taking the President at his word, that he is going to help state HFAs. Our national association has been in talks directly with the HUD Secretary and with folks at Treasury about what this would look like.

The part that's been made public, that is being talked about, are two things: One is, a way for Treasury to buy state HFA bonds at attractive rates, which would allow us to turn around and offer loans -- a good cost of capital for us.

The other is to offer liquidity through the GSEs, through Fannie and Freddie, so that when these liquidity agreements come due -- or if we want to just outright replace them -- but when they come due, that Fannie Mae or Freddie Mac would step in and provide the standby bond purchase agreement.

We have expanded that conversation into the potential for letters of credit -- a broad letter of credit instead of just the standby bond purchase agreement, which would be much more beneficial to us in the event of bad news from Moody's. So we're working on that.

And the only thing that is not on this list that we probably should have put on, Bruce, and that is that we are talking to liquidity banks about their plans for standby bond purchase agreements out into the future, getting there, who's interested, who's not interested, and try to get those ideas lined up.

So we have put in here -- and I can let Bruce go into more detail about each one of these actions -- but, obviously, this is taking up a great deal of staff time. Just on the swap-and-hold and bulk sale, Gary has an entire team of people in homeownership lending that probably used to do compliance or they used to do some portion of the loan processing, that are now off, pulling files, looking at them, seeing what needs to be done to swap-and-hold or sell them to Fannie Mae. It's a huge process, and they're very busy doing that so we can go into this in more detail. Bruce has kind of put his side-by-side benefits/concerns on each one of these.

Pleasure of the Board?

MR. GILBERTSON: For the benefit of time, maybe what I'll do is just hit what I think are the highlights. And if there's a question on any one of these topics, if the Board just asks.

I think on the first one, the securitization of loans, liquidity is one of the things we're watching carefully. If we're successful on this billion dollars, it would raise about $200 billion of cash for the Agency. That would be quite significant.

You know, one of the concerns, and one of the big concerns, is that all of these loans have to fit through the underwriting criteria of Freddie Mac, who ultimately will be the guarantee on the bonds.

Sale of Bay Area Housing Plan bonds, we've talked some about this. This is something, I think it's interesting that we started this financing project in 2005. Here we sit, four years later, and we're still working on this financing. All of the delays certainly are not of the Agency's. There's a lot of issues with having the facilities ready to go, closure of the state hospital and those things. And, of course, in the meantime, the capital markets totally disintegrated on us, unfortunately.

This is something that would be a limited obligation of the Agency, backed only by the loans, the revenues on the loans, the lease assurances, the other reserves that we've built into the structure. And so the Agency is not going to be assessed a capital charge if we are successful with this financing.

The unfortunate part of this is that if we sell bonds at interest rates of 9, 10, 12, 15, 18 percent, it's the State of California that will have to appropriate money sufficient to make debt service effectively on the bonds.

Fannie Mae "Swap and Hold." There's two different Fannie Mae proposals. Both of these are to try to remove real-estate risk from the balance sheet of the Agency. We can do a swap of whole loans, where we have the risk if the loans have less value, if the properties have less value than they did at origination, by having the loans put into a mortgage-backed security, then Fannie Mae would be guaranteeing all of the payments due on the loans. We'd eliminate the gap-insurance exposure that we have. We'd eliminate other capital charges for the real-estate risk.

Fortunately, we have a lot of loans that the current loan-to-value are significantly above 100 percent. Fannie Mae likely will not accept them unless they think from a policy perspective there's something that they should be doing to help the HFA community, specifically CalHFA.

The same notion on selling loans outright. This was a strategy we first talked to the Board about last fall. One of the things that we were trying to do is to deleverage the balance sheet. If we could sell loans, we would have cash, we could call out bonds and get out of some of those bank bonds that we were holding back in October and November, when we had in excess of a billion dollars of bank bonds.

This is progressing. It's a much smaller scale than we had envisioned. We're continuing to work with Fannie Mae on a variety of things in this space.

