STATE OF CALIFORNIA

CALIFORNIA HOUSING FINANCE AGENCY

BOARD OF DIRECTORS

PUBLIC MEETING

Hyatt Regency Sacramento
1209 L Street
Sacramento, California

Thursday, July 9, 2009
9:40 a.m. to 1:30 p.m.

Minutes approved by the Board of Directors at its meeting held:

Attest: November 19, 2009

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

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APPEARANCES

Board of Directors Present

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

MARJORIE M. BERTE
for DALE E. BONNER, Secretary
Business, Transportation, and Housing Agency
State of California

KATIE CARROLL
for BILL LOCKYER
State Treasurer
State of California

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

JOHN LLOYD
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

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

A P P E A R A N C E S

Board of Directors Present
Continued

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

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Participating CalHFA Staff:

MARGARET ALVAREZ
Director of Asset Management

GARY M. BRAUNSTEIN
Special Advisor to Executive Director
and
Acting Director of Homeownership

ROBERT L. DEANER II
Director of Multifamily Programs

BRUCE D. GILBERTSON
Director of Financing

THOMAS C. HUGHES
General Counsel

HOWARD IWATA
Acting Director of Administration
and
Acting Director of Fiscal Services

CHARLES K. McMANUS
Director of Mortgage Insurance Services

JOJO OJIMA
Office of the General Counsel

LINN WARREN
Multifamily Programs

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BE IT REMEMBERED that on Thursday, July 9, 2009, commencing at the hour of 9:40 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'd like to welcome everyone to the July 9th meeting of the California Housing Finance Agency.

The first item of business is *Roll Call*.

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Item 1. Roll Call

MS. OJIMA: Ms. Peters for Mr. Bonner?

(No response)

MS. OJIMA: Mr. Gunning?

(No response)

MS. OJIMA: Mr. Hunter?

(No response)

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: 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. Lloyd for Mr. Genest?

MR. LLOYD: Here.

MS. OJIMA: Mr. Spears?

MR. SPEARS: Here.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Here.

MS. OJIMA: We do not have a quorum.

CHAIR CAREY: We will proceed with items of information in anticipation of having a quorum soon.

The next item of business is approval of the minutes from May 21st.

MS. JACOBS: Can you do that without a quorum?

CHAIR CAREY: No, probably not. Thank you.

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Item 3. Chairman/Executive Director Comments

CHAIR CAREY: We will move on to *Chair and Executive Director Comments*.

I'm simply going to turn it to Steve, our executive director.

MR. SPEARS: Thank you very much, Mr. Chairman.

There are a number of things like that that we're going to update you on, and so I won't spend a lot of time going over the roller-coaster ride that we continue to be on. All of the staff are having a measure of fun on this roller-coaster ride, but it's, you know, from one day to the next.

Some good news. New Board members -- we have two new Board members: Jonathan Hunter from CSH in San Diego, and also Michael Gunning. And both have been appointed: Mr. Hunter by the President Pro Tem of the Senate, and Mr. Gunning by the Governor. And that's welcome news.

We've also begun lending in a small way again. Our CHDAP program is back out, and we continue to do MHSA projects. And we also have started the Cal30, a 30-year fixed-rate product, where we're delivering to Fannie Mae's window for cash. And we'll talk more about that in the business plan. But we're lending again.

On the federal assistance package, we continue to work directly with U.S. Treasury staff and FHFA staff and GSE staff -- at Fannie and Freddie, both -- to provide input on various proposals, to provide pricing indications, and to help them put together proposals. Our understanding is that proposals have been presented to Treasury attorneys, that they're reviewing that, and they're working with policy staff.

We should have an announcement very soon, which is also what I said at the May Board meeting and also what I said at the March Board meeting, so we view that with some skepticism. But there is some evidence that they have been able to now get their entire time together to consider these proposals.

The final thing, before we get to a couple of housekeeping things, are the rating agencies. We continue to work with Moody's. We continue to be under watch for possible downgrade. Again, that started in September, on September 29th. It has extended into December, and it still goes on. So we're about ten months in.

Mr. Carey and I were talking about this this morning. We view it as good news that, obviously, if they had found evidence that required a downgrade at some point during the last ten months of their review, they would have probably done that. So it's encouraging to us that they continue to look at our situation.

Bruce and his staff continue to provide statistics and data and analysis and discuss methodology. So we believe there, too, that they're coming down to the wire.

Moody's placed Maryland's HFA on watch for possible downgrade on Monday, I believe; and on Tuesday announced that a billion dollars of the Illinois Housing

Finance Agency's bonds had been downgraded from Aa2 to Aa3.

I believe that's right; is it not, Howard?

So they're working very diligently and working their way through a lot of reviews of lot of HFAs at this time. So we're on the list. At some point very soon I think they'll come out with a decision about what to do on CalHFA's bonds.

The S & P, however, has been at work in two different areas of CalHFA. They've been working on a rating, the claims-paying rating of the Mortgage Insurance Fund. And this was accomplished by their Corporate Mortgage Insurance Group. We spent a lot of time trying to get them used to the state environment that we're dealing with. They were unhappy with the loan loss experience that we're having, and they were also unhappy with a decision that was made to reduce the backstop that the housing fund has for the Mortgage Insurance Fund. It was reduced from $100 million to $10 million, and that was my decision that was created by Board resolution several years ago.

The basis for that decision was an analysis that we'd accomplished, that looked at the capital adequacy of the Mortgage Insurance Fund. And we used Standard & Poor's model for capital adequacy. And under that model, there was no situation where we needed any amount of the $100 million backstop.

Moody's was concerned about that $100 million drag on our general-obligation credit on that side. And so the decision was made to reduce that backstop from $100 million to $10 million. That would reduce the capital charge that Moody's was charging by $90 million, which is a very significant amount, given, you know, where they are in their analysis. But that apparently sent a signal to the mortgage insurance analysts that we had somehow, you know, backed off of our commitment to Chuck and the insurance fund which, strategically, they're still as important as ever. And that was part of their decision. So that's written in their analysis and it's available for viewing.

But it had a ripple effect. And so the result was that the Mortgage Insurance Fund was downgraded from A+ to BBB. We have major concerns with their result. We have major concerns with their methodology. And one major concern is that 75 percent of the risk in the Mortgage Insurance Fund is carried by Genworth. Genworth's rating is BBB+. BBB+ plus the adequate reserves that we have in the Mortgage Insurance Fund ought to make a floor for our rating in the insurance fund; and yet they decided to go through that, all the way to BBB straight. And that is just not -- that just defies comprehension on my part and our finance insurance staff. So we are trying to figure that out. Our plan is to approach executives at Moody's on the mortgage-insurance side with our objections. And we plan to do that next week. Just so you know, we're going to be fighting city hall on that. I don't know that we would win, but we want to at least put on the record that we don't believe that that's correctly done.

At one point in the process, we were reviewing a report that was on the way out the door. It was sent to us for review. And the statement was made by the S & P analysts that "CalHFA's loans are mainly to low- and moderate-income borrowers who mostly come from the civil-service background." When questioned about why they put that in there, the analyst said, "Well, I, once upon a time worked in California for CalPERS and CalSTRS, and I was familiar with their programs, and just made the assumption that you guys are just like them."

So when I told him on the phone call that wasn't a confidence builder, he didn't take kindly to that, and so words ensued. But that's the lack of analysis that we're concerned about, frankly. And that's all I'll say about that topic.

However, the decision to reduce the rating of the claims-paying ability of the insurance fund, of course, attracted the attention of the bond analysts at S & P. They're now talking to Bruce, and they're concerned because the Mortgage Insurance Fund backstops the bonds. The first 35 percent of all conventionally insured loans are supported by or backed by the insurance fund. This caused them some concern. They started conversations with Bruce; and, surprising to us, went to their credit committee earlier this week and placed our issuer credit rating and our HMRB indenture on credit watch -- this is their technical term - "*credit watch with negative implications.*" It is exactly the same as Moody's watch for possible downgrade. It is a 90-day review. We've already started the process of talking to them about their methodology, about their timing of their decision, what they need for data and all that sort of thing.

So we'll be in a Moody's conversation and an S & P conversation at the same time.

I'd be happy to -- we're going to talk a little bit more about that in the business plan and our assumptions. If there are any questions from any of the Board members, I welcome your questions.

And that concludes my comments.

I just have a couple of housekeeping items.

You have three slide handouts in front of you for -- let me make sure I get the item numbers correct.

(Ms. Berte entered the meeting room.)

MR. SPEARS: You have -- the first is -- or should be -- may I borrow yours, Jack -- "Financial Markets and Agency Update." That is for Item No. 4, I believe. This would go under Tab 4. They're all conveniently -- Tab 4 is empty, it's all ready for your slides to drop in.

The next --

MR. SHINE: We'll put it on "report watch."

MR. SPEARS: Thank you.

The next set of housekeeping is this set of slides for the business plan, two-year business plan. And that one is also conveniently three-hole punched, and that goes behind Item No. 6, Tab No. 6.

And finally, you should have this one for the operating budget. And that goes behind Tab No. 7, if I'm not mistaken -- yes, behind Tab No. 7.

I hope there's room for all this.

MR. SHINE: There is now.

MS. JACOBS: JoJo always gives us nice, big binders.

MR. SPEARS: Excellent.

One final item that I'll get to when we --

there is an important typographical error that I need to correct when we get to the budget negotiation -- "budget," not "negotiations." That's a Freudian slip. It could be. It could be -- to the budget discussion. I'll point that when we get there. I won't waste the Board's time at this point.

CHAIR CAREY: Great.

For the record, we now have a quorum.

MS. BERTE: Sorry for being late.

CHAIR CAREY: No problem. Welcome.

For the record, Marjorie Berte.

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Item 2. Approval of Minutes

CHAIR CAREY: Okay, with that, we'll move on to *Approval of the Minutes of the May 21st Board Meeting*.

MS. JACOBS: Move approval.

MR. SMITH: Second.

CHAIR CAREY: Moved and seconded.

Roll call.

MS. OJIMA: Thank you.

Ms. Berte?

MS. BERTE: Here.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: 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 4. Report, discussion, and possible action regarding the Agency's financing and program strategies and implementation, in light of financial marketplace disruptions

CHAIR CAREY: Okay, we'll move on to Item 4, the report and discussion regarding action re Agency's financing program.

Steve?

MR. SPEARS: Thank you, Mr. Chairman.

I've asked for the able assistance of Mr. Gilbertson on this. This will start under Tab 4 of your slide program.

This is getting to be a regular item in the Board agenda to update you where we are in the financial markets, with our variable-rate debt, with our loan portfolio delinquencies, with our rating agencies.

So I'll turn this over to Bruce at this point. Please feel free to stop him at any point and ask questions throughout this presentation.

MR. GILBERTSON: Thank you, Steve.

Good morning, Mr. Chairman, Members of the Board. As I sat here this morning, I was thinking about, it's almost been a year since we were in the capital markets for a publicly issued financing. We closed the deal in August of 2008, $250 million for a single-family program. We were rather excited, back last July or August, because we had received news from the federal government that all of our bonds -- mortgage revenue bonds -- were now exempt from even the AMT penalty of federal tax law. So we quickly moved to market, did a $250 million financing; and then, of course, we know what happened as September unfolded.

So quickly, some thoughts about capital markets today.

There is a fixed-rate bond market for stronger credits who want to issue new financing. It doesn't work extremely well in the housing business these days. There is limited participation from institutional investors. And I think it's safe to say that most or the vast majority of the bond transactions by housing issuers, housing finance agencies, and others, are for single-family bond programs.

I have some statistics here that kind of illustrate this.

Housing bonds for the first six months of calendar 2009 are down by 75 percent from the first half of 2007. 2007 was really the year before the crisis all began in the early months of 2008.

Single-family bond issuance is down by 80 percent. So by comparison, in calendar year 2007 through June 30th, housing issuers had issued over $13 billion of bonds in 2007. In calendar year 2009, it's just over $2.5 billion. So significantly, significantly lower than had been historical, by historical measures.

