STATE OF CALIFORNIA

CALIFORNIA HOUSING FINANCE AGENCY

BOARD OF DIRECTORS

PUBLIC MEETING

The Westin
San Francisco Airport
One Old Bayshore Highway
Millbrae, California

Thursday, November 19, 2009
10:05 a.m. to 3:08 p.m.

Minutes approved by the Board of Directors at its meeting held:
21 January 2010

Attest:

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

Daniel P. Feldhaus, C.S.R., Inc.
Certified Shorthand Reporters
8414 Yermo Way, Sacramento, California 95828
Telephone 916.682.9482 Fax 916.688.0723
FeldhausDepo@aol.com

A P P E A R A N C E S

Board of Directors Present

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

KATIE CARROLL
for BILL LOCKYER
State Treasurer
State of California

MICHAEL A. GUNNING
Vice President
Personal Insurance Federation of California

PAUL C. HUDSON
Chairman/CEO
Broadway Federal Bank

JONATHAN HUNTER
Managing Partner, Region II
Corporation for Supportive Housing

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

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

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

A P P E A R A N C E S

Board of Directors Present
Continued

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

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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

LORI HAMAHASHI
Fiscal Services

TIMOTHY HSU
Financing Risk Manager
Financing Division

THOMAS C. HUGHES
General Counsel

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

A P P E A R A N C E S

Participating CalHFA Staff:
continued

CHARLES K. McMANUS
Director of Mortgage Insurance Services

JOJO OJIMA
Office of the General Counsel

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BE IT REMEMBERED that on Thursday, November 19, 2009, commencing at the hour of 10:05 a.m., at the Westin, San Francisco Airport, One Old Bayshore Highway, Millbrae, California, before me, DANIEL P. FELDHAUS, CSR #6949, RDR and CRR, the following proceedings were held:

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CHAIR CAREY: I would like to welcome everyone to the November 19th meeting of the California Housing Finance Agency Board of Directors.

Fortunately, no one is flying in; or if they were, their flight wasn't delayed. But we are here.

And our first order of business is the *Roll Call*.

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Item 1. Roll Call

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

MS. PETERS: Here.

MS. OJIMA: Mr. Gunning?

MR. GUNNING: Here.

MS. OJIMA: Mr. Hudson?

MR. HUDSON: Here.

MS. OJIMA: Mr. Hunter?

MR. HUNTER: Here.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Here.

MS. OJIMA: Mr. Lockyer?

Oh, Ms. Carroll for Mr. Lockyer?

MS. CARROLL: Here.

MS. OJIMA: Thank you.

Mr. Shine?

(No response)

MS. OJIMA: Mr. Smith?

MR. SMITH: Here.

MS. OJIMA: Ms. Bryant?

(No response)

MS. OJIMA: Mr. Genest?

(No response)

MS. OJIMA: Mr. Spears?

MR. SPEARS: Here.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Here.

MS. OJIMA: We have a quorum.

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Item 2. Approval of Minutes

CHAIR CAREY: The next order of business is *Approval of the Minutes of the July 9th Board of Directors Meeting.*

MS. JACOBS: Move approval.

MR. SMITH: Second.

CHAIR CAREY: Moved and seconded.

Any further discussion?

(No response)

CHAIR CAREY: All in favor?

Oh, I'm sorry. Roll call.

MS. OJIMA: Ms. Peters?

MS. PETERS: Aye.

MS. OJIMA: Mr. Gunning?

MR. GUNNING: Aye.

MS. OJIMA: Mr. Hudson?

MR. HUDSON: Aye.

MS. OJIMA: Mr. Hunter?

MR. HUNTER: Yes.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Yes.

MS. OJIMA: Ms. Carroll?

MS. CARROLL: Yes.

MS. OJIMA: Mr. Smith?

MR. SMITH: Yes.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Yes.

MS. OJIMA: The minutes have been approved.

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Item 3. Chairman/Executive Director Comments

CHAIR CAREY: Okay, I would like to very sincerely welcome our three new Board members: Michael Gunning, Paul Hudson, and Jonathan Hunter.

It is great to have a nearly full team. And these are certainly challenging times, but the mission is important. So I'm sure we all are thrilled to have you here.

Thanks for being here.

I would like to announce that as we move forward, I have taken the Chair's prerogative to restructure the Audit Committee, and have asked Ruben Smith if he would be willing to be the chair of the committee, and he's accepted. I appreciate that. And I've asked Michael Gunning if he would join the committee, and he does agree.

So the Audit Committee has some new strength, new structure, and ready to go.

Let me just mention how our agenda will go a little bit today. It's probably a long agenda. We will be in closed session at the appropriate time on the agenda. And also, we'll take about a 30-minute break for lunch, and then come right back to work. And that will work within the flow -- the break for lunch will probably be about 12:30.

I also want to appreciate the fact that our birthday person is here today. I understand it's Ms. Jacobs' birthday today.

(Applause)

MS. JACOBS: And I'm spending it with my favorite group.

MS. PETERS: Last year, I spent mine with Maxine Waters, testifying. It could be worse.

CHAIR CAREY: And the only other thing I'd like to say is, that has been -- as you know, we canceled our meeting two months ago. It has not been a quiet period of time at CalHFA. And some of what we will hear today is the result of very hard, dogged work and leadership by the leadership of this Agency. Our acting executive director, Steve Spears, and the whole team have worked very hard. And I would say that, from my perspective, that the federal package that will be discussed today shows their fingerprints, and the results are positive.

It was fun to be in Washington, D.C., on Tuesday, when everybody was saying, "Did you see the story in the Washington POST? CalHFA is the big winner on the federal program." So that looked -- it was good.

And with that, we will move on the agenda. And this is the point for the Executive Director's comments.

MR. SPEARS: Thank you, Mr. Chairman.

A lot has happened since July. And I would also, by the way, like to add my welcome to the three new members. Thank you so much.

We have provided some individual briefings, so that these folks are sort of in the process of catching up. And I hope that was helpful.

And also, happy birthday to Lynn. Thank you for joining us.

It is a very big agenda. We're going to try to move through this as quickly as possible. But I'd like to also add my thanks to some folks on the senior staff that worked very, very hard on the biggest item, the Federal Assistance Plan. These folks have not gotten the national recognition that they deserve.

Peter is right that our fingerprints are all over this. We were behind the scenes. Mainly, though, it's Bruce Gilbertson and Tim Hsu and Tom Hughes that have done a tremendous amount of work on this plan.

I'd just like to say "thank you," and perhaps a round of applause is in order.

(Applause)

MR. SPEARS: I can't even -- others have helped because there were little drills along the way where we had to have information immediately. You know, some of our investment banking and legal partners from outside the agency, also very helpful. Stan Dirks and Howard Zucker both have been helpful in the whole process of what can and can't be done and how is it going to get done. So thank you to those folks as well.

So without further ado, let me do a little housekeeping.

You have several things that have been given to you. An envelope of this color *(indicating)*, which I would set this aside. This is the secret envelope for the closed session, with the closed session memo from Tom, and also the slides that will be presented in closed session. So I would just set that aside.

The white envelope that you have is our annual report, which you may have already opened up. There's nothing secret in this one. You can open it up, perhaps on the flight home, if you actually get your flight home -- Ruben, Paul and Jon, and others who may have to battle the air traffic control FAA problems.

So that's for future reading.

And then you were given a set of slides, I think, like so, 3-hole punch, it's beautiful in color. And please don't be frightened by the number of slides. If you all did your reading homework, I think we can certainly move through these as quickly as possible.

I don't want to rush today. Please, you know, stop us anywhere along the way with questions that you have.

But some of this will be familiar to you. We're trying not to backtrack. We're trying to strike a balance between reminding you of issues that were in the past, that are now being corrected. But these can be organized by your tabs later on if you like. That's the way I have them in my book. But I wouldn't worry about that right now. Just, you know, things to follow along.

MS. JACOBS: Keep it handy.

MR. SPEARS: Keep it handy. We'll be moving along.

So what I want to do first is, if Steve will bring up that first slide.

MR. POGOZELSKI: It's going to be a minute. The laptop just crashed.

MR. SPEARS: Oh, great.

Then in that case --

MS. JACOBS: The packet.

MR. SPEARS: -- refer to your packet, this colorful slide that Bruce made me reorganize the colors on because the original colors were garish, I think this is how we're going to approach the topics today, starting from the top and moving down.

The blue box at the top -- what I want to give you, first of all, this is the biggest news that we got, and it's some of the most complex. And we'll get to some of our complex financial structure issues, is the federal HFA initiative. I want to keep it high, an overview, "This is what it is, this is how it works."

But then we'll go to the seafoam-green box on the right top, and talk about the liabilities part of our portfolio, which as you know is part of our capital structure, our bond structure. How does that blue box help the seafoam-green box. This program also gives us the opportunity to issue new bonds that will be purchased by not only the federal government, but also the private sector.

And then move over to the light-yellow box and talk about the asset side. Part of this discussion on the asset side is that the blue box doesn't yet help the yellow box very much. You know, we'd love for the federal government to tack on to the end of the program, "Oh, yes, here's a giant check to help you with your loan loss problem." But it doesn't.

What it does do, though, is allow us to do lending. And we'll get into how that helps us in the long run, in the financial position of the Agency.

And then we move to the -- well, salmon-colored box, I guess. And what we want to talk about is, how we're moving reserves that have been held in the fund balance of the Agency over to offset loans that are delinquent and that we're losing money on, transferring those over to the assets.

And at that point, we'll also talk about the -- have the report of the Audit Committee come in and talk about the Agency's operating loss for the year.

And at that point, it's a good time to call time-out. That may be lunchtime right there, or maybe just before that, and go into closed session, and talk about some things that Tom wants to talk about.

And then sometime in there is lunch. We come back out and talk about a business plan update. What does the top blue box -- what does the federal initiative mean for our business plan for the remainder of this fiscal year and for the 2010-2011 fiscal year? And finally, what impacts are there on the operating budget? Do we know yet? What about staffing issues? And that's where we'll wrap up today.

Included in the business plan, by the way, are the two items about the Citibank transaction and also the Performance-Based Contract Administration. Those are Items 9 and 10.

So it's a very full topic -- I mean, a very full agenda. Lots of topics. So we should start right away, unless someone has a question about order and that sort of thing.

CHAIR CAREY: Go.

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Item 4. Discussion, recommendation, and possible action regarding the Agency's participation in the United State Treasury Department's HFA initiative

MR. SPEARS: All right. Item 4. I'd like to bring Bruce and Tim up.

We'll give you an overview, perhaps a little more detail.