Steve kind of covered this. I was literally on the phone at 8:30 this morning with Moody's, kind of getting an update as they're progressing. They've been very busy in the housing group within Moody's the last couple days. They came out with a 23-page report on the state of HFAs and the single-family programs.

To be honest, I haven't had a chance to review it; but they're concerned. They have a much less positive outlook for the housing sector than Standard & Poor's does. I'll say it nicely. And that's reflective in the PMI companies that they've downgraded into the 'BB' range.

S&P has not downgraded the PMI companies into that territory.

So we still work with this watch for possible downgrade. I asked them specifically when they thought they would be complete with their analysis. Certainly it's not going to be in the next week, but more likely, in the next two to three weeks. So we'll be having a lot of conversations with them as they wrap that up.

And as Steve pointed out, part of this has been timing. But we think as they get very close to going back to committee, we'll outline our differences of opinion and methodology, because it's not the analysts that I talk to on a day-to-day basis that will make those changes, it's the senior level municipal-bond rating committee at Moody's that might be willing to consider some of this. So that's something we hope to get out very soon.

Steve, do you want to talk more specifically about the proposals in front of Treasury?

MR. SPEARS: Well, there are two veins. The National Council of State Housing Agency has, again, opened up conversations with Treasury and HUD. Their execution of this will be through Fannie and Freddie. And their main idea is to provide access to the bond market for state HFAs. New bonds for new capital, and also liquidity to help with existing variable-rate debt.

The downgrade of the private mortgage insurers threw this into a completely different light. State HFAs, like CalHFA, that hold whole loans on their balance sheet suddenly became much more vulnerable to talk of downgrade by Moody's because of the downgrade of the private mortgage-insurance companies.

What this means when Moody's is calculating how much Genworth will contribute to us, they only give us partial credit. They used to give us 100 cents on the dollar; now, they only give us 25 cents on the dollar. Obviously, that's going to make a big increase in what's left for us to pay and pick up with our own capital.

So the downgrade of Genworth by five notches to 'Baa2,' and the fact that Genworth is our business partner makes it a double impact to us.

What we've done is open up a separate channel of communication with Treasury, thanks to a contact that Ms. Peters has in Treasury, and talked to them as late as last night about something additional for states that have this problem. And so this may wind up being part of the discussion, the overall discussion that Treasury and HUD are currently having with the private mortgage insurers as opposed to the first bullet here. But we're in the middle of starting those conversations.

They all recognize that everything changed when the private mortgage insurers were downgraded. And now the conversations are a little bit different for the whole-loan states.

That's where we are. And, again, six or eight weeks from now, we'll know a lot of things. We'll know what Moody's decision is going to be, what the federal assistance is going to look like, whether the Bay Area

Housing plan bonds were sold, whether we were able to consummate these transactions with Fannie Mae and Freddie Mac on single-family loans and multifamily loans. There is a great deal that will be learned between now and then.

In the meantime, we have multifamily staff working on the resecuritization of multifamily loans, we have single-family staff working on the Fannie Mae transactions, and we have loss-mitigation and REO staff working on REO management. Folks are busy. And they're mostly busy with these things that we've just discussed. Obviously, we want to start lending again.

The folks in this room that are out in the audience, the employees, I've told you before, we're tired of being on the sidelines. We want to lend. That's what these people got hired to do, that's what they love to do, it's what I love to do. We'd like to get back in the game.

There are some things between us that we need to take care of, and that's going to take up our time in the next two months.

Mr. Chairman?

MR. SHINE: Let's eat.

CHAIR CAREY: Any questions before we adjourn for lunch?

MS. PETERS: Just a comment, if I may. Because it is so rare that we as a board have an opportunity to see so many employees of CalHFA together at one place and one time, I just wanted to take a moment to echo the comments that other Board members have made here today and I've made before, that the staff here is outstanding. We recognize that. We thank you for your service. We know it's difficult in these times to be on the sidelines and to be outside of our comfort zone in dealing with a lot of fires that we didn't start. But I just wanted to take a moment to say thank you to everyone and thank you for coming here today and for everything you do every day.

We're trying to support you through this. And there will be a brighter day. We will be back, and there will be affordability in the market that we can get back to doing what we all love. So thank you all.