There is a few absolute interest rates from recent bond financings in New Mexico, Idaho, Washington, Ohio. The purpose of this is to show the bond rates that are being paid by issuers, and then comparing it to the mortgage rates that are published by Freddie Mac on a weekly basis. So I simply gave you the last four months.

The first Freddie Mac survey in each of the last four months, in a range from 4.78 in April, more recently to 5.32. So perhaps things are going in the right direction, but there was a significant rally, I think, in interest-rate markets yesterday. So that's kind of changed a little bit. But the point in all of this is that the financing costs do not support the mortgage rate.

Recently, an investment banker told me that for single-family loan programs financed with fixed-rate taxes and mortgage-revenue bonds, they're estimating that the mortgage rate would have to be over 6½ percent to be a self-sustaining program for an agency. Clearly, CalHFA is kind of in that space these days with the challenges we face. So we have a disconnection in the mortgage marketplace as it's compared to the mortgage-revenue bond market.

Turning to the variable-rate bond market quickly, as you all know, we have several billion dollars of floating-rate debt. There is some calmness in the marketplace, an abatement of liquidity and credit concerns. There isn't a lot of new credit or liquidity support from commercial banks for housing issuers. A lesson learned over the last few years, I think. And so we continue to experience higher basis mismatch on the majority of our interest swaps, which have a percentage of LIBOR basis.

Some data points here, SIFMA, which is the tax-exempt floating-rate index that is widely used in the market base was recently at 35 basis points. You know, one month LIBOR reset into the end of June at 31 basis points. So this relationship, or the ratio that we talk about, SIFMA to LIBOR ratio was equal to 112 percent.

By comparison, our interest-rate swap contracts perceive that we would receive 62 percent of LIBOR. So even if we were paying SIFMA and receiving 62 percent of LIBOR, we have a significant gap. And there is a chart coming up here that will demonstrate that.

This is the historical perspective of what we refer to as "basis mismatch," from the inception of our variable-rate program back in 2000 through June 1st of this year.

Just for clarification, the yearly increments shown here are actually kind of a bond debt service year. It starts on August 1 of a given year and it goes through July 31st of a given year. So 2009 actually represents ten months of basis mismatch activity. But, clearly, the orange or gold bar is growing. That's the periodic mismatch. So that's for ten months. The last ten months through May 31st we've experienced over $40 million of basis mismatch, variable-rate portfolio that's in excess of $4 billion. And that's approximately half of the basis mismatch from the time we started the program in 2000.

As you can see, the blue bar now totals in excess of $80 million of basis mismatch.

So this, again, is the difference between the interest rate we have to pay to the bond holder, who has a floating-rate instrument issued by CalHFA, and the variable-rate payment we receive from our swap counterparties as a part of the interest-rate swap contracts we entered into over the last ten years.

Another complication of the basis mismatch is this notion of having bank bonds. These are variable-rate demand obligations that have not been successfully remarketed for one of two reasons:

The bank liquidity support is of such a low rating that the investor community doesn't want to purchase the bond, or it could have -- some of our bonds still have bond insurance attached to it and that has become a credit challenge for investors as well.

And the other reason is that the facility itself has expired. When we entered into these transactions, we knew that we were issuing 30-year variable-rate bonds, and we had a liquidity facility that ran from three to seven years, sometimes as short as one year and we would have the rollover risk, that we would face renewals at times in the future and have to address that.

The good news from this chart is that, remember, back in October we gathered around a table somewhere, either in Sacramento or in LA, and we had to tell you that we were approaching $1.2 billion of bank bonds. So we've really done a remarkable job of trying to bring that down.

Clearly, you can see it's been very stagnant over the last few months. And what really remains is $313 million of bank bonds, $92 million are due to failed remarketings. Investors simply don't want to buy the bond because of the liquidity support provided by the bank. And $210 million are due to expiration of the underlying facilities, the first one going back to November of last year. This is where the federal assistance program will come in very handy for the Agency. It would -- as we understand the program -- and we'll talk more about that in a few minutes -- it would provide a new liquidity source for housing finance agencies; and certainly we are hopeful that it would take us out of all of the bank bonds.

A quick snapshot of our debt portfolio as of July 1st. It really hasn't changed much. We do have some redemption activity that will be targeted to the August 1, 2009, debt-service date. But we're sitting on $8.127 billion of bonds. It's kind of color-coded again.

In prior board meetings, we've talked a lot about debt restructuring plans. We've done about everything we can absent the federal assistance program at this point. We certainly could do some potentially fixed-rate issuance. We've shied away from going to the marketplace because of the cloud hanging over our issuer name because of the rating agency credit watch and watch for downgrade.

So we have a few auction-rate securities that are still outstanding. Ironically, they're paying an interest rate of about 3½ percent, which in the context of things, is not horrible. And then we have some VRDOs that are insured and otherwise have poor liquidity names, such as Dexia, Depfa, and Fortis.

$3 billion of fixed-rate bonds and all of our index floaters or index floating rate bonds of a billion dollars are performing quite well.

If you tally all this up, I would say today we're looking at just short of 20 percent of the debt portfolio that has structural problems. And the performance is causing undue pain to the Agency and its operating performance.

A quick look at the swap counterparty portfolio that we have as of July 1st. Again, we have a number of different counterparties that we've entered into swap contracts with over time. The total amount of swap notional understanding is $4.5 billion. And a recent market value of these swaps, if they were all to be terminated, is $237 million. That's a payment that CalHFA would have to make to the counterparties to get out of those contractual arrangements.

Maybe I'll stop there and see if there's any questions from Board members regarding the marketplace that we are facing today and the challenges within the debt portfolio.

MR. SMITH: Bruce, is the only solution you see to getting out of the variable-rate bonds is the federal government?

MR. GILBERTSON: For now, we're waiting it out. You know, at some point, I believe commercial banks -- some commercial banks will find that this is a business line that they want to get into. I think the theoretical discussions over the last ten years with partners that supported this liquidity to variable-rate issuers has become reality. And nobody really ever expected this to be the reality.

MR. SMITH: What's the -- if somebody has a variable-rate loan, what's the cap on the minimum that it goes down?

MR. GILBERTSON: On the variable-rate bonds?

MR. SMITH: Yes, I'm thinking on the home loans.

MR. GILBERTSON: Okay, now, remember our home loans are all fixed rate, home loans to the mortgage.

MR. SMITH: Okay, so it's just the bonds that are on the variable rate?

MR. GILBERTSON: Yes, so it's just the bonds.

This was a financing strategy where we're using the interest-rate swap market to effectively have a fixed rate, a synthetic fixed-rate borrowing cost.

MR. SMITH: Right.

MR. GILBERTSON: Any other questions?

MR. SMITH: If we've refinanced some of the loans that are in those portfolios to get cash to then pay back some of those bonds, does that help relieve some of the pressure?

MR. GILBERTSON: Yes, if we had a viable refinancing alternative with our home buyers. One of the biggest problems we have in the portfolio is that the borrower's home value is well underwater.

MR. SMITH: Are the loans that Fannie Mae is offering today, are they of lower interest rates than the ones we have out there?

MR. GILBERTSON: In general, I would say no, they're probably about the same place.

We have, on a weighted-average, loan rate on the portfolio was probably somewhere in the 5.4 percent range. Some lower, some higher.

Any other questions?

(No response)

MR. GILBERTSON: We're going to take a look here at the single-family loan portfolio quickly.

These are the delinquency ratios as of April 30th. So these are fully reconciled loan payments to the servicer records.

You've seen these charts before. I'll just walk through the way we presented this to you quickly.

33,708 loans in portfolio for $6.5 billion of loan balances.

This first chart is sorted by the mortgage insurance type. As you can see, we have over 15,000 FHA loans. $2.1 billion, we're not concerned about the performance, the borrower's ability to pay there, because we have the federal government backstopping the mortgage insurance. They cover 100 percent of principal and interest. So even though you have a 14.68 percent delinquency ratio, it's simply -- it's even viewed by the rating agencies as a AAA-type asset.

In our situation here, the mortgage loan servicers are contractually obligated, upon foreclosure, to repurchase the loan from us, CalHFA, before they file a claim with the federal government.

You know, a few VA loans, $71 million, 12.87 percent delinquency rate. And this RHS is a pretty small component of the overall portfolio.

I think the concerns are really in the conventionally insured portfolio. We've broken that out into those loans that have a primary mortgage insurance policy written by the California Housing Loan Insurance Fund -- you know, Chuck's group. We have 10,000 loans outstanding, $2.7 billion. In large part, every one of these insurance policies covers 35 percent of the loan amount. And 75 percent of that risk is reinsured with Genworth.

Steve mentioned earlier that both of those entities have now been downgraded into the BBB range.

The rating agencies, as they view this, are very concerned about total delinquencies in excess of 15 percent, and the significantly delinquent loans that are 90+ days delinquent that are now over 10 percent.

I will also mention, we had some early indicators -- as we go through May and June, these numbers don't really improve. I've seen some indications that perhaps June might be 13 percent. So we're still increasing slightly.

The one thing that -- my personal belief -- is distorting this a little bit, is that because there's been a number of moratorium programs to prevent servicers from foreclosing, including that we told our servicers about at the holiday season at the end of last year, and even as we were developing our loan-modification program, we do have more loans that are more than 120 days delinquent that simply have not gone through foreclosure. And some of these will go through the cycle and then become REO properties. Not that that's a better situation for CalHFA, but I think sometimes when we compare our delinquency ratio to other benchmarks in the industry, we may be more inflated because of those moratoriums than others.

Another look that overall number does not change. This is simply looking at the portfolio by the loan product. I think what I want to point out here is that the interest-only 35-year fixed-rate mortgage program that we created in 2005 certainly has a lot of pressure on it. And none of these loans yet have had an adjustment in their interest-only payment to a fully amortizing payment. That will happen about 12 months from now. But we have 20 percent of the portfolio is delinquent, and even the 40-year portfolio is running slightly higher than the conventionally insured 30-year portfolio. But please remember that we only offered the

40-year program beginning in 2006, kind of at the peak of the housing market.

Here's a perspective by vintage. Again, I think there's some pretty simple takeaways. 2005 and 2006 were not good years, and that's because we were at the peak of the housing bubble, if you will. I'm looking, again, at the IOP, the 5/35 program. 22 percent total delinquencies for the 2005 portfolio, and similarly, 22.85 percent delinquencies on the 2006 book of $649 million.

MR. SPEARS: I just want to comment, Bruce. In the discussions that we're starting to have with Standard & Poor's bond analysts, you can see the difference -- the impact of vintage year on delinquencies. S & P's model does not account for vintage year of loan. It's that unsophisticated. It's something that we're going to discuss with them at length. There is not a chance of them doing an accurate analysis of our entire loan portfolio without taking this chart into account.

MR. GILBERTSON: Here's a chart. Again, the same loan totals, just sorted by who the servicing agent is on the loan.

CalHFA has the highest number of loans, the highest dollar amount as well. A total of 11.55 percent.

These are kind of getting on top of one another. There are no superb performers in this list. You might look at some -- Dovenmuehle and WaMu, but they do have a relatively small number of loans that they're servicing for the Agency.

And then this last chart shows delinquencies and loan counts by counties. So these are the 15 counties where we have made the most loans. And so this is kind of telling, too. I mean, we certainly know that San Bernardino, 20 percent delinquency; Riverside, 19 percent delinquency were kind of huge targets for subprime. And I think as home prices declined in those regions, the other borrowers financed with appropriate products such as CalHFA's were still drawn into this high-delinquency and foreclosure mess.

CHAIR CAREY: So, Bruce, do you see a correlation between decline in market values and the performance here?