And then finally, there is a resolution, and this requires Board action to allow us to proceed with participation in this program, to enter into agreements, to change indentures, to issue and to come up with a new indenture.

So, Bruce, let me start with this first slide.

This is a quick overview.

This process started in February, at least, probably before that, in the transition. Several housing -- national housing leaders got in touch with the Obama Administration and asked for help, because at that point in time, after the Lehman Brothers bankruptcy, the tax-exempt bond market was nonexistent and the tax-exempt housing bond market was more than nonexistent. That's why.

The Obama Administration expressed interest, and they made this plan part of the Making Home Affordable program. And it took quite a while, but we finally got a way to do it. The authority is based on the HERA authority from the previous year, which allows the Treasury to buy securities of Fannie Mae and Freddie Mac.

So the bottom line is, in the New Issue Bond Program, we will be issuing bonds that will be purchased by Fannie Mae and Freddie Mac. They will issue securities that are backed by those, and that will be what the U.S. Treasury will buy in the New Issue Bond Program.

It also includes another element that's badly needed by us. We have $3.8 billion of variable-rate bonds that are supported by the liquidity agreements with banks. We applied and were granted permission for participation for all of that. And it will replace all of the liquidity agreements that we have on all of those bonds. We'll get into more detail about that.

Bruce, why don't you go ahead and take over and start moving on through the details?

MR. GILBERTSON: Thank you, Steve.

Good morning, Members of the Board.

Just by a little way of background, the last time CalHFA went to market to really sell bonds for lending purposes was August of 2008. You know, we'd love to get back to that place. That's a long time ago -- 15 months.

And at that time, you might recall, it was because of HERA that we had newfound tools. We were able to issue non-AMT bonds for the first time, which would give us a further advantage in the marketplace.

But shortly after the issuance of those bonds, we entered into September of 2008 the Lehman Brothers bankruptcy, and our world changed dramatically at that point.

So on page 5, what the Treasury and the GSE initiative has done for us is allow us to access the bond market again, primarily because of the support from the U.S. Treasury buying bonds directly. Not directly from the HFAs, but from the HFAs with a wrap from the GSEs.

Clearly, for the first time now we have defined terms for what kind of interest rate we would achieve in a bond market. These are all spreads of the ten-year Treasury. We do have some decisions to make over the next few months as to when we rate-lock and things like that. But this is a huge benefit for the Agency.

We will have two different types of new lending programs or bond programs to finance the lending programs: One for single-family, one for multifamily. We're creating two new indentures as a part of this initiative. And, you know, probably we'll change our risk profile somewhat as a result of what's happened over the last couple years.

But certainly as we go forward, we think this is a tool to really make us relevant again in the affordable housing finance marketplace.

The bonds have a requirement, fixed-rate bonds only. If it's under the single-family new-issue bond program, GSEs, ultimately Treasury, are willing to buy 60 percent of a financing. So 40 percent of the bonds, we'll retain an underwriter. We'll use conventional marketplace and sell the remaining 40 percent of the issuance to the marketplace, likely to be serial bonds and perhaps intermediate term bonds.

No bells and whistles. No, the Treasury wants this to be a pretty straightforward pro rata redemption activity. Housing issuers have oftentimes put some additional structure into these things, taking prepayments and targeting specific bonds.

The interest rate, as I mentioned earlier, will be a spread to the ten-year Treasury. And the spread depends on the credit rating of the new bond indenture. We expect at this point -- although we do not have ratings in hand -- that those would be solid AA credit ratings from either one or both of the rating agencies.

And ultimately, to convert the short-term bonds to long-term bonds, we will have to have received from California Debt Limit Allocation Committee tax-exempt issuance authority.

By way of background, we currently have a significant amount of authority for the single-family bond issuance program. But as we think about the Multifamily Program, we'll have to go back to CDLAC -- we have application in currently for carryforward allocation. But we'll have to be awarded tax-exempt issuance authority by CDLAC as part of this initiative.

The timeline, quickly -- and I want to correct one of the dates on here. The amount -- we need to complete everything by the end of December 2009. That means that we need to close the bonds and have delivered the bonds to the GSEs, and then they're going to go through a process to securitize the bonds, because it's only a GSE security that Treasury can buy. They can't buy an HFA bond directly.

The whole intent is we create the bonds, issue the bonds, create an escrow that we will hold at a neutral reinvestment rate. We're going to be charged by Treasury the 28-day T-Bill rate for a period of time while we hold these bonds, until we have reason -- a pipeline of lending to finance, to go along with the bonds, and then we'll convert them to a long-term financing.

The one correction I want to make is that the conversions -- the last bullet under "Timeline" should really be December 31, 2010. We have the entire calendar year of 2010 to make the conversions from escrow-bond proceeds to a long-term financing suitable for the financing of first-time home buyer loans or loans to rental housing developers.

Lynn?

MS. JACOBS: Do you have to get the CDLAC authorization before December 31st, 2009?

MR. GILBERTSON: No, we can receive CDLAC volume cap in 2010. But it's a precondition to converting the bonds swap.

MS. JACOBS: Okay, thanks.

MR. GILBERTSON: So the use of proceeds -- for the single-family program, the plan is to create mortgage-backed securities. You know, because of the recent events of CalHFA, we just think it's a more sound approach, not take the real-estate risk, at least for a period of time. Make us all feel more comfortable inside of the Agency as well. But we'll create MBS, add the full guarantee from Ginnie Mae or Fannie Mae or Freddie Mac on those. We'll get guaranteed payments on a monthly basis. And if there were defaults downstream, we don't take that risk in any way, shape, or form.

We're still looking at different alternatives to financing the Multifamily Program. Bob Deaner will talk a little bit more about that later in the presentation today.

But again, probably reverting back to an FHA risk-share model or some other form of credit enhancement or the specific underwriting criteria allowed by the GSEs.

And then a third use of the proceeds, it will still be considering and probably make a determination in early 2010, is that the initiative allows us to do some fixed-rate refunding of existing variable-rate bonds.

You'll see during the course of the day, we have $3.8 billion of variable-rate demand obligations. We have to make it work economically. We have to make it work and find investors in the single-family program that will be willing to buy 40 percent of the market-rate bonds as well. So something we're going to probably push off into January to try to make a determination.

The last kind of slide on this, and I'll quickly run through this, it shows you the amount that we applied for and the amount that we were actually allocated in the last week.

As we went through and decided upon an amount to apply for the new bond program, the $1.1 billion really relates to the volume cap that has previously been awarded to us at CalHFA. It has an expiration date at the end of December 2010, so it matches this program pretty nicely.

Multifamily was sized for some other reasons. It was a $600 million request. We're hopeful in this that there might be an opportunity to do a fixed-rate refunding of $185 million of auction-rate securities.

And if you were to do the math, you'd determine that six thirteen is the number we need to have 30 percent of the new bond program eligible for this fixed-rate refunding. So there's really no magic in these numbers.

We were awarded almost all of it. Just over a billion dollars for the single-family program. $580 million for the Multifamily Program. And we would expect the long-term rate payable to Treasury on the bond purchases they make to be equal to the ten-year Treasury bond plus 75 basis points.

By way of reference today or this week, the ten-year Treasury has been trading in the 3.35 range. So this would be a long-term bond rate of, like, 4.10.

Any questions on that before we go?

MS. CARROLL: The portion that has to be sold to investors, how will that get priced?

MR. GILBERTSON: So we will use, actually -- we'll appoint an investment banker to perform an underwriting role, new disclosure document. Because by then, we will have an accumulated pipeline. And it will be the traditional market sale, if you will. Yes, full underwriting.

MS. CARROLL: So different rates?

MR. GILBERTSON: Yes. And what triggers at that point, you know, for the single-family program, it's a little clearer. The 60 percent of the single-family new-bond program will convert to the long-term rate, ten-year Treasury plus the 75 basis points, at that time. It's actually 60 days after we close the transaction, because they're allowing us an even further benefit of not having to have negative carry on the bond proceeds until the loans are actually in place. And then we will close the 40 percent.

But it's based off the amount of market-rate bonds sold that you convert the Treasury bonds.

MR. GUNNING: Bruce?

MR. GILBERTSON: Yes.

MR. GUNNING: What's your sense of the private market, given what's happened in the past and your ability to sell?

MR. GILBERTSON: Well, I look to what Katie's been doing over at the Treasurer's Office. They're finding a lot of investors, you know, retail, and --

MR. GUNNING: They sell to insurance companies.

MR. GILBERTSON: Exactly. I think we'll have some demand because we've been out of the bond market for so long.

You know, housing bonds are a unique creature. Certainly, if we have an MBS as collateral to the bondholders, I think we'll have pretty good results.

MR. HSU: And these indentures for these new bonds, there would be new indentures in a special obligation indenture, so it's as if we're starting anew, and separating these bonds from the bonds that we have in existence now, which could be associated with more challenged assets, if you will.

MR. GILBERTSON: Yes, we're, in some respects, starting anew. A new program, certainly a new marketplace. You know, real estate values have been reset significantly lower within the state.

So we think all of those are positive attributes as we face that new marketplace and try to find new investors.

MR. SPEARS: And the new indenture will own mortgage-backed securities guaranteed by Fannie Mae and Freddie Mac and Ginnie Mae, not whole loans.

MR. GILBERTSON: Well, let's move along then. And Tim is going to go over the temporary credit and liquidity program that is the other component of the HFA initiative.

MR. HSU: While Bruce talked about the new business plans that we might have in terms of selling bonds to finance our new lending programs, Steve had talked about earlier that there is a part of the federal initiative that would help us deal with the existing capital structure that we have.

We have actually spent quite a bit of time over the last 18 months briefing the Board over some of the troubles that we have in our existing capital structure. The composition of the Board has changed a lot. But, briefly, we used to show these charts that shows how our capital structure is based on selling variable-rate bonds and putting, let's say, an interest rate hedge on top of the variable-rate bonds. And we used to color these variable-rate bonds by the banks that support the liquidities of these bonds in different colors. And we made the case that if these foundations or these variable-rate bonds are, let's say, impaired for some reason -- let's say the credit of the bank that's supporting those facilities are impaired, then the entire capital structure is weakened, irrespective of how some of the things that stack on top are doing.

And what this temporary credit and liquidity program is attempting to address is that very foundation of our existing capital structure, which are the banks that provide the liquidities to support the constant reset of interest rates of these variable-rate bonds.

The Agency's plan currently is to use all of the Temporary Credit and Liquidity Program -- we call it TCLP -- to use all that's been granted to the Agency to replace every single liquidity facility that we have.

And this does four things. I only listed two things here, but there's four things.

For one thing, as I mentioned, it deals with some of these banks that we have signed on over the last five or six years, to provide a liquidity to support these bonds. But their credits are no longer what they once were. So it will replace a lot of these credit-impaired banks, one.