CHAIR CAREY: Thank you, Heather. You speak well for all of us on that.

To reiterate, we will be breaking for lunch. I anticipate we'll be back in this room by 12:30, to immediately go into a closed session to deal with potential litigation. Once that's over, we'll be back in public session.

We will send someone downstairs when we go back into public session, so that you folks are aware that the meeting is open again.

Once again, because I know that Carla has a commitment in the Bay Area this afternoon, I want to thank her, once again, for her time and wish her all the best.

(Applause)

CHAIR CAREY: With that, we are adjourned for lunch.

(Midday recess from 11:44 a.m. to 12:47 p.m.)

CHAIR CAREY: The California Housing Finance Agency is back in session. And we will now adjourn to closed session to deal with matters of potential litigation.

We're in closed session.

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Item 5. Executive Closed Session

(The Board met in closed executive session from 12:47 p.m. to 3:00 p.m.)

(The following proceedings commenced with Mr. Sheehy, Ms. Javits, Ms. Carroll, and Ms. Jacobs absent from the hearing room.)

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Item 6. Discussion and Possible Action Regarding an Update of the Agency's Five-Year Business Plan

CHAIR CAREY: We are back in open session.

And next up is Item 6, preliminary discussion regarding the Agency's five-year business plan.

Steven?

MR. SPEARS: Thank you, Mr. Chairman.

We're going to move right through these slides in this part of the presentation.

The most important thing I think we need to talk about is, what's the new business environment they're going to be operating in and what are the assumptions for going forward, what are CalHFA's value-adds, and what are the assumptions about the success, what actions are being pursued. But to me, one of the biggest things is, how are we going to deliver CalHFA products in this new business environment, new operating environment.

So then we have some additional services and business opportunities that we are considering. We'll probably spend less time on that at this board meeting and save this until the May board meeting. But the final thing is, the next steps in the business-planning process, the main thing that I'd like to put out here on the table is that I believe that the most prudent thing for us to do in this environment, where we know so little at this point, is to have a two-year business plan rather than a five-year business plan because the future is so uncertain. And that's the way we're going to develop it, unless the Board has a different idea.

So let's move to the next slide.

The new operating environment. The combination of everything that has been going on that we've been discussing -- the balance-sheet risk, the Genworth downgrade, the bond market challenges, and other things -- create a new environment for CalHFA.

The bond market, we believe, is not going to be functional as we have had it in the past, until late 2010. And by that, we mean in the past, Bruce would package up loans, go to the bond market, which was more or less routine. We always had investors, always got a pretty good price. And those days are over, I think, until late 2010.

Even then, we're not totally sure that investors will come roaring back to the municipal tax-exempt housing market like they were before. It may take longer than that for it to return to what we've been used to in the past.

Given our balance sheet and given the analysis by the rating agencies, we do not believe that we can put more real-estate risk on our balance sheet. There are ways to keep lending and not do that, but that's a tenet going forward. This means, on the single-family side, and on the multifamily side, until things improve.

No additional mortgage-insurance risk. With the downgrade of the private mortgage insurers, we don't believe that we can put more mortgage-insurance risk on our balance sheet. It kind of goes along with the second point about no additional real-estate risk, but that's the situation.

Were the mortgage insurance companies to be upgraded, their situation improves, they get federal assistance, that could change.

The final thing is -- I'm sorry, to go along with that, no additional exposure to Genworth, especially with their five-notch downgrade. And again, if they were to get assistance, if their situation were to improve, that could change as well.

But the final thing is, there will be very little in what we have always referred to in Board meetings at this point in time of HAT funds for a variety of things: Down-payment assistance, preservation, rehab, those sorts of things. That cash will be needed for our activities to strengthen our balance sheet over the next few months, and perhaps a couple years, those programs will be short for that period of time.

The next slide, please.

So going forward, our value-add -- and this is not an exclusive list -- but in thinking about this, CalHFA is a stable source of lending, through good times and bad. That, yes, multifamily folks, for example, have competition from other banks during a time like this, when the economy is bad and banks go chasing, you know, anything and everything, and all of a sudden Bob starts hearing, "Well, this bank or that bank is offering this rate." In the good times, we don't hear those. So we are there, good times and bad.