MR. GILBERTSON: Yes, clearly. And there was a *Wall Street Journal* article, I think earlier this week, that someone -- I can't remember who did it -- did a survey -- help me, folks -- I think the survey results were 25 percent of those surveyed suggested -- these are borrowers -- suggested that they would default on their mortgage even though they had not had hardship, an economic hardship. Just the psychology of owing more than the asset is worth.

MR. SPEARS: After it got over a certain LTV, after it got over -

MR. GILBERTSON: Yes.

MR. SPEARS: And when it got to 150 -- they kept going up the ladder. When they got to 150 LTV, if you were that far underwater, 25 percent said that they would walk.

CHAIR CAREY: Ms. Jacobs?

MS. JACOBS: Do we have any statistics comparing the delinquency rates to what the major mortgage banks are saying their delinquency rates are?

MR. GILBERTSON: We have -- I believe there's a board --

MS. JACOBS: It might be in here further. I don't know.

MR. GILBERTSON: Well, no, I don't have it in the presentation. But I believe in the Board report, in the back of your binder there should be -- on page 3 of the Delinquency and Loss Report -- I'm not sure which tab it's under -- there are two charts that kind of show our delinquency ratios compared to California mortgage bankers ratios.

MS. JACOBS: Okay, great.

MR. GILBERTSON: I guess it's really -- we have a lot of charts, Ms. Jacobs.

The one on top is really -- it's not doing a comparison. I'm sorry, I thought it was. My mistake. It's showing the two insurance types. We have those, and we can send those to you electronically, if you'd like.

MS. JACOBS: Well, it might be interesting. It would be interesting to me. I'm sure it would be interesting to the Board. I know that we're -- CalHFA is doing a better job than the rest of the market, and I think we can't say that enough.

MR. SPEARS: A lot of those delinquency statistics have to do with servicing subprime products and Alt-A products and that sort of thing. But what we try to do is compare ourselves to the MBA prime loans, so that it's a close comparison. Not quite the same. But we're very proud of the fact that we actually underwrote loans and we actually asked for documents, and we stayed by the good practices. We were the good actors in all of this, I believe.

MS. JACOBS: Right.

MR. GILBERTSON: Then the next slide, on page 16. Again, we showed this to you, I think, at the last Board meeting as well -- maybe the last two Board meetings. It shows the reserves that have been established by us or the reserves that we believe are established at Genworth to really cover some of these losses as they materialize. It's one thing to incur on financial statements or accrue a liability for a future loss. It's another to actually have money set aside.

These are the reserves that are established.

Within the insurance fund, at March 31st, we had $34.6 million set aside. The simple math, we believe Genworth would have set aside $102 million for that purpose.

For these gap-insurance losses that we would be paying, which are the insurance that is supplemental or replacement coverage, where there is no primary, we set aside almost $62 million of reserves.

And then there's an additional loan-loss reserve on delinquent loans of $11.7 million. And that really represents losses that would be through the insurance coverage. It goes all the way through 50 percent mortgage insurance coverage on every loan.

And then we have an additional $9.7 million of write-down of assets that are actually owned by the Agency as an REO.

A total of $220 million, up approximately $57 million, $56 million from the end of calendar year 2008.

MR. SPEARS: And we're currently calculating the June 30 numbers. We're not quite done with that since the fiscal year just ended, but the $220 million will increase substantially.

MR. SMITH: Steve, is this the same area that you're talking about, where you had the reduction in the reserves? Or is that a different reserve prime?

MS. JACOBS: 100 percent.

MR. SMITH: Yes, that 100 percent.

MR. SPEARS: That's different. It's connected, though.

I think if you look at that top line, "CalHFA Insurance Fund Loss Reserves." If that number increased and was actually drawn on above what the fund equity in the insurance fund, then the housing fund would start to backstop it if that number gets that high. And what we -- the analysis that we did was to look at that, stress the portfolio, calculate the amount. And remember, this is the first 35 percent coverage on only the insured conventional, and it's only 25 percent of that number, because the next line is 75 percent of that risk by Genworth. And when we stress that, it never exceeded the amount of fund equity that is in the insurance fund at any stress point. And that's the reason why we reduced the backstop. It's not the reserve. It was a contractual agreement, if you will, between the two funds.

MR. SMITH: Okay, and the $90 million that was taken out of that reserve, where did that go to get used for?

MR. SPEARS: Here again, it's not an accounting entry. It's a number, though, that Moody's was looking at and saying: "If anything ever happened, then there's $100 million that you're responsible for, so we're going to have to charge you for that."

Regardless of the probability of that actually happening, they were charging us that $100 million on their analysis for our capital adequacy.

MR. SMITH: Right.

MR. SPEARS: So all it means is that on Moody's ledger sheet, when they're adding up the risks that we have to guard against, that number went from 100 down to 10.

MR. SMITH: But where did we move the other 90 to? Was it to another reserve?

MR. SPEARS: No, it just is a commitment that is no longer there between the two funds, contractually. It was not an accounting --

MR. SMITH: So it's a contractual commitment --

MR. SPEARS: Yes.

MR. SMITH: -- not a -

MR. SPEARS: Right. It's a "what if."

MR. SMITH: So if we went back to the former contractual agreement, would that bring back the rating, or change the rating back to what it was before?

MR. SPEARS: That's a question that we've asked ourselves. S & P's mortgage insurance group was primarily concerned with the losses that they saw in the insurance portfolio. This was a factor. But the thing they talked about the most was the number of losses that they were seeing, and consistently increasing over the past few months.

So I can't guarantee you that it would have gone up a notch or two notches or would have not even been downgraded at all, because every single mortgage insurance company in America has been downgraded for that reason in the last few months. In fact, Genworth was downgraded five notches in February or March, in that time frame.

So our insurance fund is one of the last ones to get downgraded. And even after the downgrade, it is ranked No. 5 out of the top eight rankings in the United States.

So I don't know what the answer to the question is. It would signal to them that we're still committed to the insurance fund in a monetary away.

In their write-up, they said, "We continue to believe that the Mortgage Insurance Fund is strategically important to the housing fund." So I'm not sure how to respond. It would be pure speculation to say that they wouldn't have been downgraded as far had we not pulled that --

CHAIR CAREY: In essence, we've only seen half of the impact of that because the goal also was to mitigate the potential at Moody's.

MR. SPEARS: Right.

CHAIR CAREY: Right, and so we haven't seen that side.

MR. SPEARS: And the question will be, if we're sitting here a few months from now and Moody has affirmed our rating -- I hope I haven't jinxed that -- but if Moody has affirmed our rating, would they have done that without reducing the backstop? Not sure. It's a call that we made. It was based on applying Standard & Poor's own capital adequacy model, and we decided to move ahead.

We believe it will make a significant impact on Moody's analysis.

MR. GILBERTSON: Steve, it may be worthwhile to just go over some of the events that led up to the decision.

Remember, June 9^{th} we spent two hours on the phone with Moody's. Most of that time was going over liquidity. You know, there are stress levels on the liquidity balance of the Agency, which is really the cash available to pay operating expenses, to cover insurance-claim payments, to cover contractual obligations with swap counterparties, those types of things. And they had -- because of the Board resolution in 2003, they effectively were tying up $100 million of our available liquidity because the insurance fund had the ability to draw a line of credit, if you will, to cover -- to augment their liquid resources to pay claims.

So after a lot of discussions two weeks later -- and we went back and looked at some of the other rating methodology -- we determined that we were better served by reducing the backstop, because we believe that we might be in a position now with Moody's that the combination of that event and some other things that we'll be talking about in closed session might allow us to survive and be reaffirmed at the AA level. But the problem is, we're not -- we're serving two masters here. S & P has different rules, and Moody's has…

CHAIR CAREY: Right.

And I think, as I heard earlier -- and correct me if I'm wrong, Steve – that there's far more transparency and clarity to the S & P process than there is to the Moody's process, which makes it…

MR. SPEARS: I'd have to agree with one reservation, and that is, there's clarity and transparency with methodology that we completely disagree with.

MR. GILBERTSON: Well, and I would defer because we're just starting a process here.

MR. SPEARS: Yes, and to be fair to them, in the announcement that you're going to see today, Standard & Poor's says, "We're putting these two ratings on watch. If we find X, Y, and Z, we're going to have to downgrade. If we find A, B, and C, we'll be able to affirm." That's more clear, more clarity than we've ever had from Moody's, so…

But as Bruce said, we're just starting the process.

MR. HUGHES: I think there's just a couple of points that might help the Board's understanding, to understand the structure of this, because it is a bit confusing. The $100 million, as Bruce just correctly pointed out, is simply a line of credit. It is not a cash transfer in any way. There's a line-of-credit agreement between the housing finance fund and the insurance fund. That line of credit has never been drawn upon.

But I think the key thing is that back in 2003, the Board of Directors passed a resolution that enacted two different credit supports for the insurance fund. And one of them was authorization to create a line of credit in the event that the insurance fund needed cash. It was a liquidity provision for them.

One of the conditions of the Board resolution was that the amount of the credit, which was initially set at $100 million, was required to be adjusted annually. We have the -- the Agency had to review it and adjust the amount annually. And that the amount of credit extended could not adversely impact the Agency's issuer-of-bond rating.

So one of the things I simply wanted to correct is that we're not actually changing the agreement; we're simply implementing the actual agreement that the Board passed, which said, "You can extend a line of credit, but don't extend more credit -- don't extend credit to an amount that would adverse impact the Agency's rating." And that's the internal adjustment we made, and that's actually required by both the Board resolution and the terms of the line of credit.

MR. SMITH: Right. And then just so I can understand this because I'm kind of new to all this, but

CalHFA insurance fund not only insures our loans, but we insure other loans?

MR. SPEARS: Correct.

MR. SMITH: So at the end of the day, we're just insuring ourselves?

MR. SPEARS: Yes, sir.

MR. SMITH: So that really is kind of a circular --

MR. SPEARS: With a strategic partnership with Genworth.

MR. SMITH: Right.

MR. HUGHES: The HMRB, the bond indenture that the single-family loans are primarily carried in, requires 50 percent coverage. And it can be by any insurer. It can be by the Agency's insurance fund or outside. But that's essentially correct. But that insurance is provided because of the requirement in the indenture.

MR. SMITH: So it's really for the bondholders?

MR. HUGHES: Yes.

MR. GILBERTSON: Historically, there have been small programs where the insurance fund did insure loans of others. You know, they were low- and moderate-income programs. This goes back ten years or more -- small amounts.

MR. SPEARS: A very, very small amount.

MR. GILBERTSON: Okay, Steve did you want to cover this, or did you want me to cover the federal assistance package, what we know and --

MR. SPEARS: Here again, there's not a lot to report. We've discussed this, and I think we, at the last Board meeting, discussed the three basic elements in this plan. And we've not seen these proposals. These are things that we've talked to staff about. But our understanding is that there are four or five variations on this theme that they are sitting, being analyzed by U.S. Treasury attorneys, HUD attorneys and staff, and the policy staff at Treasury.

The three elements still are basically the same: That the federal government -- and I use that term broadly; we're not sure if it would be Fannie and Freddie, Fannie and Freddie selling something to the Treasury, Treasury buying something directly -- we're just not sure -- but they would buy new bonds and provide us with new bond money at these rates that would allow us to offer competitive loan rates to low- and moderate-income borrowers. We don't know what the pricing is going to be.

I don't think they're going to offer us pricing on these bonds that would allow us to be 100 basis points below market. That's just not going to happen. They don't feel that's their mission.

They will allow -- we're hoping that it would allow us to get back into the market in a gradual way. We're just not sure.

The second element are these replacement standby purchase agreements that Bruce talked about before that are expiring or already have expired. And that will help get rid of some of those bank bonds, where the bank bonds have been put back on a preemptive basis because they don't like the bank that's there. And they don't want to take any chances, and investors have put bonds back to us.

And those agreements are expiring. And over the next -- I don't know, what -- 12, 18 months, Bruce, how much do we have that's expiring that's going to have to be replaced?