Two, is that we have banks who used to be in this space of business who are exiting this space, and they have been extending their facilities with the notion that there is going to be a federal assistance package coming in. So these are otherwise, if you will, expiring facilities that will be replaced.

And then thirdly, we will have some facilities that are coming up over the next couple years that are going to be challenged in terms of rollovers, that the banks have already -- some banks have already sent out notices saying they won't roll over, which is well -- they have 60-day notices but they're giving us 180-day notices, for whatever reason.

And the last thing is, that is a bit more subtle, is that this TCLP actually has a credit wrap on the standby purchase agreement as well, meaning, that it's sort of a hybrid of a letter of credit and the standby purchase agreement. And this credit wrap could be very useful for the Agency because some of these existing indentures that we have which are associated with more challenged assets, is under some credit pressures from the rating agencies.

So this credit component, once we use it, would also ensure that these bonds will continue to get remarketed in the marketplace, even if our underlying credit is downgraded for whatever reason at whenever.

So, ultimately -- you may step back and say, "What is all of this going to do?" Well, ultimately, what we hope this will all do is lower our cost of funds, and also take out an element of liquidity risk that we talked about at some point. Because if some of these facilities don't get renewed, they become bank bonds, and bank bonds have certain accelerated payments which can cause cash crunch or liquidity pressure on the Agency. So those are the two overarching things that we have accomplished by doing this.

And some of the more salient things that are really great features about this TCLP that we're getting from the fed, are that once we're implement it, there's really no rating triggers inside the documents that would make us pay a higher fee if we were to get downgraded in the future, which is a great feature.

And as I mentioned, there is no accelerated term-out payments, unlike all the existing facilities that we have. There is a ten-year balloon, but that's a much better feature than what we have currently.

As Bruce was saying about the new bond program, likewise here, all the documents have to get executed and signed before year-end. And basically, some of the events trickle into January for execution mode.

The way I think of it is that beyond January the program has to be on auto pilot. You're sort of in execution mode, and things just happen. All the commitments, all the documents have to get signed in December.

And as I mentioned, we basically got everything we applied for. We applied for 2.9 in the single-family world and $900 million in the multifamily world, and we got everything we applied for.

The fee structure is worth talking about. In the single-family world, we're going to pay a slightly lower fee than in the multifamily world because going into the program, your existing rating determines how much you pay over the next three years. So it is an escalating fee structure in which we pay slightly more every year. So you can see that we start at 50, 75, and 100 for the single-family world. And in the multifamily world, it's basically about 20 basis points higher every year.

You could also look at this and then say, "Well, is this a fantastic fee that we are getting into?" Well, as it turns out, a lot of our fee structures we have, in our existing portfolio, they have been entered into when the risk premium was very, very low. So some of the facilities that we have, actually have a fee structure of 8 basis points for five years.

So on the average, our portfolio has a fee of about 20 to 25 basis points, which is close to what we were expecting when we went into this program. So on average, these fees are higher than what we have currently. But we expect, with this facility, our bonds will trade through what they've been trading at, so that the higher fee may justify itself by the fact that these bonds are traded better than what they've been trading at.

MR. GILBERTSON: Just a couple other thoughts to chime in on this whole notion.

We're showing you the current ratings of the two indentures that we have. We have AA-, Aa3 for the Home Mortgage Revenue Bond indenture.

You know, the individual bond series that attach this facility will now be AAA, because we have the gold standard for credit and liquidity support in the bond world. We have the U.S. Treasury backstopping it.

So the individual resets on those bonds for the term of this facility should be the best you could ever imagine. So I think there are some significant benefits there.

The downside is the escalating fee. Clearly, Treasury wants this to be temporary. That's why there's an incentive for us, as the fee escalates, that we continue to look for other options to rid ourselves of the situation that we find ourselves in today.

MR. HSU: There's one other thing that's worth pointing out. It's that while these fees are higher than our portfolio's average fees now, these fees are better than what the market charges now.

MS. CARROLL: Going back to the term-out on these, if for some reason the market doesn't come back and you can't find replacement facilities, you said the term-out provisions are better. Does that mean that if the federal government holds your debt, that there's really -- you don't get into this escalating term-out that is such a problem now?

MR. GILBERTSON: Yes, I don't know that that's a good solution but, you know…because to have the federal government be the holder of all your debt may not be ideal.

MS. CARROLL: I agree with that, but just in a worst-case scenario.

MR. GILBERTSON: Yes, as you know, though, Katie, our typical term-out provisions under most of these banks average five years.

MS. CARROLL: Right.

MR. GILBERTSON: So we had ten semiannual debt service cycles to kind of repay all of the principal.

And again, as we've talked with the Board before, the intent was to pay off the bondholders over a 30-year time horizon because we're making 30- and 35-year loans.

So we do get a significant benefit by having no accelerated amortization for a full ten years from the end of the facility. So it's 13 years from today, and then there is a balloon payment, of course, through natural amortization, prepayments of loans, and other things, the principal amount will be significantly lower in 13 years.

I don't hazard to guess at that amount.

Tim, I don't know if you have --

MR. HSU: Well, it depends on the prepayment fees on it.

MR. GILBERTSON: And so many other things.

You have normal amortization or scheduled amortization as well as the prepayment aspect.

And the one other thing -- Tim touched on this -- market facilities today, if we could find one, we would clearly be over 100 basis points today. Some of the renewals we have done have been 125, 150, and higher.

So this is -- from that perspective, it's better than the market is providing. Clearly, there's incentives to get out of this.

I think the key thing in all of this is the temporary nature of both of the programs. They're not in it for the long haul. They're in it for a short period of time.

MR. HSU: I think, Katie, in large part, that ten-year balloon versus the five-year term-out, accommodated that request, in large part, because they knew that the rating agencies were stressing out cash flows. They were assuming that a billion or two of our portfolio will go into bank bonds and whether or not we need the term-out payments.

So I think that accommodation wasn't a hint that they're willing to take in all the bonds, but it was, rather, an attempt to help us deal with the rating concerns.

MS. CARROLL: Right. Now, I fully understand that they wouldn't want to have to take in all of your bonds. I'm just kind of trying to figure out what this would mean in an absolute worst-case scenario.

MR. HSU: It's an embrace, not a bear hug.

MR. GILBERTSON: Yes, that's a good one.

MS. CARROLL: Good word for that.

MR. GILBERTSON: So with that, on page 114 of your binder, there is a resolution, Resolution 09-14, that is --

MR. SPEARS: Is there a page? The resolution is on page 114.

MR. GILBERTSON: Yes.

Clearly, what we're asking the Board to do is to support the Agency, Steve Spears as Executive Director, in entering into these agreements with the GSEs and Treasury.

MR. SPEARS: Acting executive director.

MR. GILBERTSON: Acting executive director.

MS. PETERS: I'd like to move adoption of Resolution 09-14.

MS. JACOBS: Second.

CHAIR CAREY: It's been moved and seconded.

Is there any further discussion?

MR. SMITH: I just had a quick question on the bond indenture.

How will it change? What's the significance of it?

MR. HUGHES: As I think Bruce or Tim pointed out, there will be new indentures created for this program.

What historically happens is that each January, the Board enters into a series of financing resolutions that authorize the staff to take a very, very broad range of financing actions. And those authorities also approve specific forms of indenture that we can use. And there's a whole long list of approved indentures.

This program is evolving daily. We're getting documents every day. And what the second component of this authority does, is to allow us to take the previously approved forms of indentures and modify them however is necessary to fit into this new federal program.

MR. SMITH: There's no negotiations? Pretty much, take it as it is?

MR. HUGHES: No, it's -- I have been told personally, and the Agency knows, that we're not going to be negotiating these. We have, nonetheless, tried to fit in our little bits, and that's here and there.

But I think one of the main takeaways, you can tell from Tim and Bruce's presentation, is there is a gigantic amount of work to be done by December 31st. Because after December 31st, all federal authority for this goes away and it will not be extended.

So this is a very practical exercise of trying to get all this implemented in a very, very short amount of time. And, frankly, we won't be in the position that we normally are to try and get the bear hug rather than the embrace. I like that a lot.

MR. GILBERTSON: That was great.

MR. SPEARS: Let me make one comment in response to that.

This will give us the ability to form this new indenture, according to whatever they come up with. It's not negotiable, I get that. We have made objections to various things, including the legal fees that they told us -- the fee schedule that came with this thing.

We had a phone call yesterday, that said that we object strenuously. But it doesn't force us to participate if this winds up to be something that we really shouldn't do. And, I mean, at that point, I would just back down.

I don't anticipate that happening. But if the indenture winds up to be injurious to the Agency from some standpoint that we really shouldn't do, we will just simply back away.

But, again, I don't anticipate that happening.

CHAIR CAREY: Further discussion?

Roll call.

MR. HUGHES: Mr. Chairman, we just have to make sure that we solicit any public comments as well before going on, before action.

CHAIR CAREY: Thank you.

If anyone in the public would care to comment on this item before we take action, please step forward.

(No response)

CHAIR CAREY: Seeing none, roll call.

MS. OJIMA: Thank you.

Ms. Peters?

MS. PETERS: Yes.

MS. OJIMA: Mr. Gunning?

MR. GUNNING: Yes.

MS. OJIMA: Mr. Hudson?

MR. HUDSON: Yes.

MS. OJIMA: Mr. Hunter?

MR. HUNTER: Yes.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Yes.

MS. OJIMA: Ms. Carroll?

MS. CARROLL: Yes.

MS. OJIMA: Mr. Smith?

MR. SMITH: Yes.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Yes.

MS. OJIMA: Resolution 09-14 has been approved.

MS. PETERS: Mr. Chairman, just before we move on to our next agenda item, I want to take a moment to fill Board members in on a little more detail of what a herculean effort this was on behalf of this staff.

I know that when it gets to our level, we see five slides, and we move on to resolution. And that's only due to the fact that the staff has moved mountains.

I was involved with this very early on, on behalf of the Governor's office and the Agency, when we understood that the Housing Finance Agency Association, that's our national group of housing finance agencies, was not necessarily articulating California's unique aspect to the degree that we would like it to be heard in Washington; and introduced Steve to the Treasury contact that I had dealt with on numerous occasions, and watched this progress.

It was intense, intense labor of creating something that had never been seen before in the midst of the financial crisis, in the midst of a transition of presidency, and the Treasury looking at very many other programs that had higher priorities for them.

The Agency was able to really get in there, roll up their sleeves, and help write this, to make sure that it was a success for California. And I really can't say enough about the efforts that went forward.