Chuck's operation, offering mortgage insurance through good times and bad, that's one of our major value-adds.

High-quality borrower service, quality lending products with quality underwriting. Obviously, when we're able to do lending.

Programs that provide the gap needed to achieve financing, whether it's on the down-payment assistance on single-family or on the multifamily side, in preservation. But we've, in the past, have had HAT funds available to do this, had G.O. bond money available to do down-payment assistance. So that's been our value-add.

Finally, leveraging relationships with local governments, with local organizations like Self-Help Enterprises and others, and leveraging dollars to achieve affordability. That's been one of the hallmarks of our success.

So the assumptions going forward, though, is, we're going to have to maintain this 'Aa3/AA-' credit rating as a minimum to do that because our cost of capital depends on that.

We're going to have to have access to housing bond markets, either through the regular bond markets, through regular investors, or through some type of federal assistance that they're talking about.

And the other thing is, our core programs have to be financially successful. We have to make money on those to fund these other programs and to keep our balance sheet healthy.

All right, so how can we keep going in this kind of environment, where we're not taking real-estate risk? There are ways to do that.

On the single-family side, there are ways that we can lend, that we can move loans through us onto GSEs, like Fannie Mae and Freddie Mac, where we hold an MBS security, others hold the loans, others have the mortgage-insurance risk.

We will only have CHDAP available for

down-payment assistance, but in a limited amount because of the PMIB's issue and the Treasurer's issue with going to market with G.O. bonds, it would fund CHDAP. But hopefully, if the Treasurer is able to get back on the general-obligation bond market and provide us with more funds for CHDAP, that would make that number go a little bit higher.

We're going to have to have a higher number of FHA loans because conventional loans are requiring more down-payment assistance from mortgage insurers. Many mortgage insurers -- Gary and Chuck will tell you -- will do 95 at absolute maximum. Most of them will only do 90 percent loans in California. That's requiring, you know, 5, 10 percent down payment. From first-time home buyers, that's a very big number. And that is out of our hands. So we would have to have more down-payment assistance available, we think.

But the best-case scenario in the near-term is for us to become more of an FHA lender, with only 3.5 percent buyer participation. We believe that's probably the future for us in the near-term.

We also have the ability to deliver whole loans for cash to the GSEs on a flow basis. Gary has this ready to go. He'll have it ready to go for both conventional loans, for FHA. Fannie Mae is buying FHA loans. And that will be a business model that will work for us. But on a going-forward basis, all CalHFA borrowers will receive home-buyer counseling to go along with this.

So that will be the operating environment and business model on the single-family side.

On Mortgage Insurance Fund, because of that, less Genworth exposure, more FHA loans, the Mortgage Insurance Fund will see less business in fiscal year 2009-10. We don't think this will be a long-term situation. The activities in Chuck's shop are going to be focused on loss mitigation, loan modification, REO management, working with servicers, as we mentioned this morning. That's going to be their main function for the near-term.

The multifamily business model, to focus on new loans. There will be not a lot of funds available, again, for HAT, for loans for properties that are in our portfolio.

We do have the ability, again, to deliver loans to Fannie Mae and Freddie Mac, where we take limited real-estate risk. We're developing a risk-share relationship with both Fannie Mae and Freddie Mac. And that will keep 100 percent risk off our balance sheet on the real-estate side, over on the multifamily side of the house.

This is a fee-based business model. Again, it's not a long-range model for us. But in the meantime, so that we can keep lending, we can keep meeting our borrowers' needs to get out there.

On the special-lending side, the most unfortunate part of all this is that we really will not have any funds available for these programs in fiscal year 2009-10.

That's unfortunate. These are our partners and stakeholders. They have been with us for a very long time. And it's sad to say, but that is the environment that we're going to have to function in for the near-term.