MR. GILBERTSON: It's approximately a billion and a half.

MR. SPEARS: So we need those -- we need this help to -- and all through this is pricing. It wouldn't be very helpful for them to offer this liquidity at 200 basis points, when a few -- last year, a year and a half ago, we received an almost unsolicited offer for $3 billion worth of liquidity at some ridiculous price as, I think, 30 basis points or something. The pricing has just gone through the roof.

But the final thing is one of the most important things that we've been talking to them about. Four HFAs that are under threat of downgrading -- and the list is growing: Maryland just got added this weekend, Illinois's downgrade became a reality a couple of days ago -- that credit support would be offered by -- again, a broad term -- the federal government. We're not sure how or what the pricing would be. But that's the third element, and very important.

So, next slide.

This is what we've just talked about. The most important thing on this slide is the last two issues. We were on the phone with FHFA. And, again, that's the organization that regulates Fannie and Freddie, and that's the organization that's been brokering ideas back and forth between Treasury and HUD and the GSEs. That's been the focal point. So we've really focused on getting our ideas in to that individual.

And Bruce asked the question, "How soon after the announcement can we do this? Are you guys going to be ready to go right now?" -- and didn't know the answer.

So the last thing is related to that, the last bullet there. The rating agencies, both of them, have said -- a nice announcement, that says, "We're going to do some nice things for the HFAs. Details to follow" just won't suffice. They're going to have to know exactly -- enough details to know exactly how this program will apply, not to some theoretical HFA, but to CalHFA specifically, before the rating agency will be able to take into account the benefits from this package. So timing is very important.

I believe that's all we have to say about that. Do you have any questions?

(No response)

MR. SPEARS: We will keep you apprised. As soon as an announcement comes out, we will alert the Board members and analyze the package that comes out and try to give you our best estimate as to how that will help us. We'll do that by announcement, e-mail, and clear it through our esteemed General Counsel to make sure that we meet all Open Meeting Act requirements.

On the ratings update, this may be --

MR. GILBERTSON: Let me add a few other details, potentially. Don't need to dwell on this; but certainly if there's questions, we want to respond to them.

You know, with Moody's now, we've been almost ten months on watch for downgrade. So one can say that's somewhat positive. I mean, that is abnormal. You know, this is usually a three-month cycle and they make a determination. So we've either been doing a good job sharing additional information for their consideration, or they've been overwhelmed, or a combination of both, I think.

The conversations more recently have become sporadic. I mentioned earlier that we had a lengthy conversation with the analysts the early part of June. We provided them a lot of additional information for them to consider once they showed us the analysis, you know, largely centered around the liquidity position of the Agency. They then kind of went dark for a period of three weeks. And I tried to schedule update calls, and they simply said, "Oh, we won't have time. We'll defer, defer."

And then last Friday, I got a quick note, just wanting some very minor pieces of additional information that we shared. That led to an e-mail I received yesterday morning that they actually wanted to have a conversation on Friday of this week. I suggested that perhaps we do that early next week. So we're now scheduled to have another update call Monday at noon, California time.

So I think they're getting close, is the way I would assess this. They have a lot of information. They were also going to do an updated loan-loss assumption on this real-estate lending business that we have.

So I would expect -- we didn't know what to say -- a rating decision very soon. My personal belief, I think maybe by the end of the month, we will know Moody's one way or the other. I just don't think this is going to continue forever.

You know, S & P -- Steve covered, you know, most of this. I think I would just add, I do have press releases that were issued very late yesterday afternoon. I think their full rating assessment of this *"credit watch with implications"* will be available probably as we sit here today.

They've mentioned a number of things for the reasons. It's certainly the real-estate lending, higher delinquencies, higher foreclosures, home-price depreciation. They mentioned operating performance of the Agency. We've talked pretty openly with you that we certainly are going to have an operating loss for the fiscal year. They've mentioned the use of variable-rate debt instruments that, of course, historically performed quite well for CalHFA. But because of their recent performance, that that is -- I think they've labeled us a high-risk portfolio, something like that.

Bottom line, we're a solid AA today. We don't know if we'll be able to sustain that. And one of the most significant fears we have is if we don't retain AA ratings, is that the largest investor base that buys variable-rate demand obligations, money market funds simply won't be able to. They won't be to what's called "*2a-7 eligible.*"

Anyway, we expect to get going in earnest with S & P in the next week, sharing with them loan information, trying to get them to take a look at vintage, FICO score, the borrower, loan product, and all of the other elements, rather than putting it all into one, big kettle and saying, "We're going to give you -- assume 55 percent foreclosure frequency," which I think is ridiculous.

CHAIR CAREY: Okay, any questions from Board members?

(No response)

CHAIR CAREY: Thank you, Bruce.

MR. GILBERTSON: You're welcome.

CHAIR CAREY: That was very good.

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Item 5. Executive Closed Session

CHAIR CAREY: We are now going to adjourn to closed session under Government Code section 11126(e)(1) and (e)(2)(B)(i) to confer with and receive advice from counsel regarding litigation.

(The Board of Directors met in closed executive session from 10:37 a.m. to 12:05 p.m.)

CHAIR CAREY: We are back in open session, and on the record.

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Item 6. Discussion, recommendation, and possible action regarding the adoption of a resolution approving the Two-Year Business Plan for Fiscal Years 2009/2010 and 2010/2011

CHAIR CAREY: And the next item of business is Item 6, regarding the two-year business plan.

Steve?

MR. SPEARS: Thank you, Mr. Chairman.

This is unusual because normally, we are at the May Board meeting updating a five-year business plan. But as we discussed at the May Board meeting, we thought it was more prudent, given the circumstances that we're in, to present you the business plan for the next two years, managing towards getting the Agency through these challenging times and back to lending again.

I think all of us here would love to be talking about housing issues and not 100 percent financing issues at future Board meetings. And that would be wonderful.

So we are under Tab 6 in your binder. And there is a memorandum there for the resolution. This will be an action item to adopt this two-year plan. The plan itself is included in your binder; and, of course, we have slides, and we tried to summarize those.

So let's go to the major assumptions.

Here again, these are summarizations of what you see in the plan itself, that we have adequate capital reserve requirements -- this is what Moody's and Standard & Poor's is looking at -- that is sufficient to meet real-estate losses, credit adjustments, general obligations of the Agency, including insurance payments of the insurance fund, and that sort of thing. That we will be able to maintain an issuer credit rating that's in the AA category. And that's going to be a critical assumption. We believe that that assumption depends on a number of different things, things we talked about in closed session. The federal assistance package. So that's a very important assumption.

And finally, the tax-exempt bond market. Without federal assistance for new bond money, we don't think that the tax-exempt bond market will come back to the point where it makes sense and the cost is in the range that would allow us to offer competitive loan rates on single-family and multifamily until the last half of

2010. It will recover gradually, that it may not recover even to the volume that we saw before. But in the meantime, for new bond money, what makes the most sense is if there is a feature in the federal assistance package for new bond money, that would be where we would look.

Let's see, let's just move on to the next slide.

Other assumptions:

That home-loan portfolio losses will be contained through loss mitigation efforts and aggressive REO management. That is, our loan servicers, both CalHFA and non-CalHFA and REO management of Chuck's group.

That Agency liquidity will be sufficient to fund our operation, insurance-claim payments, and other obligations.

That we're going to put in place new business models that reduce risk to the Agency and to the Agency's balance sheet. We're going to shift real-estate risk to other partners. In homeownership, we have several different programs that we're going to be talking about. In multifamily, we're talking about renegotiating risk-share agreements and new agreements with either Fannie or Freddie or both.

That there are no HAT funds, no Housing

Assistance Trust funds available for down-payment special lending and multifamily programs in this two-year period.

That is a very difficult assumption for us to deal with. It really is. It affects people around this table, and it's a very difficult thing. But we are trying to manage this situation to get back in the game, and this is what we have to do in the meantime. But there are G.O. funds available for down-payment assistance, and we're doing that right now.

So moving on to single-family lending, let me stop first and ask if there are any questions from Board members about those assumptions?

(No response)

MR. SPEARS: If not, we can move -- I've asked Gary and Chuck to join us at the table for the next two or three slides.

We have this new business model --

MR. SMITH: Steve, before you move on, is there some way we can get, I guess later, maybe some kind of report as to what the efforts are going to be for loss mitigation?

MR. SPEARS: Yes, absolutely, we can do that.

Chuck can speak to that in the next slide a little bit, and we can get you something more detailed about what those efforts are going to be, too.

So on the next slide, Bruce, the new business model of transferring risk in the homeownership-lending area are two new business models.

Let me just summarize those quickly. One is to deliver loans to Fannie Mae on a flow basis, meaning, loan by loan by loan. And we do this for cash, and it's on a market basis. We get preferred pricing from Fannie Mae because of an agreement that we worked out with the state HFAs' national association, so we can offer slightly below-market rates, but not giantly below-market rates, with some limited down-payment assistance. And we can actually do some lending.

So let me jump --

MS. JACOBS: Can I ask a question?

MR. SPEARS: Yes, absolutely.

MS. JACOBS: I'm assuming that you will do the same -- you will still be doing the underwriting of the deals? That won't change; right?

MR. SPEARS: Yes. The loans that come through will be handled on a reservation basis. Files will come in. They will be underwritten. And the only difference is, instead of delivering to us and we're the final investor in holding whole loans on our balance sheet, we'll flow it straight through.

We're using Bank of America/Countrywide as a master servicer in this case; and they're helping us flow those through and help take care of the back office. But we will still be underwriting them. They will be fully documented.

This new Cal30 program, that I'll let Gary talk about for a second here, is a 30-year, fixed-rate, fully underwritten, fully-documented loan.

Gary, why don't you tell them a couple of features about that? And then if we want to get more into volume, there is a lot more detail about the volume that we expect inside the business plan.

MR. BRAUNSTEIN: Okay, thanks, Steve.

Hello, Board Chairman and Board Members.

As Steve had mentioned, the Cal30 is a 30-year, fixed-rate, conventional loan product. As indicated before with the M.I. Fund, we're not adding any new business to that fund so that this Cal30 program will allow for outside private mortgage insurance holders to be applicable to these submitted loans through our approved lenders. They will be underwritten, as Steve had mentioned.

Some of the features of the product does allow for our down-payment assistance program, which we did roll out June 8th, which is our CHDAP or down-payment assistance and closing-cost assistance.

Because of the design of the product, it's similar to a standard secondary-market product that is delivered directly to Fannie Mae for cash through the Fannie Mae cash window.

As Steve indicated, we are earning a fee for that because it is strictly cash. And our net gain on sale spread is about 100 basis points on a per-loan basis. So estimated revenue on those returns would be based off of the loan volume that you'll see on the next slide that we're projecting.

The eventual access to the bond market obviously would give us opportunity in the future to be able to drive that interest rate down more dramatically, to how we had interest rates structured in the past. But on the Cal30, most -- initially, in our roll-out, it's about a .25 to three-eighths interest rate that's below the market. So not as heavily below market as we once offered our loan products in the tax-exempt bond offering but slightly below market to allow us to get back into the game.

We don't have that slide? Oh, I'm sorry.

MR. SPEARS: So here again, volume -- this would be in your Board packet, pages 105 to 106. What we've tried to do is look at what we think volume will be in a number of different scenarios. And it ranges from, you know, $40 million for conventional Cal30 loans, to, you know, $200 million or $300 million in a best-case scenario, if the bond market comes back.

So that's going to be the difficulty in talking about the business plan and the volume of lending that we expect. It just depends on so many different factors all across the board, in single-family and multifamily.

Actually, in multifamily, because we have a different source of funding for MHSA, it's actually a little more predictable. But for single-family lending, here again, we're talking about lending that's 90 or 95 percent LTV, not 100 percent as before. More limited down-payment assistance. Those are going to be barriers to really high-volume lending.