It's very rare that the Agency will step back and not even participate on phone calls. When Treasury would call me, I'd say, "Call Steve," and that speaks volumes of the ability and quality of folks that we have working for us. So just because it's five slides here doesn't mean it wasn't a childbirth moment many, many months.

Thank you, all.

CHAIR CAREY: Thank you, Heather.

--oOo--

Item 5. Report, discussion, and possible action regarding the Agency's financing and program strategies and implementation, and loan portfolio performance, in light of financial marketplace disruptions

CHAIR CAREY: We will move on now to Item 5, which is an overview of current issues and challenges.

MR. SPEARS: Well, the first part is how the federal plan helps meet some of those challenges.

The second half is the loan portfolio, which presents an ongoing challenge that we'll get to in just a minute.

MR. GILBERTSON: Thanks, Steve.

So clearly, at this point in the Board meeting, the tone changes a little bit, yes. We had the energy of the federal initiative, and it is going to be helpful.

And now, we have to get back to a little bit of reality and some of the challenges that we have talked so often to the Board about. We took a little different approach this time. Even for us, it becomes very repetitive, the types of things that we were sharing with you. Hopefully, this will be meaningful. And I know we have some new members on the Board as well.

The first concept -- and "basis mismatch" is a phrase we use inside the Agency a lot. I want to step back. I don't expect everybody to grasp that and say, "Wow, I get it." But the point on the first bullet here is that for our fiscal year that ended June 30, 2008, basic mismatch amounted to $12 million on some $3.8 billion or $4 billion of variable-rate debt.

On a percentage basis, or if you calculate the amount of basis points, it's not all that large. It grew to $38 million in the fiscal year that ended June 30, 2009. So a tripling -- and I think that everybody gets that.

I'm going to ask Tim to slip forward to slide 17.

So here's a bar chart depicting basis mismatch since we started our variable-rate financing program. Just to be clear, the blue bar is the cumulative total of dollars -- okay, basis mismatch.

You can see the furthest-right bar, a little over $100 million basis mismatch on a large amount of variable-rate debt over a ten-year period.

The gold bar is the periodic mismatch. So you can see the dollars. You can see the bar for the 2009 time period. That's reflecting -- it shows more than 40 -- we measure this on a bond year rather than a fiscal year, so we're just -- we have a little timing difference, because we're doing the payment year from August 1 to July 31, so it's off by 30 days. Clearly, that tells you that July of this year was much worse than July of the prior year.

So I just want to show you, this is the issue we're talking about. And then I'll go back and define, what is "basis mismatch"? So basis mismatch is the difference between the interest rate we pay to -- I'm sorry, it's equal to the interest rate we pay to our bondholders on these variable-rate instruments, variable-rate demand obligations, auction-rate securities, that are hedged with an interest-rate swap, okay. So we elected to not leave them floating. We wanted to put a hedge in place to create what we call a "synthetic fixed rate."

So the interest rate on the bond payments minus the variable-rate payment we receive from the swap counterparty.

All of our interest-rate swaps are fixed-payer swaps. We pay a fixed payment in exchange for a variable-rate payment from our counterparty.

Two reasons basis mismatch has really blown out in the last couple years. The first one is the underperformance of the bonds. I'll show you the other chart in a moment that shows you the history of our bank bonds. You know, bank bonds are the bonds that aren't accepted by the marketplace. An investor doesn't want them, so the liquidity bank takes the responsibility on and owns them.

But the business transaction that we entered into with the liquidity bank was such that they get a higher rate. They didn't want to take this on for nothing. They're getting a small fee and they want to get a higher rate. So underperformance of the actual bonds themselves.

And then the significant change in the relationship between short-term taxable rates and short-term tax-exempt rates. Tax-exempt rates should always be set at a rate lower than the taxable rate, one would think, because you don't have to pay income tax on it. However, we're in an environment today where short-term tax-exempt rates are higher than a short-term taxable rate.

You know, market dysfunction. You know, a higher-rate environment overall will help that situation.

We hope that will come back in the new term.

This chart -- let's stay on that one for a moment. The purpose of this -- and we've shown this to the Board repeatedly over the last 15 months -- beginning with the Lehman Brothers bankruptcy in September of 2008 we started to get these bank bonds. You know, investors were tendering their bonds back to the tender agent and the bank was having to buy these bonds. It grew very, very quickly in early October of last year, to over $1.1 billion. We worked hard in dialogue with the remarketing agents, and then the market in general became better. And so that's been a much lower amount.

Then the low point was February of this year. It kind of ballooned up a little bit for a variety of reasons. And now we're at an amount that's just under $200 million.

All of the bank bonds we have today are the result of the liquidity bank not willing to extend the facility. So it's expired. Can't find a replacement. The federal program won't resolve this because we're going to have that facility in place in January.

Okay, let's go back to page 14.

Just the other bullet then that I want to talk about here is because of the interest-rate swaps, we faced a couple of situations over the last year, year and a half, where we had to deal with the underlying interest-rate swaps themselves. The Lehman Brothers bankruptcy caused us to face a termination event under interest-rate swaps. We had to pay net payment of about $16 million to that entity to get out of our swap contract with them.

We pay a termination payment when the market value of the contract is a negative value to us. It's a market-based pricing. We went through this exercise in November of 2008.

We included in the back of your board binder a two, two-and-a-half-page memo on that subject.

It's complicated. We try to do justice in the form of that with a written report. So certainly later or now, if there's questions, we'll respond to those.

So let's -- again, we've talked about some of this already. But with the Treasury's TCLP program, CalHFA will be able to accomplish several things.

Replace the $197 million of expired liquidity facilities we have today. Again, that represents all of the bank bonds that we currently have, ad will alleviate the accelerated term-outs required by these banks. And we talked about that in the earlier agenda item. Most of our liquidity agreements require a five-year term-out provision, in addition to a higher interest rate.

So once we get to the end of January and all the new facilities are in place, we certainly expect a lower cost of funds going forward. We expect very high demand for these securities. All of those things will improve the basis mismatch. Wide acceptance, lower rates.

These are bonds that if they were in place today, we would expect these bonds to reset on a weekly basis at 25 basis points, .25 of a percent, or 30 basis points. Very, very low interest rate.

The other thing to keep in mind without the TCLP program from Treasury, we'd be looking to replace or extend a total of almost $2 billion of liquidity support over the next 13 months, something that the marketplace simply isn't willing to do in this environment for CalHFA.

So Tim is going to just take us through. And we're going to take a look at a composite snapshot of our debt portfolio today and then what it will look like once we put these new facilities in place.

MR. HSU: This is a chart that we started developing after the credit or liquidity crisis started.

Across the top here, you see some of the headline news, if you will, about the bond insurers going sour and causing havoc in the financial market. So you see the AMBAC and the MBIA and FSAs of the world across the top and we also have some uninsured bonds.

And on the left-hand side here, you see from top to bottom, a different dimension of the capital structure. You see if we had used variable-rate financing or used index bonds or used fixed-rate bonds.

And it's really at the nexus of the components going across the top and the components going from top to bottom, that you can see where the really troublesome spots are.

So this is a snapshot as of October 1st, and it's representing where we are today. And you can see that we have some red numbers here. These are auction-rate securities which, when the credit crisis started, they seemed really, really horrible. But in today's life, without the federal assistance initiative, they actually are relatively less troublesome than some of these blue numbers that we have. And the reason is that some of these auction-rate securities, they have formulaic maximum rate reset formulas to make their resets not as high as some of these blue variable-rate demand obligations are sitting at.

So you can see that if you look on the bottom right-hand corner here, that in total, you're roughly looking at about 18 percent of the bonds that are being either colored red or blue or dark red. And this dark red of $197 million is the number that Bruce had alluded to earlier, are sitting in bank-bond mode.

And on the next page, this is again the same chart, but it's meant to give you a before-and-after of what our composition looks like after we put on the Federal Assistance Package's TCLP program.

So the TCLP does not allow us to convert the auction-rate securities into VRDOs, so they'll stay red. But many of the blues that you saw will get converted to green. And we are working with FSA to strip their insurance as part of this process, we left them in there, the $549 million in blue, because it's still a process we have to go through to strip them. We hope to move that $549 million into the green as well.

You will note that on the bottom right-hand corner again, that 2 percent plus 7 percent is 9 percent. So it will seem as if the benefit here ostensibly is to move from 18 percent of color bonds, into 9 percent of color bonds. But I would note that this green here, is greener than the green on the last page, in the sense that we have now dealt with many of the risks that we often talk to you about, like the expiring facilities and the rollover risk, and also that we expect these bonds to trade much better with the TCLP in place.

MR. GILBERTSON: So that kind of wraps up the debt side of the challenges.

I think Steve and Chuck and maybe others are going to go over some of the portfolio aspects as well.

CHAIR CAREY: Questions before we move on?

MR. SPEARS: A federal program will be helpful. I hate to understate that, but it will be.

All right, the mood changes slightly more.

But we're now on to the yellow box, if you remember the discussion box up front.

And CalHFA's main income-producing asset, of course, is its loan portfolio.

I will start with some bright news and tell you that the multifamily portfolio is performing well. We do not have significant issues there.

We have seen an increase in vacancies. And anecdotally, we believe that's because people are eschewing apartment living for living in the homes that are out there, vacant, that have been purchased by investors, that are now for rent at very reasonable rates. I can't prove that exactly, but that's what we hear anecdotally.

The single-family portfolio is another story, of course; and that's where we'll spend most of our time right here.

What you see on page 21 of your slides -- and there is also a more detailed report back in the appendix, under "reports." It is behind Tab B, starting on page 147. If you want to refer to that for more detail at some point.

I think what you'll see is a picture that as unemployment numbers have increased in this state, our delinquencies have gone right along with that and increased dramatically over the last four months. They had increased from about 10+ percent in December of 2008, and had steadily increased until about August, and then they really increased since then.

The report that you see before you on page 21 is the last reconciled report. We have reconciled to the penny exactly what payments have come in from borrowers.

I have asked, starting a few months ago, for unreconciled reports, so that we could get a better clue. And they're not materially different, usually.

And this 15.8 percent number that you see on the bottom right-hand corner has now increased to just slightly over 17 percent as of the end of October. Pretty much along the same lines.

A couple things to point out. One is that, of course, the federal guarantee loans that you see up at the top, the first three lines, those are not the ones that we're concerned about. We're very concerned that people in those homes will be probably not paying; probably have to leave those homes. And that's not our mission, and we're not happy about that.

But from a financial standpoint, those are 100 percent guaranteed by the federal government. The ones that we are concerned about are the conventional loans on the bottom three lines.