As a one-pager take-away for your lamination and pocketbook to carry around, this is what we used to look like, this is what we're going to have to look like for the time being. Whereas we purchased whole loans before, and we took 100 percent risk on the balance sheet on the single-family side and we had our own mortgage insurance and high LTV loans, all these things are going to have to change. We're going to be purchasing MBS from Fannie Mae and Freddie Mac. Loans are going to be owned by the GSEs. We're not going to be able to take real-estate risk and mortgage insurance for the near-term.

We're going to have to be doing lower LTV loans because that's what is going to be only available to us out there. We'll do more FHA lending and we'll have ability to flow-deliver loans and not have 100 percent reliance on bonds. That's the single-family side.

On the multifamily side, the same kind of thing. Instead of being a portfolio direct lender on the multifamily side, we're going to deliver loans straight through on a flow basis to the GSEs where we don't take 100 percent of the risk. How much risk we'll take is an item up for negotiation and will impact the fee that we get, but that's where we stand at this point.

So on the financing side, something we've already discussed with the Board for some time now, and that is, we're taking less reliance on variable-rate bonds. And we'll have more fixed-rate bonds into the future as we come back into the market.

And we're obviously going to have to rely on other sources of liquidity, look for other sources of liquidity, for example, the thing that we're looking at with Wells Fargo at this point. And we'll have less reliance on PMIB, and this is the reason why. The PMIB warehouse line that we bank on is extra cash that they have above and beyond cash needs of the State and bond proceeds that are needed for projects. Right now, the State is going to be selling notes, RANs, just to barely meet their cash requirements for operating. They're going to be selling G.O. bonds just to barely make the demands for projects. There's not going to be extra water in the bathtub, if you will, at PMIB. It's not going to be there. So that's what we use our warehouse line on.

Now, for Lynn Jacobs and MHP money, that depends on the State Treasurer selling bonds. That will be available to be funded. But extra cash just floating around in PMIB, I don't think that happens for a very long time, so we're going to go in search of other liquidity.

In the meantime, the transitional activities are as follows -- and these were on the earlier slide, we're just recapping everything here -- the resecuritization of multifamily loans is the Citibank transaction that we've discussed.

Obviously, we've talked and talked about the sale of Bay Area Housing Plan bonds.

The "swap and hold" transaction with Fannie Mae.

The bulk sale with Fannie Mae.

The federal assistance that we're working on with Treasury and HUD.

All of those things are going to occupy our time in between. What we really want to do is time all this so that we can get these things done, get back into the market, transition staff from working on these bottom items down here under "Transition," and get them working again on multifamily loans, on single-family loans, get back in the business.

I don't know at this point what the volume will be for these next years. We will know so much more in the next six to eight weeks with regard to what Moody's plans are, what the federal assistance package will look like, what liquidity we'll have available to us, that it's very difficult to predict what kind of volume we'll have with the MBS programs, with the flow programs, on both the single-family side and the multifamily side. So that's what we'll look at.

So save that page. Keep that in your pocket.

Other things that we've talked about before -- Chuck mentioned the loan modification last time, at the Board meeting, and almost immediately, the President began to talk about a loan-modification program. So we're trying to reconcile this, too. But ours has to be specifically designed for CalHFA, because we have bond indentures, we have obligations to our bondholders. It's a little bit different situation than if we were a private servicer or a private bank.

We are talking about expansion of the Community Stabilization Home Loan Program, where we are making REO properties available to first-time home buyers.

One of the things we're talking about there is a program that Gary has termed the "Circle of Hope," and that is to make REOs available and partner with local governments with NSP funds that they have. We've already talked to Lynn Jacobs about perhaps even tapping into some of the state MHP funds to expand that program.

One thing that Margaret's group in Asset Management has looked into and we're going to move forward on, are performance-based contract administration programs with HUD. Right now, those programs are with other entities. They're looking to rebid that in 2010 for a start in January 2011. So we're going to be going ahead and working on that. It's a program that would be statewide and involve working with HUD, so we'll have more to talk about that in May.

There is another use of NSP funds that is being talked about right now, and that is where you have a tight group of REO homes, particularly in urban areas, that could be made available for rentals. Rather than have an apartment unit multifamily project, you could work on a project where you have -- I think it's within a mile -- is that right, Bob -- radius?