MR. BRAUNSTEIN: Steve, if I could just add to that. Our approved lender database, who submits loans to us -- again, we, as an investor, are dealing with approved lenders. They view us obviously in the past as a high loan-to-value lender with a multitude of down-payment and closing-cost assistance.

Currently, through today's environment and the Agency looking to avoid risk, we don't have those luxuries anymore. So part of our business model in homeownership, in an outreach approach to our lenders, in part, is to attempt to reinvent ourselves and to perhaps be slightly more proactive than we have been in the past.

We had the luxuries of a very below-market rate, a multitude of down-payment and closing-cost assistance, lenders came to us. And we were able to, obviously, do the type of loan-volume production that we've done in past years.

Going forward, with many of the mergers and acquisitions and closures of many of our approved lenders, we'll be outreaching to add new business partners to the homeownership group of approved lenders, and look to target adding additional lenders, so that our scale and scope of who we outreach grows larger, in an opportunity of dealing with more lenders who now have less volume to send to us; whereas before, we had less lenders that were sending to us at a higher volume percentage.

So going forward, in 2009 and 2010, we will be slightly more proactive; and our reach-out to our lenders will be to allow them to understand that CalHFA and homeownership's value-add to them has changed slightly, from 100 percent lending, to now being more in line with the marketplace but still allowing them the opportunity of access to down-payment assistance, the layering of localities and jurisdiction programs, and piggybacking on our first-mortgage Cal30 conventional fixed-rate loan at a 95 percent loan-to-value.

So the projections that we've established with all the moving parts creates a worst-case, mid-case, and best-case scenario, broken down to the fact of not having bond financing, nor a warehouse line, and probably as important is no longer having internal mortgage insurance capability to offer to our approved lenders to the past high loan-to-values that we used to enjoy.

MR. SPEARS: Any questions from Board members?

(No response)

MR. SPEARS: The last bullet here is a different business model all together. Again, in the past, we have purchased whole loans and held them on our balance sheet and taken the real-estate risk.

A new business model -- but in the past, we had decided against purchasing mortgage-backed securities, where you bundle these loans together, they're guaranteed by Fannie or Freddie, and you offer those to -- you use bond proceeds to buy those mortgage-backed securities, and you hold those on your balance sheet. They're guaranteed by the federal government. There is no real-estate risk.

If we have access to the bond market, this would be the way that we could do volume business and reduce risk to the Agency. That would require access to the bond market and a warehouse facility. And those are big "ifs" at this point.

So we're just putting it out there that if a federal package came through with new bond money and if a warehouse facility that's sizable enough to make sense to do that, that's the direction that we're headed.

And here again, the idea is transfer risk off our balance sheet, partner with the federal government, allow them to charge us a guarantee fee.

The only problem with that strategy is, it makes it more expensive for the borrower because we have to cover that extra expense of a guarantee fee from the GSE. And that's the reason why it hasn't been done in the past.

CHAIR CAREY: Ms. Jacobs?

MS. JACOBS: Thank you.

I think the homeownership programs that you're presenting are very good. And I actually do think when you're lending 90 to 95 percent, you're going to be by yourselves in that market a lot of times, which is great. I mean, I think that's exactly the mission, and that's who you want to serve. And I think that's terrific.

I would be concerned about anything that has the words "mortgage-backed securities" in it. And before there's a final program with mortgage-backed securities, I'd like it to come back to the Board.

MR. GILBERTSON: I was just going to ask for a little clarification. We do have currently authorization from the Board to issue bonds that would be used to fund the purchase of mortgage-backed securities.

Is it the intent that we would clarify the loan program that we establish, that would create the mortgage-backed securities?

MS. JACOBS: The loan program and the quality of the securities at this point.

MR. GILBERTSON: Okay.

MR. BRAUNSTEIN: Steve, could I add a quick comment on the homeownership and the loan-to-value consideration?

MR. SPEARS: Yes.

MR. BRAUNSTEIN: The Cal30 loan program is a conventional loan product that does have an available loan-to-value to 95 percent. The fact that we are no longer offering internal mortgage insurance as a functional component of the loan programs as we used to offer, our availability of offering that program would be also dictated by the outside private mortgage insurance industry as it exists today.

We have the program structured where we're using any approved -- Fannie or Freddie -- approved mortgage insurance -- insurer. And, of course, our loan program carries with it a cross-reference between qualifying under our loan program, but also is cross-benchmarked against the mortgage insurers' guideline. So as the mortgage-insurance industry changes, as it is constrained right now in the 90 percent loan-to-value, and just one insurer that we know of is currently offering 95 percent -- as that industry changes, we will either be constrained or unconstrained on how high of a loan-to-value we can offer our prospective borrowers based off of our approved lenders getting a mortgage-insurance certificate by an outside mortgage-insurance holder.

MR. SPEARS: Okay, are there any other questions?

(No response)

MR. SPEARS: If not, we can move to the next slide. And this is Chuck's area.

I mean, obviously, we still have a very large portfolio of insured loans. Chuck's responsibility -- part of his responsibility is to maintain that relationship with Genworth, our insurance partner; monitor their financial strength, maintain that relationship. But in the coming two-year business plan, we don't have plans for adding a lot of new mortgage-insurance business to the insurance fund simply because of the amount of risk that's there already. And so that -- but Chuck has taken on new responsibilities of mainly seeing the loss-mitigation efforts, the REO management. So I think we'll let him answer Mr. Smith's question about what our loss-mitigation efforts are.

It's pretty obvious, we've been pretty clear with you about our expectations of increasing delinquencies and increasing REOs. In the business plan, again, the expectation is in the coming year, that we take in an additional 2,900 REO properties on the single-family side, and dispose of an equal number. That will take an immense amount of work, and it's very labor-intensive again.

So let me turn it over to Chuck and let him talk about those efforts for a couple of minutes, and then we'll take questions.

MR. McMANUS: Okay, I'd like to follow down the slide that's there, just so we have a clear understanding of what we're insuring and what we're not insuring and how the reinsurance works.

As indicated, we have $3 billion of insurance in force. That means there's $3 billion of mortgages on which we've written insurance. Our coverage average is about 35 percent coverage. So our risk in force is about $1.1 billion. We then reinsure 75 percent of that with Genworth. So the remaining risk is approximately $280 million. That's what the insurance fund is on the hook to guarantee.

And so we've run through all of the Standard & Poor's risk analysis and stress tests and so forth, and it would appear that we have sufficient capital and reserves. You add together your equity and your loss reserves -- sufficient capital to pay anticipated claims over the next two years at a stress level, which is about one out of four foreclosing.

But they've downgraded us to a BBB, which still means we're going to pay all our claims and have some excess cash. But they're going to watch us to see how the California market performs on an ongoing basis, but certainly the balance of this year.

In the portfolio management area, the single-family portfolio management, we have two sections. One is the loss mitigation and audit of our outside servicers; and the second is the REO management.

I'd like to introduce Linn Warren.

Linn, would you stand up?

Linn is part of the reallocation of experienced management. Linn has come over from the multifamily area to run the portfolio management section, and so he's over loss mitigation as well as REO.

On the loan modification, to respond to about what we're doing on loan modification, Linn and his team developed, in conjunction with the financing department and the legal department, a loan-modification program which would allow us to help people who have short-term financial difficulties. We are only helping those that have financial difficulties. So there must be some event which has caused them to have difficulty in paying their mortgage. This is not an across-the-board available to the entire portfolio. If you have the money and choose not to pay, that is not who we are offering this program to. So there has to be a change of some kind: Loss of some income, a partial loss, or a loss of one of two income earners.

Given this hardship -- it's just called a "hardship qualifier" -- we can offer an extension of term. Most are 30- or 35-year. We can extend it to 40-year term, which lowers the monthly payment. We can reduce the interest rate. And I would say our average interest rate is about 5½ percent in the portfolio. We can reduce it to an effective 3 percent interest rate, again, reducing the monthly payments.

In order to qualify for this, besides having a hardship, the people must be able to make those payments, plus all of their other cost-of-living payments, and have approximately a $200 surplus. It's a cash flow, "Can you pay your bills after we make this change?"

No checking of credit scores; no, you know, anything else. We're expecting these people to have financial problems. That's why they come to us: They have a hardship.

This program went out in early May. And that just began the review of people seeking help. And there's quite a significant number of people in difficulty who are delinquent.

The other qualifier was that they are 60 days delinquent. And Linn has -- so the servicers have been trained, they're to package and put together proposed -- people to get a modification, they come to Lynn's people, make sure all the documentation is there. We underwrite the credit to make sure the surplus, which can be a range of, I don't know, $150 to $250 a month -- we're aiming for $200 a month -- is there so that the people can make payments. We don't want them just to go into default again.

CHAIR CAREY: Chuck, I'm sorry, how do borrowers become aware of the program?

MR. McMANUS: We have trained all of the

servicers on the program, and they -- it's on our Web site and everything else. But the servicers are the ones that when people call in, if they have a CalHFA loan, should be exposing it to them. They have worksheets to complete, and then can offer this.

It's similar to the Freddie Mac, Fannie Mae, FHA. There are a lot of loan-modification programs out there. They have people that are dedicated to modifying loans for people to qualify. We now have a CalHFA program that they can offer to these people.

MR. SPEARS: I also believe that they received a piece of correspondence from us, that each borrower over a certain delinquency level received a letter that says, "This is available."

MR. McMANUS: And it's going to be constant follow-up because a lot of these people are hard to reach. They don't answer their phones. They think it's a collector and everything.

But Steve is right, it's a challenge to get people to participate, to get them to understand and to get them into the program. And we are at the initial stages right now.

We are not writing down the principal balance, which is a program that some investors have embraced to maintain; and the federal government has considered reductions in principal. That is not something we feel we can do under our bond indenture. We have to protect the interest of the bondholders so that is not one of our options. We do not write down the balance due.

MR. SMITH: Do you extend maybe a 30-year to a 40-year?

MR. McMANUS: Yes, sir. Either the 30-year or 35-year can go to 40 years. That's the first adjustment. The second adjustment is to reduce the effective payment rate from 5½ to as low as 3; and then underwrite to see if they can generate a cash surplus on a monthly basis, so they can pay their bills. It's that simple.

MR. SMITH: When you reduce the rate, are they negative-amortizing then at that point, or --

MR. McMANUS: No, sir.

MR. SMITH: -- it's a reduction --

MR. McMANUS: The shortage in interest going to bondholders is, in most cases, in the privately -- in the insured by our insurance company, the advances are covered by our insurance fund and Genworth, our reinsurer, as an advanced claims payment to the Agency. So the cash flow is coming from the insurance funds, which was a very big, positive to make this work. And it's in effect -- and they don't get it back. It's just a subsidy for the interest rate in hopes that these loans will cure in the long-term and not turn into a claim. And that was negotiated with Genworth.

So that's our program.

Please understand that we don't expect more than 15 percent of the people to qualify. And then of those that get it, the general experience has been approximately half will default later. You know, in nine months to two years, they'll be in default.

MR. SMITH: Would we have any other programs for other folks, to the point of maybe just extending the payment period to 40 years or 35 years, and not reducing the interest rate as another option to reduce their payment?

MR. McMANUS: That is the first option we check. That is the very first thing we'll do, is extend term. That's just a cash-flow problem for Bruce on his indenture. But that one is the first thing we test, and then we do the reductions in interest rate.

MR. SMITH: I guess the question is, would we have another program down the road for everyone else in the pool, to encourage them to stay, continue to pay, by reducing their payment by extending the term?

MR. McMANUS: If they don't have a hardship? Let us think about that and come back to you next meeting, if that's okay. It's a cash-flow thing on the bonds, is the only issue, okay. Otherwise the guarantor has no problem with that, but it does reduce the cash-flow interest to the bondholders. And Bruce would have to have his people model it and making sure we can afford it. But that would be an easy one because it's not losing money.

CHAIR CAREY: Are you thinking of the borrowers who are underwater and could be enticed to hang on?