And if you turn to the next page, you'll see that all conventional loans, the percent delinquency -- total delinquency on those is on the very bottom line of page 22. And they are at 14.57 percent, reconciled as of October 31.

That number is slightly above 15, I believe, Chuck, for the conventional ones.

MR. McMANUS: At least, yes.

They're all unreconciled that I'm looking at, so…

MR. SPEARS: Right.

I'm also looking at an article from the Wall Street Journal the day before yesterday, which says that mortgage delinquencies across the country rose in the third quarter again. And the two things they point to are the two things we've been talking to you about all along. And they say, several months of home value appreciation and the unemployment rate improves mortgage delinquencies -- unless that happens, mortgage delinquencies will continue to rise.

We don't see that happening in California in the near future.

Yes?

MS. JACOBS: Since you already gave me a birthday present of the federal program -- an excellent present -- could you indulge me for a moment to reinforce the unemployment issue?

I am such a good HCD director, that when I took office in 2006, residential construction was the number-one industry in the state, accounting for 960,000 jobs.

It's down 72 percent, to 163,000 jobs. And it's one-third of all the unemployment in California. So it is kind of a double help when we can get government money out to build new affordable housing, because we are a big percentage of the unemployment rate. So if we can put people back to work with our money, whether it's HCD or CalHFA or Proposition 1C, that would be great.

MR. SPEARS: Those are the two factors, there's no question.

What I'd like for you to do is to turn to page 25, if you will.

Our delinquencies vary a great deal by product. And so what you have is -- a green line there is the Mortgage Banker Association's California prime delinquency rate.

I would caution you that those are not the kind of loans that you see for all these different types.

The orange line are interest-only. They would not consider a prime. Even though it's a fixed-rate loan, it is an interest-only loan for a period of time, so you would see a different benchmark there. But it is a benchmark that we have used in the past.

What you see is that the 30-year loans are edging up. 40-year loans have really taken off since August, and interest-only loans have really taken off since August.

The interest-only loans don't start resetting -- the first ones start resetting, I believe, in May of -- next year?

MR. McMANUS: That's correct.

MR. SPEARS: So their payments are remaining low. I think what's happening there is that people are seeing that there's a payment jump down the road. Their home price is far below their loan balance. And I think, Heather, this is the correct term, a strategic default is happening, and they're simply making the decision to not be in the home.

So this is the picture, it is resulting in loan losses which we will get to in a minute. But what I want to do first on page 26, is to talk to you about what we're doing to try to combat this.

I'll say right off the bat, that it's difficult when you call a borrower, they don't answer the phone, and you eventually go to their house and they have been gone for a couple of months or several weeks. A lot of folks just simply are making that strategic decision to walk away. But for those borrowers that are still in the homes and will talk to us -- and it's very difficult to communicate -- we have shifted, as we talked before, staff from loan production, where we had -- you know, we've been idle for a while. A lot of the staff have been moved over to loan servicing. Our own loan servicing department that Rhonda Barrow runs, to loan modifications, which is a combination of Rhonda, plus Chuck's shop, which works with other loan services.

Loss mitigation and REO management, which is Chuck's responsibility. We've shifted a large number of people over there. In fact, just -- when I sent news out -- just so you get an idea of employee, I'll call it "morale." When I send a note out that the federal plan had been finalized, that we were now going to participate, that we were going to be able to lend again, hopefully in the coming year, I got more than one e-mail from an employee that said, "Thank heavens, I'm going to be underwriting loans again."

And they didn't mean it necessarily in the sense that what they were working on now is not vital to the Agency. It was that they really want to get back to the lending; they really want to get back to putting people in homes and homeownership and working on that side instead of their reassigned duty.

It's difficult work for these folks. And as much as we praise Bruce and Tim and Tom and others for working on the federal plan, these folks need encouragement on their own. They are doing the difficult work that we have to do to manage this portfolio. And I just want to give them recognition of that at this point.

Here's some other things that we're doing. We have two loan modification programs that we'll talk about on the next page, one for FHA and one for conventional loans.

Unfortunately, we are not able to follow the President's modification programs because of our bond indentures. We have tried to map, as closely as we can, to that program, and still keep our bond investors happy and our bond counsel happy.

We've started a "Keep Your Home" campaign. It started being called as the "Stay in Your Home" campaign, but it sounded like meteors were about to hit the earth, so Ken convinced me of a different name.

But the idea is that we contact folks --

MR. HUDSON: I think Ken was right.

MR. SPEARS: Yes.

MS. PETERS: That's why he gets the big bucks.

MR. SPEARS: But Heather and I visited a couple of outfits that are interested in this idea of strategic defaults, folks that are in that category, identifying those people.

What we've done is a broad-scatter distribution of people that are likely to walk away and send them something, and say, "Think about it before you do that. There are consequences that you may not have thought about, tax consequences, credit consequences. Talk to us first. Now, we're not trying to threaten you, we're not trying to" -- all we're trying to do is educate them on the consequences of walking away from their home.

We have reorganized. We are in the process of relocating our own CalHFA loan servicing staff. We've provided training and we've got them better equipment.

We have had problems. I'll be frank and admit it. We've had problems from going to a loan-servicing operation which was simply processing checks and the occasional call from borrowers to 30-, 45-minute, hour-long phone calls trying to work with them and doing personal financial counseling over the phone.

Some of our folks weren't trained for that. We're getting training to them. We're putting in a new phone system. We are hiring more managers, and we're moving them to a location which we'll talk about at the very end of the day that allows for expansion and allows for better equipment and better organization.

And the final thing that we have done is, when we started getting information in from outside services, something that Heather's talked about before in Board meetings, we found that, here again, when delinquency rates are 1 percent and 2 percent, they probably don't pay as much attention to this. But what we found is people were reporting at different times in the month. Some of them were literally printing out thick computer paper with little stripes on it -- you know, the old-fashioned type -- and putting those in a box and mailing them to us, and they were getting here about the 20^{th} or whatever.

And a variety of information was being recorded. Not much of it standardized.

We have standardized all that. We now require them to report electronically by the 5th of the month. And we are in the process of developing metrics, where we can go to them and say, "You're not standard on this or that performance measure."

What we would like to be able to do is have a bit of a lever, hammer -- call it whatever you want -- so that if they're not performing, we're going to take those loans away from you and do a better job ourselves.

I'll have to tell you that we're not in a position to do that right now because we're in the midst of this reorganization and relocation project for our own loan servicing. We don't have the staff to do it.

If we did take the loans back at this point in loan service, then we would have to find a subservicer to do that and probably deal with some of the other problems that we already have. So those are some of the things we're doing.

Any questions on that before we move on?

MR. GUNNING: How is the training received?

MR. SPEARS: Well.

The one problem we've had -- and not to rain on the furlough program, but --

MS. JACOBS: Please don't. Please don't.

MR. SPEARS: But it has been difficult. We have hired temp help. Some of those folks coming in are experienced in collecting mortgage payments, some are bill collectors that we've hired. There's a huge difference. And those are the folks that we have put through the training because it's very different. They all need to understand our mission.

And again, this is the tougher side of what we do, but we still have to be compassionate.

And if it turns out that a homeowner cannot stay in a home because they have lost their job, they've had a major illness, they've had a change in marital status, they've been cut back in their hours or something, our goal is to view this on as a compassionate basis, on as fast a basis as possible. And that's a little bit different than calling up and collecting an auto payment. But it's been well received. It really has.

MR. HUDSON: How is your loss experience instructing your new origination? I mean, what have you learned from your delinquencies that could help you with your new origination?

MR. SPEARS: As we move forward with the new lending?

MR. HUDSON: Correct.

MR. SPEARS: There is no question that FICO scores are the absolute key.

I'm going to let Chuck talk for a bit -- one of the things that I need to -- there are two things that I need to give staff credit for.

Long before I ever got here, Chuck improved this after we hired him from the private sector. One is, we have reserves to put against losses only because this has been well managed in the past. And we didn't spend all the reserves on one program or another. We have the reserves that we're going to talk about, moving from fund equity over into offset losses.

The other is that we have -- we did not do the subprime loans, we did not do the no-doc, low-doc loans. They were properly underwritten. We were berated, I'll use that word, for taking so long to get a CalHFA loan, and everybody else was getting a loan overnight. "Oh, don't go to CalHFA. They take forever to get all that work done."

Well, it turned out that all that work, that was underwriting work that everybody should have.

So let me let Chuck comment briefly, and I think he will probably agree.

MR. McMANUS: I think he doubts an Irishman can be brief, but I'll try, okay.

We began tightening -- first of all, putting in minimum FICO scores in July of 2006. Maximum total debt ratios, the same date, we went to 620 minimum, 55 total debt ratio. We had been accepting Fannie Mae DU approvals. I found 7 percent of those approvals had total debt ratios over 55 percent. Unacceptable. It's not fair to the borrower, et cetera.

So we attempted to give them -- we only wanted to make loans to people we thought could afford to make the payments. However, we did not anticipate a 40 to 50 percent drop in real-estate values.

What has resulted is, it's just like people have made -- gotten a loan on a car. The house is now worth less than when you bought it. You have no fallback. You cannot get a second mortgage to bail you out because you overspent, you did something wrong. So the safety net of equity in housing does not exist in our market.

Our down payments for the first year I was here average 1½ percent out-of-pocket, okay. They may have had downpayment assistance and so forth, but our average LTV was 98 and a half.

So we had a borderline customer. And when the safety net of the value of the house fell down, that's where we are today, that's why we're dealing with the foreclosure rates and the losses. But we have done full underwriting, full documentation. And that has helped us.

And so relative to others who don't do full docs, we're performing well, even though it's terrible.

And our 2006 book may go out at 35 to 40 per hundred, when you project out to the life of the loan.

We're at, today, about thirty- -- if you have all the delinquencies, 34 percent.

So I'm not saying they're all going to go to claim. But we've got a very tough book.

The prices peaked December of 2005, January of 2006 overall in California. And we had our biggest year in 2006. We did $1.7 billion of single-family loans. So that --

MR. HUDSON: Let me ask specifically about page 25.

Is this instructing you in any way, this product mix that you have?

MR. McMANUS: Yes. But I want to show some -- underneath the sheets, here are some secrets.

The orange line, the interest-only product, which is maligned tremendously, those payments have not changed. They're fixed, flat-line payments. There is no equity buildup. But equity has dropped 40 percent. So if you've had a 2 percent, you'd have a 38 percent drop in value.

But that is the marginal buyer. This is a self-selection thing. That was the lowest monthly payment. So our customer that wanted the lowest monthly payment took the IOP loan. It was lower than the 40-year amortizing or the 30-year.