MR. DEANER: Right.

MR. SPEARS: That you'd have REOs that you could turn into rental units and manage those.

We're not really set up to manage single-family residents, but we're looking into the possibility of that.

And finally, but not least, something we talked about this morning, and that is to move to restructuring of the loan-servicing unit, where we're servicing 100 percent of all CalHFA loans. We think it makes sense from an economic standpoint, but mainly, we think it makes sense that our loan-servicing folks do a much better job than outside folks. They're mission-driven, and we think that serves our borrowers better.

The last slide.

What's the next steps? Again, we'll know a lot more in six to eight weeks. We're going to be resolving those. Look for e-mails from me to the Board members on developments on all levels from time to time. So we'll be doing that.

Again, we don't know a five-year business plan at this point makes a lot of sense. We're going to shorten it down to two years. And we really need to know what this world is going to look like to get volume and activities nailed down. So that's our plan.

Any comments from the Board, from Board members? We've kind of zoomed through this part.

CHAIR CAREY: Board members?

MS. PETERS: Well done. Thank you for zooming.

MR. SPEARS: Well, it will be a very different world. We are trying to get back in the game and do what we need to do to get our mission back on line.

CHAIR CAREY: Ruben?

MR. SMITH: Yes, I think you've done a great job. I think with every negative, there's always a positive. And I think you're looking at trying to find opportunities. And I think that's the way to go. So good job.

MR. SPEARS: Thanks very much.

CHAIR CAREY: And we're all comfortable with the idea of focusing on a two-year business plan in May, right?

MS. PETERS: Absolutely.

MR. SPEARS: Okay.

CHAIR CAREY: Good.

MR. SPEARS: Thank you very much.

CHAIR CAREY: Thank you, Steve.

MR. SPEARS: And thanks to the good work of staff. It's not only Bruce and the Finance Division, but Chuck and his folks have worked on this presentation. Gary and his folks, Bob.

If I'm missing somebody, I apologize. But it's been a group effort.

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Item 7. Public hearing pursuant to Health and Safety Code Section 51657(a) regarding revisions to Agency's schedule of mortgage insurance premium rate

CHAIR CAREY: Okay, our next item is a public hearing regarding the Agency's scheduled mortgage insurance premium rates.

MR. HUGHES: Mr. Chair, I would just note, this has come up in the past when we've done this. It's not a board action item; it's simply a public hearing. Our statutes require a public hearing to change our rate card. And so we take the opportunity to use the Board of Directors meetings as that hearing.

CHAIR CAREY: Great.

(Mr. Shine left the room for the day.)

MR. McMANUS: Shall I begin?

CHAIR CAREY: Yes, please.

MR. McMANUS: Thank you.

I'm Chuck McManus. I'm going to take you through -- bottom line, this is a pretty simple issue. Risk is high in the current market in California.

All of the private mortgage insurers have increased their premium rates, have abandoned the 95 percent LTV. They've already abandoned the 97 and the 100 before that. And we find ourselves needing to raise the premium rate in order to stay in the market to be able to provide mortgage insurance in this market and obtain reinsurance, which we need to do based on our concentration.

We were formed to provide low-payment mortgage insurance for low-income people on low down-payment loans. And we historically provided below-market premium rates for the first-time home buyers.

The rates I'm showing you today are market rates that the outside private mortgage insurers would charge if they were in the market. They have abandoned the 95 LTV. And so we need to move to that in order to afford our reinsurance. That's basically what Number 3 says.

And we will be able to review the status of the market on an ongoing basis. Should the market improve, we'll be back and advise -- you know, returning to the previous rate levels and so forth, hoping to charge the lowest possible rate and still generate sufficient returns to maintain the profitability of the Mortgage Insurance Fund and its ongoing availability of insurance.

The rates being proposed are shown under the "Distressed Markets" column. The rates to the right, "Standard Mortgage Insurance Rates" are our current rates. And the ones to the far right, the "Stable and Rising Market," were the rates we had before we raised them to the standard rates approximately one year ago.