MR. SMITH: Yes, I'm just trying to think, is there a way -- I mean, it seems to us, the longer they stay in their home, hopefully, the market turns around and we're all okay.

CHAIR CAREY: Right.

MR. SMITH: And so how do we continue to give incentives to people not to default for whatever reason, and just stay in and hang in there with us.

MR. SPEARS: It's a difficult issue because at some point, if we do this on a large scale, the math doesn't work out. We're now amortizing loans over 40 years, when we have 30-year bonds to pay back.

It's difficult -- Di Richardson and I, and Rhonda Barrow is in this room -- we're all three having personal conversations with people who are underwater, who believe that it's unfair that we're going to collect $300,000 on a home now that's worth $150,000. And until we explain to them that, you know, we're not just going to pocket that, but we have to turn around and pay that ourselves; that we're not, as I put it in with one person, "I'm not in a boat like your boat. I'm in your boat," that I'm turning around and paying somebody that we borrowed money from. That's what makes this particular thing difficult.

If we were dealing with shareholders, we could go to and say, "You're going to have to take a lower return. That's just the way it's going to be. You're not going to get your whole investment back. That's the way it's going to be." Dealing with a bond-funded program is different. It's more difficult.

And that's the test, when we looked at the President's loan-modification model, when we looked at this idea of reducing principal, we always have to come back to that we're bound by the indentures of the bonds, and that's the standard.

MR. McMANUS: We have one other program, which is a short sale, which is where we give permission for them to pay us less back if they have a buyer of their home that's less and they have a hardship -- again, we are not trying to cover people that just had a loss on their principal. Basically, the entire portfolio, after 2002, has had some loss on the value of their properties.

But if there is a hardship, we will take the deed in lieu -- not really that, we'll approve the short sale, and then take less proceeds. So that's another one.

And we've always had a capitalization of delinquent payments. If you had a very short-term problem, we just add it on and amortize it over the balance of the time period.

So those are the tools we have right now.

If we can go to the next page, although it refers to the forecast in here of 2,900 new REOs and 2,900 sales, the next page shows the delinquencies were up to 1,636 just in the insured portfolio, there also where we've canceled the insurance and where it started at 80 percent LTV. But just the insured, and 1,209 of these are over 120 days delinquent. Our experience is, those are not going to cure. Those are going to foreclosure or short sale. And so we have forecast an increase in our REOs coming in. In 2008-09, the last fiscal year that just ended, we acquired 493 properties. And we now expect, in the next 12 months, to acquire 2,874. The round figure is 2,900. So we've gone from 500 to 3,000, a sixfold increase in the REOs expected over the next 12 months.

In sales, over the past 12 months, we've sold 218 properties for about $30 million. In the next

12 months, we anticipate selling 2,922 sales for about $450 million.

So the comparisons in relatively huge volume, we're going to have to take in and resell is significant; and we have reallocated resources to this department to take on the properties, evaluate them, price them, fix them, put them on the market, and handle the sale and the closing of the sale. And so there's just a tremendous amount of work going on, trying to liquidate foreclosed properties.

If there are no questions, that's the end of my section.

MR. SPEARS: All right, we have multifamily lending and portfolio management next.

So we're going to ask Margaret Alvarez and Bob Deaner to come and join us.

Bruce is going to stay and earn his pay, pushing buttons at the laptop.

On the multifamily side, as I said before, there are different funding sources available. The MHSA program is still very active. We're, in fiscal year 2009-10, expecting fifty-plus deals, with $75 million to $100 million of deals there.

The tax-credit program, which we're hoping that Bill Pavao could stay and talk about, but we'll let Bob say a couple of other things about that.

The thing, with both single-family lending and multifamily lending, the demand is there. We're at the low end of the single-family market. There is rental demand there. The bank lending has declined on the multifamily side. It's a great time for CalHFA to be lending. We have to fix these other issues so that we can get back in and be a factor, once again.

But, Bob, why don't you spend a couple of seconds talking about the tax-credit programs that we're going to be assisting on? HCD is also going to be involved in that. And then get to some of these other business-model considerations very quickly.

MR. DEANER: Sure. Under the tax-credit program, Bill Pavao has requested or has asked CalHFA and HCD to assist in just administering the program. So our role purely is not a lender, but to administer the money that they've gotten from the federal government. And the role primarily will be to close the loans on behalf of TCAC because we have the ability to close the loans.

There's two different programs within the tax-credit program. There's a gap program and an exchange program. And under the exchange program, we are going to do a little more due diligence for TCAC, which is doing some underwriting, looking at some documents for them -- the sponsor, the market, to make sure that the current deals that they came back and reapplied for, make sense to go forward.

So we are going to have kind of a few staff members working on different things. One would be from a underwriting role. Two would be, we are going to help them disburse the first 40 percent of the exchange money. They're calling it "cash in lieu," which is basically they're giving cash, and the folks that couldn't get tax credit investors give the tax credits back and in lieu, they get cash for their tax credits.

We will administer the first 40 percent of that money for TCAC through our disbursements group, because the construction lenders have asked that the first 40 percent go in from the cash-in-lieu program.

So we'll have our underwriting group, our disbursements group, and then our closing through our legal group close the loan. So we could have eight, ten, 12 people working on this program.

TCAC has approximated about 150 projects. Talking to Bill earlier, that could be down to about 120. And then we'll share that with HCD. So there could be anywhere from 75 to 100 projects that CalHFA will be asked to help administer in the program.

We're looking forward to administer the

program. We've set up a light application. We're going to make this seamless and easy for the borrowers. And we're here to support TCAC and to get this money out so we can get these projects moving.

Moving down to the other business model considerations, we're looking to do two things, as Steve has mentioned. Our role has to change as putting our general obligation on our bonds and multifamily projects that we've presented to the Board over the years. What we need to do today is have that risk be shared with other groups.

The first is, I have been or the Agency has been in negotiations with Fannie Mae. And I was a previous Fannie Mae lender for 12 years, being on the multifamily side. And they've established an HFA group which they are now going out to HFAs and approving HFAs as sellers/servicers, similar to their other multifamily public groups -- or private groups.

So CalHFA, my understanding, is the first group that's been approved by their credit group to move forward under a seller/servicer agreement, in which now we've got to negotiate a counterparty risk agreement, meaning, what CalHFA and Fannie Mae are going to share going forward in the risk. And that, we're hoping to do in the next two to three months. This will give us the ability to sell tax-exempt bonds with Fannie Mae's AAA credit enhancement, and which the bondholders that buy the bonds see Fannie Mae facing the bonds as a AAA credit, we get better pricing. And behind the scenes, CalHFA and Fannie Mae then share the risk in the event of a loss. And there's a *pari passu* agreement we'll come up with. And that's the counterparty risk that we still need to negotiate. So Steve and I and Bruce will have conversations with the HFA group on how we can do that.

The second piece would be, we have a risk-share agreement with HUD currently in place on a 50-50 basis. We are asking FHA to increase that to 75-25. Them taking 75 percent of the risk, us taking 25, going forward. And we've got that in front of them currently.

If we had to, we could go back to the 50-50, but we're looking to share some more of that -- or have them share some more of that risk going forward.

That would be with them still accepting our underwriting. If we go beyond a 75 percent and say we wanted them to take 100 percent, we could pursue that avenue, but that is a completely different underwriting model that they would want from CalHFA and a different approval process. So we're just trying to take what we have and modify it up a little. And in the Fannie Mae, we're 90 percent to the goal line.

So between these two programs going forward, we'll share the risk when we can get back out and lend again. It's just a function of what we've talked about a number of times, and if the bond market comes back, to have the ability to sell bonds, even under the Fannie Mae or Freddie Mac or FHA model going forward.

MR. SPEARS: Right. It's the same theme. What we're trying to do is reduce the risk of the Agency on an ongoing basis. We're getting back into lending but doing it a different way. We're not taking as much risk in the future.

MR. DEANER: And I should just mention one more thing. Under these two models, their risk share under the permanent loan, we still want to pursue being the construction-loan permanent lender. And the construction loan that we have also asked HUD to ensure the construction draws going forward so when we sell a bond, CalHFA doesn't have 100 percent of the risk during the construction period, and sharing just on the perm.

Fannie Mae is now -- is only a perm lender. So we will always have the 100 percent of the risk during the construction period. And that is the difference between what Bruce and I need to talk to the rating agencies about, is what that particular capital charge would be for that short period of time.

So we want to maintain our current model as a construction perm lender. But knowing that, part of -- more of that risk during the construction period will be borne by CalHFA.

MR. SPEARS: Okay, any other questions?

CHAIR CAREY: Yes?

MS. JACOBS: Sorry. I don't know if you're going to talk separately about the Multifamily Asset Management or you just think it's covered, because that's what I have a question on.

MR. SPEARS: That's the next one.

MR. DEANER: Well, Margaret is up here to talk about that.

MR. SPEARS: That's the next one. This is Margaret's area.

MS. JACOBS: Okay. Leaping ahead, as usual.

MR. SPEARS: Leaping ahead, right.

And Margaret's workload continues to increase. As we close loans on the Multifamily side, that portfolio that she has to manage gets bigger and bigger. She is up to about 500 properties. But that -- there are a number of those loans that are getting close to the end of the term. Remember, those projects need rehabilitation and recapitalization. That's difficult for us to do right now because of the lack of internal funds to help out with that.

One thing I wanted to know if she could spend a couple of minutes explaining, there are about 70 properties that are problem children. The rents are soft, the costs are going up; and currently, the debt-service coverage is less than one. That means the owners are having to put in money to make this work. And these loans are performing. In fact, the entire portfolio of loans is performing rather well, and that's not a problem. It's just that on a long-term basis, that could get very tiresome for owners.

And then finally, on a future business-model basis, Margaret had a very astute staff person who was in Washington, D.C., for a conference, and got into a conversation with HUD folks about the performance-based contract administration of HAP contracts in California. And they said they were not very satisfied with the current administration of it, and we're going to put it out to RFP.

We have jumped on that idea, and we're going to be putting that into place, I believe it's next January, if I'm not mistaken.

MS. ALVAREZ: 2010.

MR. SPEARS: And I'll let Margaret talk about that for a minute.

MS. ALVAREZ: Well, we can't just automatically do that. HUD will be putting out an RFP later this year, and we'll have to compete for that with probably the current performance-based contract administrators and anybody else who wants to compete for that contract. But that is something we hope to pursue in the next 18 months. And that would be about 10,000 units. I don't remember offhand what number of buildings that is. But it would be quite an undertaking for the Asset Management staff.

Probably our thinking would be at this time, that we would partner with another entity, which is much what the PBCAs do now. Nobody tries to do it all alone. They partner either with other states or other third-party contractors. And that would be our route as well.

But this is all just in the infancy stages. And as far as staff time dedicated to it, we're not even starting until later this year.

MR. SPEARS: Do you want to spend a couple of seconds talking about the 70 problem children?

MS. ALVAREZ: Yes. First, I just want to assure everyone that none of the properties, of those 70 -- well, one -- one property out of the 70 is currently in default. That is the only default. It's a small loan under a million dollars in the Bay Area. With the exception of that, we have no other properties that are in default. Everybody is paying their mortgage, everybody is making ends meet.

As Steve mentioned, the markets are a little bit softer. About half of those 70 are our 80/20 product, not the Section 8's. Although many of the Section 8s are also under 1.0 debt coverage ratio. It's not a problem where their mortgage payment is too big; it's a problem where rents have been soft over a number of years and expenses keep going up, and they just aren't making it.

A lot of them never made it. A lot of these 70 were always feeding a property, especially with the nonprofits.

Where our concern is today, is that the property that's defaulting in the Bay Area is because the nonprofit ownership disappeared, and that's really what we worry about is that a lot of these properties are owned by nonprofits. And as their lives get tougher, they make a lot of their money, oftentimes, by new development. As things are stalled in that area, they have to continually feed maybe not just our property, but other properties with no new income coming in. And it's just a concern of ours.