If you look at the 30-year, that's a standard 30-year product. That is the conservative borrower that picked it, and it's performing better than the rest of the California market. So it's a self-selection process in this mix.

We had our weakest borrowers taking the IOP. And those changes in price, which are about 16 percent payment shock, come next May, June, and July, and on for the next two years -- or three years. We've got to do something about that. We're making plans to do something; we just haven't settled on what, how we're going to try and avoid that shock. But that's a self-selection process, I believe.

MR. HUDSON: How about going forward, are you still going to have these products going forward?

MR. McMANUS: We do not offer the IOP. We have the 30-year. Right now, we have only a 30-year product.

MR. GUNNING: I thought we had a 40-year.

MR. SPEARS: Not anymore. No.

MR. McMANUS: No. We do not have the 40-year.

MR. SPEARS: On a going-forward basis, we're going to have two basic products: 30-year FHA, 30-year conventional.

MR. HUDSON: And what about down payments? Going forward, what are the down payments going to be?

MR. SPEARS: Well, we have -- and we'll get to this more in the business-plan update -- but at present, we have only access to general obligation -- state G.O. bond funded downpayment assistance, as opposed to our own internal programs that we had before.

So it's somewhat limited, but local localities -- cities, counties -- have downpayment programs that they have used before with our products, and we're going to partner with them and do that again.

CHAIR CAREY: Are you asking about what we can require, what we're requiring or what we're offering?

MR. HUDSON: I'm not sure. What's the difference?

Answer both questions, because I didn't know there was a difference.

MR. McMANUS: Can I -- the 3 percent cash is a new thing we put in. I don't know if we're going to maintain it.

MR. HUDSON: So 3 percent cash is the current program, and it used to be as low as 1 --

MR. McMANUS: Zero. We didn't require any borrower cash because they could get downpayment assistance. Our mission was to promote homeownership, and that's what we were doing.

MR. HUDSON: I understand.

MR. McMANUS: We just did it in a market that fell 40 percent.

MR. SPEARS: Right. And that's the discussion at the business plan update, that Fannie Mae is offering a 100 percent LTV product where they provide the mortgage insurance.

If we use that in combination with a mortgage-backed securities program as opposed to owning the whole loan, does that change our business strategy?

MR. HUDSON: Yes, and I'm asking these questions, I think you have to balance your mission with people's ability to sustain -- affordability can be defined -- make it affordable, so people that maybe can't sustain it can get in.

MR. SPEARS: Right.

MR. HUDSON: Worry about sustaining it later.

And you're addressing that kind of with your underwriting. But then your products, actual products can be designed in a way that -- from policy legislation and everything else that says zero down payment, you know...

So if you're getting people into houses that they can't stay in, I'm not sure the mission is accomplished.

MR. SPEARS: Right.

MR. HUDSON: So the balance between making it affordable and yet making it so that people can pay it over a period of time, through emergencies and all sorts of things, is the issue that they -- because if you have delinquencies, then you can't do more lending, and you have more problems because it's more affordable, so it's a cycle.

But I get it. It sounds like you guys are making adjustments based upon the experience you've had with the portfolio you currently have.

MR. SPEARS: Yes.

MR. HUDSON: Good.

MR. SPEARS: One other thing, quickly -- or, I'm sorry, two other things, quickly, and then maybe it's time for a break for Dan.

On slide 27, I just want to give a quick report on what we've seen so far. So far, we have 275 applications that we've received, 150 approved, 88 were denied or declined based on the criteria.

And we are working with folks right down to what we required, a surplus in their monthly budget, and fit that down so their monthly budget is balanced. And they can still qualify.

Twenty-five of these 150 have been accepted by the borrower, they've been executed, and we're receiving payments now. They just started. So I can't tell you that we've received three months in a row, but they've accepted.

Twenty-two of those have been declined. And the fundamental reason is, "I thought you were going to write my balance down," and we can't do that.

Seventy-eight are still in the process with servicers. We're not really sure -- what we do, we send them back out. They're in the process of getting in touch with the borrowers, finding out whether they're going to accept or reject, and that sort of thing.

And 25 are still being looked at by Genworth.

For the new members, our loan modification were conventional loans. The terms are being funded by Genworth. In other words, if we lower the interest rate for a temporary period of time, if we extend the term and it changes the cash flow that would have been flowing to the indenture, Genworth is giving us an advanced claim of paying for that, so the bondholders are happy folks.

So that's a quick --

MR. HUDSON: Out of how many -- 75 applications out of how many? I mean, the percentage?

MR. McMANUS: Are you asking reapproval rate?

MS. PETERS: Out of delinquencies.

MR. SPEARS: Out of number of delinquencies.

MR. HUDSON: The percentage of totality. Out of a thousand delinquents?

MR. SPEARS: Now, these are -- I'm trying to do quick math here.

MR. HUDSON: I always mess up when I do quick math.

MR. SPEARS: I'm afraid of that.

These are conventional loans only, because we just started our FHA loan.

MR. HUDSON: Okay.

MR. SPEARS: There are more in the hopper as soon as we get the official word from FHA that we can proceed. We're working that part.

But I'm looking at approximately 15,000, 16,000 loans that are conventional loans. And we've got 15 percent delinquency, roughly, in those right now. So that would be 1,500 plus --

MR. McMANUS: About 2,200.

MR. SPEARS: Yes, 2,200 that are everywhere from 30 days to over 120 days. But that's total delinquencies.

Now, they don't even qualify until they get to sixty-plus. So it may be more accurate to use that sixty-plus. But I would say that's anywhere from 1,500 to 2,000 borrowers.

MR. HUDSON: Thank you.

MR. GUNNING: I've still got a question.

MR. SPEARS: If my math is in error, I'll let you know.

MR. GUNNING: Some studies so far are showing that modifications aren't really helping the people that ultimately do go delinquent. Have we factored that in? Are we thinking about that as we go through this, or is there not enough experience to see whether these are helping or hurting?

MR. SPEARS: We've factored it into the model. We don't have enough experience to know yet whether or not it's coming true or not. We certainly hope it's not.

MR. GUNNING: Given the underwriting criteria, you would hope because your borrowers are stronger, that you're really going to help that these aren't marginal borrowers who just delay --

MR. SPEARS: Some of this is expectations management up front.

There may be a lot of those folks, Paul, that have had conversations with us that "I would like to have my loan balance reduced to the current market value of the house." And we can't do that. And they may just not apply right off the bat.

MR. HUDSON: So this 275 doesn't reflect all the people you may have --

MR. SPEARS: Had contact with?

MR. HUDSON: -- talked about it?

MR. SPEARS: Yes, those are folks who have gone through the paperwork, applied, they've sent something in.

MR. McMANUS: And I would estimate, more than double have been contacted and accumulated.

The servicer is taking the first look. And then when there is no chance, they say you don't have a job, you don't have income, they don't have a positive surplus. So the servicers turn down the majority of the declines. These are ones the servicers have taken all the information and they send it in. And all we're looking for is $150 to $200 of positive cash flow over above the bills we know they have. And now, we've reduced that to zero. We'll let a zero try if it looks like they really wanted to stay. We try to keep them in their houses.

MR. SPEARS: It's a good point about contact, though. We have contacted every single delinquent borrower about the loan-modification program.

Have we gone beyond that, Ken?

MR. GIEBEL: We contact everybody who both CalHFA serviced first, because we know those first, and then the servicers, we contact that on Day 32. And I think the servicers are, like, 40 days. Once they're 30 days late, within two days they're getting contacted by Rhonda's people. And then we send the post -- the "to keep your home" postcards out.

The next set of postcards will go out right after Thanksgiving, for example, to the borrowers who are newly 30 days late, plus we're also going to add -- we have noticed that some of our people, borrowers, are starting to go to people to modify their loans, the scam people, we've run into a couple of that. That's the next set of postcards that are also going out.

Every 30 days, every 60 days, we're contacting them, both on the phone -- a lot of them don't answer the phone, but they do get their postcards.

MR. SPEARS: We are trying to stay current on the latest scam schemes that are out there, and keep folks posted on that.

MS. PETERS: There's some good news on the loan-modification scam front: The Governor just signed a bill that prevents any advance fees being collected by these folks. So, effectively, they're out of business. Now, we're dealing with cleaning up the mess of what came before. But we should see pretty much zero activity on that front moving forward.

MR. SPEARS: I wanted to mention one more thing and now it slipped my mind. And maybe it will come back.

There is a map -- let's go to that.

And, Paul, you asked about things that we've learned. What we've learned is that -- and these are --

MR. HUDSON: We shouldn't lend in the state of California.

MR. SPEARS: An excellent point. It is something that the rating agencies pay attention to that we are geographically restricted and geographically not diverse.

These are -- the yellow numbers here are our top 10 locations where we have loans. Pick, if you will, San Diego, and see what pops up there. And I hope you can read this.

MR. POGOZELSKI: Click on San Diego.

MR. SPEARS: I'm having trouble from here.

CHAIR CAREY: Negative 42 percent.

MR. HUGHES: I could read it.

MR. HUDSON: And 2,900 loans.

MR. SPEARS: We have 2,900 loans. We have 15 percent delinquency there. We have 118 REOs in San Diego County alone.

Let's go to another one.

One thing that we found out, by the way, is that we don't have a lot of loans in the Stockton area. The reason being, subprime, the products were -- our borrowers were taken away from us there.

It is a point that I want to bring up about our interest-only product. This product was offered, in part, in response to some of the products that were out there. And we're trying to keep people from going into subprime products, to variable-rate interest-only loans that will really escalate down the road.

The performing part of that interest-only portfolio, which is 75 percent of it, are folks that probably would have gone off to some inappropriate product. But that's just an estimation.

CHAIR CAREY: Lynn?

MS. JACOBS: Is the median price figure, where is that from? Is that just the median price of CalHFA loans, or is that the median price from where?

MR. SPEARS: That's from the marketplace.

MR. McMANUS: That's from the marketplace, that statement.

MR. SPEARS: Again that's the last one we have. And, Chuck, when was that?

MR. McMANUS: It was for year end 2008. And we get it annually. It's a contractual thing. We tracked the change in price.

But those, as you saw, it's a 42 percent drop in price in San Diego, 44 percent in LA County. Once you're over 20 percent, you're in trouble.

So people have to want to stay in their homes.

MS. JACOBS: I was just wondering whether it was just your portfolio.

MR. McMANUS: And we want to help those that want to stay in their homes, those are the only ones we can keep there.

MR. SPEARS: We could spend a lot more time on this map, showing where we have loans and don't have loans. You can see where the top ten counties are, and that's where most of our exposure is and where most of our REOs are.

MR. McMANUS: If I could, I have the REO department.