So when I got here, they were on the far right; we moved them up to the middle; and now we propose to move them to the left, the group on the left. This is for 35 percent coverage, which is the deep coverage we have under our bond programs.

MR. SPEARS: Now, Chuck, am I correct, though, that if we, in this hearing, since we're putting all of the rates up, if we need to before another hearing, we could go back down to those other rates without having a hearing?

MR. McMANUS: That is my understanding, and it would be based on market conditions, meaning that they're more like standard conditions.

MR. SPEARS: Right.

MR. McMANUS: Yes.

This is not different from what the other mortgage insurers have. They have distressed market rates, they have standard market rates.

This shows what the industry rates are. You can see, there's none available at the 95-or-above levels. And we can't get 95 cover, to speak of.

There are a few lenders that can get it who are favored lenders; and that would be very hard to identify and maintain.

This is the rates for mortgage-backed security coverages. You'll see the reduced coverage down the "Coverage" column. This is for sales to Freddie Mac and Fannie Mae. And 28 percent was the standard at one time for the 100 percent; 25 at the 97, and so forth, down. There's actually lower rates for the charter coverage. This is the minimum the GSEs must charge.

The easiest calculation is to look at the 100 percent LTV, 20 percent coverage. It gets you down to 80 percent exposure. That's the rules when Freddie Mac and Fannie Mae were founded. They were required, at a minimum, to insure loans down to 80 percent coverage. So this is the very minimum. And Fannie does offer these programs for targeted areas -- you know, general purpose. And, therefore, we've listed these.

We haven't been selling these prior, but we would, under Fannie Mae commitments, probably offer these coverage rates and these lower insurance premiums. And that will allow us, by the way, to buy reinsurance. We have not purchased reinsurance on any coverages lower than 35, because they were so high that we couldn't afford them. Under this, we would be able to reinsure which, again, given our size and concentration, is a very important consideration.

I think that's it.

Are there any questions?

CHAIR CAREY: Any questions for Chuck?

(No response.)

CHAIR CAREY: Thank you, Chuck.

MR. HUGHES: Mr. Chair, because it's a public hearing, let's make sure there's no public --

CHAIR CAREY: Yes, I was going to open the hearing.

(Gavel sounded)

CHAIR CAREY: This is a public hearing. If anyone wishes to address the Board on this item, please step forward.

(No response.)

CHAIR CAREY: I saw Bruce move out there. I thought -- seeing none, the hearing is closed.

MR. McMANUS: Thank you.

CHAIR CAREY: Thank you, Chuck.

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Item 8. Reports

CHAIR CAREY: Moving on, any report items that warrant discussion?

MR. SPEARS: We're going to add one item at the request of Board Member Peters, that we add delinquency by servicers in the back, in the report section.

CHAIR CAREY: Great.

MR. SPEARS: So we can track that a little bit better, the issue.

CHAIR CAREY: I was shocked by those disparities today.

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Item 9. Discussion of Other Board Matters

CHAIR CAREY: Other Board matters?

(No response)

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Item 10. Public Testimony

CHAIR CAREY: Okay, this is the time when we'll have comments from anyone in the public who wishes to bring any matters to the Board's attention.

Is there anyone who wishes to raise a matter with the Board?

(No response)

CHAIR CAREY: Seeing none, I just want to remind the Board, we've got magic parking passes for reduced parking at the hotel.

Thanks for getting the materials out to us so quickly today.

And I don't think Dennis is here, but we all wish him the very best in his retirement.

And with that, the meeting is adjourned.

(Proceedings concluded at 3:26 p.m.)

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REPORTER'S CERTIFICATE

I hereby certify that the foregoing proceedings were duly reported by me at the time and place herein specified;

That the testimony of said witnesses was reported by me, a duly certified shorthand reporter and a disinterested person, and was thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for either or any of the parties to said deposition, nor in any way interested in the outcome of the cause named in said caption.

IN WITNESS WHEREOF, I have hereunto set my hand on the 31st of March 2009.

DANIEL P. FELDHAUS
California CSR #6949
Registered Diplomate Reporter
Certified Realtime Reporter

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