So we are stepping up our game in Asset Management to really -- we made 25 points of interest on each of these properties. My staff is fully engaged in kind of putting a report together that we're going to present to the senior staff of CalHFA. And we'll really be watching these as we go through the next year or two.

MS. JACOBS: May I now?

CHAIR CAREY: Please.

MR. SPEARS: I'd defer to the Chair, but…

MS. JACOBS: I was looking at both of you because you're both so handsome.

CHAIR CAREY: Won't that be stricken from the record?

MR. SPEARS: Thank you.

MS. JACOBS: I am very impressed with the programs that both of the multifamily and the single-family side are doing. And I think anytime that CalHFA can get back into any market, it's really exciting. And it's also very important to pay close attention to collateral, whether it's single-family or multifamily.

I'm very impressed with the concept of bringing the loan servicing of the CalHFA portfolio in-house. I am very supportive of that. And I'm supportive of the fact that you're managing your own Section 8 portfolio.

Where my concern lies is in going out and competing to service other Section 8 projects, as well as doing loan servicing for other portfolios. Because I think that's competing with the private sector, and I'm not sure that's in the CalHFA mission. So that's a concern that I have.

MS. ALVAREZ: Are you referring to the performance-based contract administration, the Section 8 piece?

MS. JACOBS: Yes.

MS. ALVAREZ: Okay.

MS. JACOBS: And also, somewhere in all of the stuff I read -- I can't tell you where it was -- there was talk about bringing the loan servicing in-house. And that might be more on the single-family side, which I think is great. But there was also some discussion about earning fee income by doing other loan servicing; and I have a concern about that.

Maybe I dreamt it because I read this so late at night, but I thought that was in there somewhere.

MR. SPEAR: I don't remember.

MS. ALVAREZ: We currently don't service on the multifamily side; we only service our loans. I don't think there's any intent on servicing any loans that we don't -- or any properties that we don't currently have the loans for. That is on the single-family side.

MR. SPEARS: And I would have to say the same thing on the single-family side.

MS. JACOBS: Very good.

MS. ALVAREZ: And just on the PBCAs, most of the state housing finance agencies are the PBCAs for their states, just so you'll know. So it is something we're in the very early stages. Before we did anything, we'd, of course, have to come back and talk about it because it is a big resource of people and time and effort.

CHAIR CAREY: And what's the rationale for that around the country, that it's largely HFAs?

MS. ALVAREZ: Well, in many of the other states, there's one housing agency, not three, within the state. And so in a lot of the states, it's the group that also is giving out the Section 8 contracts and other things that are doing the PBCA work.

Everything is done under one roof. All the governmental housing happens under one roof. It also is a big fee generator.

When we had this opportunity to bid it out several years ago, when the whole concept changed from traditional contract administrators, like we currently are -- we currently have our own, what they call traditional contract administrating of our own portfolio. And when they considered that in the past, we did spend a lot of effort figuring out if we wanted to do it.

We were a little afraid of it because it hadn't been done before. And from our best indications, we needed, like, you know, 40 to 60 people to administer it. And it just seemed like something that we really couldn't get into. But as it turns out, there's a lot of third-party contractors who are working with states, or with the PBCAs in doing a lot of the behind-the-scenes work of it, with the HFAs just mostly doing the administering, the third-party contractor piece.

It also has turned out to be a very good fee generator for most of the HFAs. Like we estimate that our fee would be approximately $4 million for taking it on, annually. So it is a way to bring some income to the Agency.

CHAIR CAREY: That request for proposal is not out yet?

MS. ALVAREZ: No. It won't be published until later this year.

CHAIR CAREY: So it can resurface at another Board meeting.

MS. JACOBS: I would want that particular aspect to come back for the Board because I'm really not comfortable with it.

CHAIR CAREY: Other questions or comments?

MR. SPEARS: Okay, the last section we have, just other business-plan considerations -- and I know we're running short on time here -- but I did want to cover a couple things that we're considering. Call us eternal optimists, but we are continuing with strategic initiatives that we believe are necessary to make this Agency function better in our renewed life down the road. That this is a going concern, and we're going to continue investing in these projects.

On strategic initiatives, the next two pages are devoted to that. And they are projects that are ongoing, that we've discussed with you. There is a revised time schedule -- a nice color chart later on -- that you can review. And I'll be quite willing to answer any questions about it.

I thought I would just -- since we've talked about these a lot before, it's another major workload issue for the staff this year, it's another major investment in contracts this year. I just wanted to let you know that we're continuing on with that despite the challenges that we face.

But the other couple things are, what I've asked Howard Iwata to do is to, on an acting basis, serve as the acting administration director and also the acting director of fiscal services. Between those two divisions, we have most of our business processes. And I thought that we had not done this in a long time. It would be an excellent time to review all of our business processes, the flow of business information and management information. Let's see if we can reorganize those divisions. Let's see if we can reorganize the business processes, make them more efficient, work faster, and flow information to the senior executive team and the management of the Agency on a more timely basis, in a more qualitative way. So that's a process that's going to be ongoing over the next year or so.

Succession planning in the current environment of decisions that are being made with regard to civil service staff has become more critical. That we have more and more folks expressing interest in retirement, and a very significant portion of the CalHFA workforce in the next five years is considering retirement. Some very key positions in mid- to upper-level management. So I've asked Howard to take that on as well. And let's start the process of identifying a succession plan out of that.

The final thing on here, the final bullet, is the Sacramento office consolidation. We haven't talked about that in quite some time for obvious reasons. One is that we never really identified a really terrific option for the Agency. Then we were caught up in some of the challenges that we have.

In the meantime, the Sacramento office lease market has improved or worsened, depending on your point of view, whether you're the lessor or lessee; and we have received a very interesting proposal from the folks who own 555 Capitol Mall. It involves six months' free rent, it involves a virtually free move, consolidation of everybody into three floors, where we would be contiguous, not scattered over five or six floors at the Senator Hotel and two at the Meridian.

It's a very interesting proposal. We are going to go ahead and discuss this with them, pursue it. Obviously, because that would exceed the $1 million annual limit on contracts, that would have to come back to the Board. The only problem is, we don't meet again until -- regularly, anyway -- until late September. So I thought I would bring this to your attention to let you know that we're going to continue talking to these folks and exploring that proposal.

Obviously, a lot has to do with what we're going to find out from Moody's, S & P, the federal government, our swap counterparties, et cetera, et cetera, et cetera. And it would probably not be prudent for us to sign a ten-year lease when things aren't turning out as we had hoped.

So I just want to bring this to your attention, that that building lost two very large law firms to other buildings, and they now sit on 120,000 square feet of completely empty space. We don't need all of that space.

MR. SHINE: Per floor, how many square feet?

MR. SPEARS: It's approximately 25,000 per floor. They have two wings -- I don't know if you're familiar with the building -- but they have two wings, and each have about 12,500 square feet.

MR. SHINE: So 75,000 square feet?

MR. SPEARS: Yes, right.

MR. SHINE: What do we have now?

MR. SPEARS: What we actually use and what we're charged for is a problem, because we actually use -- we're actually charged for about 90,000 square feet, but we don't nearly need that amount. But because so much common area is charged to us in the Senator Hotel especially, our rent rate there is rather high.

MR. SHINE: So does our rent per year in the total aggregate increase or decrease?

MR. SPEARS: Decrease. Over a ten-year period of time, I believe the figure -- is this right, Howard? --is an $8 million savings over a ten-year period of time.

MR. SHINE: How about the first two years?

MR. SPEARS: The first year, we would receive six months free rent if we execute this in time. And that alone is $600,000 or $700,000 of savings.

CHAIR CAREY: And what's the status of the current leases?

MR. SPEARS: The current leases, in August of this year, we earn the right under the current -- both leases at Meridian and Sacramento -- to withdraw from those leases without cost. The leases actually end, I believe, in October of 2010. So we have some time, we have some flexibility to consider this. And if we went ahead with this proposal and we withdrew from our current two leases in, say, the spring of 2010, we would do it without penalty under the current two leases.

MR. SHINE: What does it cost to move?

MR. SPEARS: Well, that's another interesting prospect. We have a proposal for a T.I. allowance, that allows us to build the offices out, plus an addition on top of that, that would be, I think, currently enough to almost pay for the entire move.

CHAIR CAREY: Ms. Jacobs?

MR. SHINE: I don't want to own that building.

MS. JACOBS: I think it's quite exciting for you guys to be in one place. I think this whole thing is terrific.

Do you have to go through the DGS process like we do?

MR. SPEARS: We do not.

In fact, when the budget comes up, I'll tell you that Howard has jumped in the deep end and analyzed our interagency charges, and found that we're being charged by the State for managing our lease by DGS, which is something they don't do. So we have asked them to reduce our charge by that fee.

So, no, we don't.

CHAIR CAREY: So the hope would be to move forward with negotiations; is that what I'm hearing?

MR. SPEARS: Yes.

CHAIR CAREY: With the potential -- and how does that work out with the next Board meeting? Not well?

MR. SPEARS: Not well.

We can ask counsel what the options are. We could -- there are several different options, as I understand it. We could sign a letter of intent, subject to ratification by the Board. We could call the Board into a special session to deal with this one issue. But we also may have other issues that we might want to talk to the Board about later this summer.

CHAIR CAREY: Are we hearing any suggestions that they hold back or --

MR. SPEARS: No.

MS. JACOBS: I think it's a great opportunity, and we should go ahead and pursue it. But I think if we need a special meeting to dot the I's and cross the T's, we should do that.

MR. SPEARS: Okay.

CHAIR CAREY: Are we all comfortable?

So, good.

MR. SPEARS: Thank you.

That is -- here again, there are a couple of additional slides dealing with the strategic initiatives. Obviously, again, the homeownership and the fiscal services are the two largest. From the standpoint of workload for staff and cost, those are the big issues. The others are smaller projects.

The last bullet there, the "Loan Servicing Reorganization," that's our goal of, one, bringing all loan servicings so that in five years, we're servicing 100 percent of CalHFA's loans. For all the reasons that I mentioned in -- I forget what page it was -- but I devoted a paragraph to that. I think it's very important from a mission standpoint. It would simplify the operations that we have now, because now Chuck has to manage outside servicers. He wouldn't have to do that. Everything would be in-house.

At present, physically, Rhonda's group is scattered all over the Senator -- in the basement, crammed into offices on the first floor. They need better space, they need better equipment, they need a better situation. So we have identified a space in West Sacramento that has the capabilities of being organized into a call-center-type loan servicing -- mass-loan-servicing type arrangement, which will work much, much better, and it's much, much cheaper. So on this other building proposal, that square footage that we need has been reduced by the loan-servicing aspect because that would be offsite.

MS. BERTE: Mr. Chair?

CHAIR CAREY: Yes.

MS. BERTE: I'm under extreme time pressure.

CHAIR CAREY: Right.

MS. BERTE: And we barely have a quorum, and I don't know that my alternate backup is going to get here anytime soon.

CHAIR CAREY: Right.

MR. SPEARS: We're done with this part and can move on.

MS. BERTE: May I make a motion that we adopt Resolution 09-11?

CHAIR CAREY: Thank you.

Do we have a second?

MR. SHINE: Second.

CHAIR CAREY: Second, Mr. Shine.

Ms. Berte, Mr. Shine.

Roll call, please.

MS. OJIMA: Ms. Berte?

MS. BERTE: Aye.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Yes.

MS. OJIMA: Thank you.

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: Resolution 09-11 has been approved.

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Item 7. Discussion, recommendation, and possible action regarding the adoption of a resolution approving the Fiscal Year 2009/2010 CalHFA Operating Budget

CHAIR CAREY: And can we expeditiously deal with the operating budget, recognizing there may be questions, but keep the presentation concise?

MR. SPEARS: I believe that we can.

The main discussion here is centered around workload.