You have San Diego, San Bernardino, Riverside, even Imperial. Those -- that is the epicenter of our REO.

LA is growing. We had an underperforming share of market in LA. We are now growing there. And Sacramento.

If you go with those five counties, you've got probably 75 percent of our REO.

We're also growing in Oakland, but it hasn't hit the numbers we have down south.

MR. HUDSON: As a new Board member, if you could briefly give me the history on the interest-only product.

How does a new product get introduced? And -- because I heard you say the interest-only was really kind of in response to subprime, to give subprime borrowers an alternative, a better alternative, a positive alternative. How, what is the process for us deciding to do that, developing a product, and then getting the product to market? Really the first two are the most important. How do you decide if you want to address that problem, and then how are you going to address that problem? Is that all done internally?

CHAIR CAREY: Could I just suggest? That the Board would be involved, that is a future issue. I'm just -- I'm a little concerned about moving us along.

MR. HUDSON: Sure, we can come back to that.

CHAIR CAREY: If you don't mind. We can

certainly come back to that. We have a lot of ground to cover and I'd like to keep us going, if I can.

Would that be all right?

MR. SPEARS: Right.

I think the short answer is, the Board is involved in the approval; the design of the program and the reactions of the marketplace is internal to staff that would develop something to bring to the Board for approval.

Moving on beyond the map, trying to keep moving along, when we get to the "what does this translate into," and what happens, of course, is, there are foreclosures, there are -- you know, we get REO properties, they get put on the market and sold and that sort of thing. And it begins a discussion that's going to carry on about how much pain is there in the portfolio.

You're going to hear next in a report of the Audit Committee that a lot of this pain was carried this year because we increased loan-loss reserves by quite a bit, by $155 million.

We have primary insurance on the conventional loan for loans that were originated with above 80 percent LTV.

We have insurance to the bondholders that we have to cover and coverage beyond the primary insurance on all loans like that, it's called gap insurance. And then there are loan-loss provisions and write-down of REO, that actually go down to the indenture itself.

The total all for the year, $155 million.

Now, Ruben asked a very good question in the Audit Committee that may come up again: Does this mean we wrote $155 million in checks? Does this mean that all of these loans were -- all of these losses were incurred during the year? It does not.

What it means is that loan-loss reserves were increased by this amount over the year.

You can see on the bottom bullet there, REO inventory has gone up dramatically during the year. It will increase further and dramatically in this coming year.

When we're sitting here next year, that number will be even higher, I can guarantee it.

If we can go to the next page -- and I think we had a slight modification but just for the sake of time, here is the history of setting loan losses aside in the last few months. You can see that a year ago, total loan-loss reserve were $164.2 million. And we've increased that to $358 million. Again, these are the conventional losses.

So if you're looking at exposure to CalHFA, you need to look at not the six and a half billion total in single-family loans, about two and a half, roughly, is FHA. So we're really talking about the $4 billion conventional loan portfolio. And of those, what's been set aside here is an accounting number, which requires us to look at the loans that are currently delinquent today, at this point in time. And that's what we've set aside on the books.

Lori Hamahashi, we will see next in the Audit Committee agenda item, is the one who is working with Chuck. And together, they come up with these numbers based on what we've got outstanding. So that's the whole picture.

Now, the one thing that's not on our books, you will not find it on our balance sheet, is $161 million on the Genworth line. We have no idea if Genworth has this on their balance sheet or not. But regardless, that's what Genworth will owe us if all of this comes true and those losses actually occur. We will be relying on Genworth to pay us $161 million. We don't record that on the balance sheet until the claim is actually filed, but it is a number that we watch closely because we want to know how much are we relying on those folks for cash.

I'll have you know, Genworth is auditing every single claim that we file with them on every file. They are asking for the origination file in its entirety before they pay any claim. It's not surprising at all. Everybody is hanging on.

We also have some problem with some servicers in paying FHA claims. The servicers are required to pay us, then they get reimbursed from the Federal Government on our outside services, our non-CalHFA services. Some of those folks are having cash problems, and we're having trouble getting that money in the door. But we're pursuing it diligently, and it's not surprising again just because of the economic condition.

So there is a lot of reliance on Genworth to stay -- to remain able to make those cash payments to us on claims. And we have surveillance on Genworth's financial health all the time.

I think if anything ever popped up in the news about Genworth, Chuck sends it to me almost immediately. So between he and Bruce's group, we have pretty good surveillance on it.

So those are big numbers and those are big increases.

I just would stop there and ask if anybody has questions.

We're getting to the point where we should take a break, Mr. Carey.

CHAIR CAREY: Yes.

MS. CARROLL: Can I ask, in the business plan, are we going to talk about how long you can sustain those losses? How long --

MR. SPEARS: We'll get to it long before that.

MS. CARROLL: Okay.

CHAIR CAREY: We have overrun our commitment to our reporter. We're going to take a ten-minute break and we will come back.

(Recess taken from 11:42 a.m. to 11:55 a.m.)

CHAIR CAREY: We are back in session.

And we'd like to remind folks that when they're talking, please speak into the microphone. It makes the transcription for the reporter so much easier.

All right, you're still on, Steve.

MR. SPEARS: Great.

To wrap up Item 5, Bruce is going to give us a quick update of where we are on the rating agencies, obviously a very important issue.

MR. GILBERTSON: Thanks, Steve.

So we have ratings from both Moody's and Standard & Poor's.

This slide is really showing you that the two ratings that are most significant to the Agency and to the marketplace is the CalHFA issuer credit rating. That's really a general-obligation rating of the Agency. We use it for a variety of purposes, including in support of our multifamily lending program and the Home Mortgage Revenue Bond program indenture, our large single-family indenture. You can see the ratings there.

The recent activity from the rating agency is back in July, Moody's did downgrade our G.O. rating one notch, Aa3 to A1 and the HMRB rating from Aa2 to Aa3. Currently still on negative outlook, which means they'll be reassessing things over the coming 12 months. And so they haven't really reached out, they've been busy.

But this is a time of year that we give them updates on a lot of financial information based off the financial audit. We update consolidated cash flows. We'll be sharing that with them, I would expect in the spring. We'll have some more serious discussions with them regarding that.

S & P, some more recent activity there.

And just a little bit of additional history, not on the slide. In late June of this year, S & P, who is the only rating agency that rates the claims-paying ability of our Mortgage Insurance Fund, downgraded the A+ rating to BBB as shown here. That led, within about ten days, S & P bond analysts placing the Agency's general-obligation rating, as well as the HMRB rating, on CreditWatch with a negative outlook.

So that we spent three months working through a lot of loss scenarios with S & P, only to get to the point where the mortgage insurance analysts within S & P decided to place the entire mortgage insurance industry on CreditWatch negative, including our insurance fund. And that happened on October 27th.

So as the bond analysts were gearing up to go back to committee to determine where our ratings should be, they decided they couldn't do it without knowing where the MI fund's rating is ultimately going to end up.

Quite honestly, it's good news for us because we had these other things, we're going to get these initiatives in place. The initiatives are based off of ratings, ironically. And I don't think they're looking to raise our rating at S & P. It's more likely to go down. So we're buying time, we'll get these things in place, the fees will be set based off the ratings at that time, and we'll see where we end up late January or February with S & P.

So the other thing, the rating action then specifically that S & P took was to reaffirm the ratings and continue us on CreditWatch negative outlook. It kind of triggers or resets another 90-day period.

Here's just a pictorial of all the ratings that are important to the Agency. You heard several times this morning, the three real ratings: The general-obligation rating, the limited-obligation rating of the Home Mortgage Revenue Bond indenture, and then the claims-paying rating of the Mortgage Insurance Fund.

A little bit busy, but we have historically been an AA credit-rated entity, all of our programs. So this is the first the G.O. has ever slipped into the single A category. And over twenty-some years, I think the Mortgage Insurance Fund was always rated A+ until this last year.

So that's -- unless there are some questions, that's kind of the status of where we are with the rating agencies. There will be more information about that in the coming months.

And I'd turn it over to Lori, I guess; is that right, Steve?

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Item 6. Report from the Chair of the Audit Committee

MR. SPEARS: Yes. I think it's time for the report of the Audit Committee. So I suppose I will hand it back to the chair for proper handling.

MR. SMITH: Well, thank you. We reviewed that in the Audit Committee this morning, and I think we're going to have a little more detail.

Do you want to proceed with the detail on this?

MR. SPEARS: Go to the next slide there, Lori.

MS. HAMAHASHI: Just for the year, just our balance sheet, we're showing that we have $10.7 billion in assets and liabilities over fund equity. In that, the cash and investments amount, what happened in that area during the year was that we did move a lot of amounts that were invested in the GICs over to SMIF, and we had a reduction of about $42 million in total in cash and investments.

As far as home loan receivable, that amount did not go up as high. What happened with that number was that, you know, back in -- as Steve has explained prior, that in September of 2008, we were having trouble -- you know, we didn't get to issue bonds since that time. So we had no new loan programs to go out there and increase that balance. And also in December of 2008, we had the warehouse -- our PMIB warehouse line of credit was frozen.

As far as the bonds payable, that amount did go down. We were able to do some refundings during the year and, you know, regular redemptions.

As far as our equity, our equity did go up during the year. The result was about a $302 million increase. But $446 million, approximately that amount came in through transfers from either HCD or Department of Mental Health. And that was offset by a $146 million loss. So it was about an increase of about $302 million.

MR. SPEARS: Can I just make one note before you leave the balance sheet?

Over the past several years, if you've been sitting here, the loans receivable net had been going up by at least a billion dollars a year. This is the first year it's declined. I believe last year it was about eight-point-four-something. It's declined to about $113 million for a variety of reasons. One is payoffs, but also loan losses, loans that have been written off over that period of time.

So that's significant. It just basically remained flat from one year to the next, instead of growing like it has in the past.

And the other is, on the equity, it's true that the equity did go up. Those funds are restricted, so they're not available to put against loan losses.

The other thing that's in that equity number is that we have taken balances out of that equity number and put them over against loan losses, so the net includes more loan-loss reserves in that number. So there's some moving around.

But when I talked about before that reserves had been managed heretofore, they're in that equity number. They're in that $1.7 billion.

What we could have done previously is spent part of that equity on downpayment assistance or other programs and that sort of thing. We haven't. In the past, those have been allowed to stay there in case something like we have today, something like loan losses, that need to be offset.

Now, we can move on to the --

MS. HAMAHASHI: Okay, in this slide, we're showing that this year, in our operating revenue side, we did have an increase in the interest-income programs net of about $50 million. And the interest income over investments dropped, primarily due to the fact that we did move over some higher-earning funds, from the GICs over to SMIF, which is paying a little bit lower.