Our assumption is that we will -- again, the same as the business plan -- we will not be downgraded. We will have some ability to lend, but we're not sure how much. That we will manage to a downgrade scenario, although we're asking for a budget that is a planning scenario, with the capability of lending, we'll manage to a smaller budget until we find out what's going on with Moody's and S & P and the federal plan.

So what we've asked for is a $47.9 million budget. Your memo says 48.1. When you have time, if you can go back and change that number.

But if you can flip, Howard, to the slide with the overall budget.

A couple more.

This is the budget that we're asking for.

We've split this out so that you can see what the baseline budget is, and you can see that each year we have spent less than that on a baseline basis. And it's less this year than last year. And it's obvious because we're not doing the lending volume that we've done before. But all I can tell you is that you're going to see staffing levels that are not dramatically less -- they're somewhat less, but they're not dramatically less, here again, because it is a labor-intensive process to manage the delinquencies, foreclosures, loss-mitigation efforts, and REO management.

If we add lending on to this, it will increase that workload. And we'll have to be doing all those things, all at the same time.

Maybe it would be -- flip two more slides, Howard, and we can show you. If we have time -- one more, if you will.

This will show you that, that last box on the right is our flexibility in staffing.

A couple other things to note very quickly. The homeownership segment has been reduced from forty- -- I'm having a tough time reading that, forty-something down to 32. And here again, the reason is, Gary is not doing quite as much lending as before. Staff has been shifted to portfolio management, to loan servicing, to more on the homeownership strategic project.

So we have about the same number of filled positions as we did three years ago, roughly. But the flexibility is going to be with the 40 vacancies. We're asking to fill ten of those right away because they're critical positions. The other 30, we're asking for flexibility to fill those down the road.

If we're not lending and if we don't fill those 30 positions, that's about $3 million of the budget, I believe. So if that doesn't happen, you can expect this budget to come in $3 million under this number, to be 44 versus -- 45 versus 48, almost.

MS. JACOBS: That's okay. The only thing I don't follow, Steve, here is you keep saying that the budget's going down, but I see that the personnel expenses are going up. I'm on page 127.

MR. SPEARS: Are you talking about positions, or are you talking about --

MS. JACOBS: I'm talking about authorized - I'm talking about dollars. And I'm just wondering --

MR. SHINE: Is this the chart? Is that the same chart as this combined budget planning scenario?

MS. JACOBS: I'm just --

MR. IWATA: The salaries, why it went up was because of increased temporary help and overtime. And that's all included within the authorized salaries in there. And what happens due to loan servicing's increase of temporary help, we added -- that includes approximately $500,000 in temporary help and about $35,000 in overtime to accommodate their workload situation currently.

MS. JACOBS: Well, I'm just -- when you look at projected actual of $18 million, I think going up to $23 million is a big increase, when we're getting different signals from the administration. That's the concern that I have. I'm just expressing my concern.

When we don't see -- I realize we have so many different alternatives going forward in terms of the income side, that we don't see an income side here, along with an operating expense side. And that's a little bit of a concern.

MR. SMITH: In this projected budget, are there salary increases to existing employees? Or what's -- I just assumed that the increase was based on salary increases.

MR. SPEARS: There are none for the exempt employees that this Board has control over, there are no anticipated salary increases. The civil-service rank and file are governed by contracts that are negotiated at the state level. So we are at their mercy, if you will. So the answer is "no" on the tax-exempt side; not sure what's going to wind up on the rank-and-file side.

MR. SMITH: So on the rank-and-file side, are we subject to all of the budget cuts and -- I mean, the employees are subject to whatever the state does?

MR. SPEARS: Right. The pay-level contract negotiations will apply to all these classes just as it would in the rest of state government.

MR. SMITH: Yes, that's not good.

CHAIR CAREY: Questions or --

MR. IWATA: I think what we're looking at, as far as when you're talking about the salaries, if you look at the 2007-08 budget, it's compared to actuals. In actuals, we don't spend as much as the budget in any of the years. In fact, throughout the history, the five-year history, we've really spent underneath our overall budget amounts for the last five years, between 0.4 percent, to actually 12 percent savings throughout the years. So providing overall personnel services that will tie to our two-year plan, just in case, it gives us the flexibility to manage the personnel services up or down, depending on how the workload goes, that's the 40 positions you're talking about.

MR. SPEARS: The only comment I would have, Lynn, is we have this balance sheet with this portfolio that we have to manage, and we have this capital structure that we have to manage. So far, with the decisions that have been made with regard to furloughs and that sort of thing, we've tried to overcome that by cancelling the alternative workweek, by authorizing more overtime. And at some point, though, the workload of managing this exceeds all that and becomes very, very expensive to have Rhonda with folks working every weekend overtime and Fiscal Services having folks work every weekend overtime because, you know, we need to keep managing this ongoing --

MS. JACOBS: Portfolio, I totally understand, believe me.

MR. SPEARS: Right. I understand.

MS. JACOBS: No, I'm just -- I'm not a fan of budgeting with a lot of cushion. That's not how I budget. So I understand that. I think that's one way of budgeting, but it's not -- I like to see the budget -- I don't like to see rewards for coming in 20 percent under-budget every year because you budget 20 percent too high. That's just my own philosophy. But I understand the reasoning.

MR. SPEARS: My only answer to that is that we're not padding the budget for the business plan that we believe will materialize during the year. What we don't know is whether that plan materializes or not. What we're saying is if that plan doesn't materialize, then we will manage this to a lower number that fits the scenario that reveals itself, which we think will not be a padded budget but will be a budget that fits that scenario. It's a budget that fits the business plan that we think will materialize. We don't think it's padded.

CHAIR CAREY: The points for coming under budget are offset by the points for misbudgeting; right?

MR. SPEARS: Or not meeting -- not coming out with a business plan that we told you that we would be able to do.

And for me, that's -- you know, you should ding us for not being able to marshal the groups and get the business plan done that we thought. That is more important than saying, "Whoopee, you missed your budget by -- you came in $3 million under the budget."

CHAIR CAREY: The results of managing the Agency will be the issue --

MR. SPEARS: Exactly.

CHAIR CAREY: -- rather than coming in under budget.

MR. SPEARS: In my mind, yes.

MR. SMITH: How would the plan to take the servicing in-house, how many more employees -- is that already covered in this plan, in this budget?

MR. SPEARS: Yes.

MR. SMITH: So you're not going to need --

MR. SPEARS: And the strategy is to hire temp help first. And one of the reasons to do that is, there is no classification in state government for loan servicing that we're aware of. We can't recruit from other places. We have to bring in folks from outside who know how to do this, who know how to service loans, who know how to work loan modifications, and do cash for keys and short sales and all that. So our strategy is to hire temporary help to come in and do that.

At some point, we plan on giving an exam and making it available -- an open exam, and making it available to folks, and bringing those folks in on a permanent basis. That's a little bit down the road, though.

MR. SMITH: So what would be the budget for this temporary help? Is that reflected in here somewhere --

MR. SPEARS: Yes.

MR. SMITH: -- or is it just within the salaries?

MR. IWATA: That's within the authorized salaries.

MS. JACOBS: It's not -- is it broken out anywhere?

CHAIR CAREY: There was a discussion of a number of bodies at some point.

MR. SPEARS: They're about -- in this colorful chart, Ruben?

MR. SMITH: Yes, I saw that you have, like for loan servicing, 24 authorized positions and then five agencies. But I'm wondering, you're going to have a bunch of temporary --

MR. SPEARS: Yes.

MR. SMITH: -- in addition to that.

MR. SPEARS: Agencywide, temporary help in this chart is about 27 people. I can't tell you right off the bat how many of those are going to go to loan servicing. I'll try to find out.

MR. SMITH: Agencywide, you have 27 temporary?

MR. SPEARS: Yes.

MR. SMITH: But if you bring them on full-time or even just on the temporary side, does that change this budget in any way?

MR. SPEARS: No. No, that's included in the budget.

CHAIR CAREY: When fully implemented, the budget represents an additional nine temporary positions in loan servicing. Page 125.

MR. SPEARS: Does that answer the question, Ruben?

MR. SMITH: Yes, I see it.

MR. SPEARS: So nine of those would be in loan services.

CHAIR CAREY: Okay, are there other issues, concerns?

I'm sorry, Ms. Berte?

MS. BERTE: I agree with Ms. Jacobs. I'm looking at chronic positive variance, particularly in the staffing model. I served on the CalPERS Board, and we would regularly -- both the Finance Committee and the Board -- make adjustments midyear as needed based on changes in business activity.

I do think we need to take a look at the OE & E, because we are anticipating an additional executive order or revised one mandating across-the-board reductions in OE & E across all of state government. And the same questions apply as to whether we are subject to or exempt from those mandates.

That being said, given the unusual circumstances that we're in, I'm not uncomfortable that we adopt a budget that appears to be sort of having -- it has a risk component baked into it, is how I view it.

But I wouldn't be averse to approving what's before us, you know, again, subject to the periodic reviews that a board, this committee would normally do.

So unless there's an objection, I would, again, step forward to move adoption of Resolution 09-12.

CHAIR CAREY: We have a motion.

Do we have a second?

MR. SHINE: I'll second.

CHAIR CAREY: Mr. Shine.

So it's Ms. Berte and Mr. Shine.

Roll call, please.

MS. OJIMA: Thank you.

Ms. Berte?

MS. BERTE: Aye.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: I'm not sure what to do here.

MR. SHINE: Go ahead.

MS. JACOBS: Yes.

MS. OJIMA: Thank you.

Ms. Carroll?

MS. CARROLL: Yes.

MS. OJIMA: Mr. Shine?

MR. SHINE: Yes.

MS. OJIMA: Mr. Smith?

MR. SMITH: Yes.

MS. OJIMA: Thank you.

Mr. Carey?

CHAIR CAREY: Yes.

MS. OJIMA: Resolution 09-12 has been approved.

CHAIR CAREY: Thank you.

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Item 8. Discussion, recommendation, and possible action relative to the approval of a resolution approving amendments to the regulations of the Agency regarding the Conflict-of-Interest Code

CHAIR CAREY: Our last item is fairly ministerial judgment to the conflict-of-interest policy.

Can we do that briefly?

MR. HUGHES: Yes, I'll do that from right here.

This is a very routine amendment of the Agency's conflict-of-interest code. Just very quickly, by way of background, the Fair Political Practices Commission requires every state agency to have a conflict-of-interest code. It simply defines which employees have to file the much-loved Form 700 and what the disclosure categories for each employee are; and the FPPC also requires that we periodically update the code so that the actual employee positions are matched with the disclosure categories. So that's what this does.

This is a routine update.

We've also tweaked some of the disclosure categories a little bit just to make them better written and to be more clear. So that is the proposal, that is the resolution.

MS. JACOBS: I have one question, then I'll move approval.

This doesn't change Board disclosure; correct?

MR. HUGHES: No, it does not.

MS. JACOBS: Okay. I move approval.

MR. SMITH: Second.

CHAIR CAREY: Ms. Jacobs, Mr. Smith.

Roll call.

MS. OJIMA: Thank you.

Ms. Berte?

MS. BERTE: Aye.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: 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: Resolution 09-13 has been approved.

CHAIR CAREY: Thank you.

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Item 8. Reports

CHAIR CAREY: We are down to *Reports*.

Are there any items that -- please come up.

MR. SPEARS: I believe we have covered all the reports that are presented to the Board in the back of the binder.

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Item 9. Discussion of Other Board Matters

CHAIR CAREY: Any other issues from Board members?

(No response)

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Item 10. Public Testimony

CHAIR CAREY: Then we will open the meeting to *Public Testimony*.

If there's anyone in the audience who wishes to address the Board, please indicate.

(No response)

CHAIR CAREY: Seeing none, I do want to mention that we have discount parking passes for those who have parked in the parking structure here.

And with that, we are adjourned. I appreciate everybody's patience.

(Proceedings concluded at 1:30 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 27th of July 2009.

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