As far as on the operating-expense side of the income statement, we had higher interest amounts to pay out related to the debt service of the bonds. And the swap expenses increased dramatically. There has been about $188 million increase in the other expenses line item. And that was primarily due to all the swap expenses, the fair value, the termination payments that went on with all the hedging activity of the Agency.

At the end of the year, we're looking at $146.1 million loss.

MR. HUDSON: When you take an actual loss on the property, where does it show up?

MS. HAMAHASHI: It is over here on the balance sheet. We're showing the write-off for the REO portfolio, is about 4.1 for the year, and we --

MR. HUDSON: So you have to take it as an expense? If you take a loss on a property, you don't have to show it as an expense?

MS. HAMAHASHI: We've already reserved for that, throughout -- while the loan is delinquent.

MR. HUDSON: So you've already reserved for it.

So the reserves show up as an expense then?

MR. SPEARS: Yes.

MS. HAMAHASHI: Yes.

MR. HUDSON: Where would they be? Are they on the --

MS. HAMAHASHI: The reserve, it's in the "Other programs and accounts."

MR. SPEARS: Well, but on this, it would be under "Other expenses."

MS. HAMAHASHI: "Other expenses." Yes.

MR. HUDSON: And how much of the other expenses is loan-loss reserves?

MS. HAMAHASHI: It's $80,132,000 is what the gap reserve is.

MR. HUDSON: June 30th is our year-end?

MR. SPEARS: Yes. We have a different year-end for the Mortgage Insurance Fund. It's 12/31. There is a separate fund for that. It's independently audited by Deloitte. So we'll get a report of that in the spring. It's not combined with this fund in the consolidated financial statements because they are two completely different operations.

MR. SMITH: If there are no other questions, I just want to commend the staff. I know we may not like the numbers, but the audit does reflect that it is a fair representation of the condition of the Agency and the funds. So it's nice to know that our staff has done a good job, even though we may not like the numbers.

So congratulations.

MS. HAMAHASHI: Thank you.

CHAIR CAREY: Any other questions or concerns?

MR. SPEARS: No, I just hope it's not a personal reflection on my acting directorship.

CHAIR CAREY: And for the record, the acting chair joins you in that.

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Item 7. Closed Session

CHAIR CAREY: With that, we are going to go into closed session under Government Code 11126(e)(1) and 11126(e)(2)(B)(i) to confer with and receive advice from counsel.

And with that, we are in closed session.

(The Board of Directors met in closed session from 12:07 p.m. to 2:09 p.m.)

CHAIR CAREY: We're back in open session.

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Item 8. Report, discussion, and possible action regarding the adoption of a resolution approving the Two-Year Business Plan

CHAIR CAREY: And we're up to Item 8 on the agenda. As we get there, I will just ask, out of consideration for everyone, if we could keep things to the point from the presentation point of view.

And also, I'd like to say that I think that the memos in the packet were helpful this time in explaining the issues as we got here.

Okay, Steve, Item 8?

MR. SPEARS: All right. If I could ask Bob Deaner and Gary Braunstein, and probably Margaret -- we might as well go ahead, if we can do that now.

And, Bruce, if you will be on-call for the

Item 10 issue.

MS. ALVAREZ: I get to be the rose.

MR. SPEARS: If somebody could hit the "page down" button there.

This is a slide that we presented, I believe at the May Board meeting, where it talked about the way we used to do business in the left-hand box, the way we need to do business in the future in the right-hand box, and the things that we were going to be doing between now and then.

Most of these things we are still working on. A couple of the transitional activities have gone by the wayside. But I think what we want to do today is focus on what impact the federal program will have on business going forward and our business planning going forward for the rest of this year and all of the following year.

So to move things forward, I think what I'll try to do is get through the slides -- Bob and Margaret and Gary are here to answer your questions.

Let's go to the next slide, if you will.

And this is a debate that we need to have. On the homeownership side, remember that the new-issue bond program element of the federal package allocated -- or the U.S. Treasury has agreed to purchase a billion dollars of bonds for the homeownership program. Another

40 percent would have to be issued to the private sector. That gives us quite a huge number for capacity over the next two fiscal years.

Gary is working on developing, revising -- I think that's probably the correct term at this point -- of three first-mortgage products, and really sort of returning to the basics, and that is fixed-rate, fully amortizing, 30-year mortgages. An FHA product that has 96½ percent LTV, that's up to that, and two conventional loan products. One that has 100 percent LTV. It is offered by Fannie Mae. It is insurance-type product that they will offer up to 100 percent LTV. But also we could continue to offer a conventional product where the person would go out and get non-CalHFA private mortgage insurance. I think at this point in time, most private mortgage insurers will only insure up to 90 percent LTV.

Lynn, do you have a question?

MS. JACOBS: On the Fannie Mae 100 percent program --

MR. SPEARS: Yes.

MS. JACOBS: -- at what point does CalHFA have any liability for the loan? At what dollar amount? At what percentage of the loan?

MR. SPEARS: I believe it's a 35 percent primary coverage. But remember that all of these products, rather than us owning the loan in this new scenario, the indenture will not own whole loans. So we use the loan proceeds to buy mortgage-backed securities that are guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae, in the case of FHAs.

MS. JACOBS: Okay, so what would CalHFA's liability be on these products?

MR. SPEARS: None.

MS. JACOBS: None?

MR. SPEARS: Because we would own --

MS. JACOBS: Okay, I'll remember you said that.

MR. SPEARS: -- we would own -- yes, write that down somewhere.

But because we own the mortgage-backed security that's guaranteed by GSE, the responsibility for the whole loan losses go to the owner of the loan, which is not us.

MS. JACOBS: So you're just a pass-through, basically?

MR. SPEARS: We're a pass-through --

MS. JACOBS: Where you process the loan --

MR. SPEARS: Yes, and the payments go --

MS. JACOBS: -- and you sell the loan basically? Or you're underwriting for them?

MR. SPEARS: Right. At any point that that pass-through stream is interrupted by --

MS. JACOBS: Flood, fire, or famine.

MR. SPEARS: -- the GSEs pick up the tab.

MS. JACOBS: Okay, excellent.

CHAIR CAREY: Do you want to add something, Gary?

MR. BRAUNSTEIN: Well, I was going to say, because it's an MBS business model versus a whole loan business model, Steve answered that the risk does get deferred off to the GSE. There's some other parts to the loan product that are being developed by Fannie Mae that will be coming out down the road that completely hasn't yet been vetted out. But on an initial term sheet we received from Fannie Mae, it's a 100 percent loan-to-value that is not including the requirement of mortgage insurance.

My take is that Fannie is self-insuring that loan and will be priced within the loan, which we in turn will be pricing our loan accordingly.

MR. SPEARS: On downpayment assistance, it's going to be more limited -- limited availability from CalHFA, let me put it that way.

CHDAP loans are subordinate loans. They're funded by state G.O. bond funds. SFF stands for "school facility fee." That's also many funded by the G.O. bond.

At present, that program is suspended. We would like to get more funds in there. We're either going to look to more bond funds in the future, which may be difficult, or we may go and talk to Lynn for Prop. 1C money. But either way, we're going to do the best we can to revive that program.

But importantly, localities -- cities, local redevelopment agencies -- have downpayment-assistance money available. And we're going to partner with those folks, like we have done in the past, but probably a stronger partnership because of that.

MS. PETERS: Steve, do you know which localities actually have the funds versus have the possibility of the funds? A lot of localities have downpayment assistance, but --

MR. SPEARS: Right. Let me let Gary --

MS. PETERS: -- but they've become victims of budget, like everyone else, and the window is closed, as far as I know.

MR. BRAUNSTEIN: Heather, if I can just answer that briefly.

In our division, we are reaching out currently to the localities and surveying them on an individual reach-out to cross-reference do they have monies, when is their allocation coming through? And we're tiering that down through the 350 programs that are part of our Affordable Housing Partnership Program, which is the locality downpayment assistance.

MS. PETERS: Great.

MR. SPEARS: So we're working on setting up these programs so that we're timed and ready to go when bonds are available in the new program.

The thought is that -- of course, right now the Federal Reserve, through the U.S. Treasury, are buying about a trillion and a quarter of mortgage securities to stabilize the market. That buying spree, if you will, is scheduled to be over next spring. At that point, the general thought is that mortgage rates will drift up, or immediately bounce up, anywhere from a half a point to, you know, 80 basis points, something on that order.

Besides that, as noted in the last time the Federal Open Market Committee met, they seemed to indicate that they would be open to a general level of interest-rate increases into next year. So the general thought is that interest rates on mortgages are going to move up as the year progresses next year.

The other general feeling is that not until possibly late next year, but we could begin to see a turnaround in home prices. A flattening out and moving up in certain markets. And we should never forget that

California is a collection of a number of different real estate markets around the state. And many of those markets are doing poorly at this point, and will turn around -- some are not doing secondly at all and some are doing very well. A few are doing very well.

Between those two signals, you started to see increases in mortgage rates and starting to see increases in home prices. I believe that's going to trigger a lot of interest in first-time home buyers who have been sitting on the sidelines, who are going to get in the game and want to buy their first house, and that is, will be customers of ours.

So I would see demand picking up as the year progresses into 2010.

So I don't think we'll see a lot of volume in the first -- you know, the rest of this fiscal year -- not tons, but it will build, this projection, down the road, as we get into late next year.

MR. BRAUNSTEIN: I just want to make a comment to the newer Board members, and I'll keep it brief.

I just wanted to point out that CalHFA is not a direct lender to the general public. We're an investor like the other GSEs. And we have a network of approved lenders that we work with. So, in essence, they are our client, our customer.

So when we look at loan programs, we also take into account what value-adds do we need to incorporate in those loan programs to allow that network of lenders to be interested in using our loan programs instead of their own loan programs themselves as individual mortgage lenders or mortgage bankers.

So as we look at these different programs, we'll vet out further internally how we could add additional value-adds to these products to allow those lenders to consider using CalHFA loan programs.

And just one other point we didn't mention in the bullet is that we'll be using a master servicer and, therefore, will not be servicing these loans ourselves. So additionally, reps and warranties in using a master servicer also do get passed off to that master servicer in that scenario.

MR. HUDSON: But why do lenders go to us if they can go directly to Fannie Mae or FHA?

MR. BRAUNSTEIN: Typically, in the past, when there was a larger spread in the taxes and bonds versus the taxable bonds, they would come to us because we were offering a much lower interest rate on either an FHA product or a conventional product.

We also have downpayment assistance available as a government agency that the banks and mortgage lenders that are part of our network do not have.

MR. HUDSON: But today, why would they?

MR. BRAUNSTEIN: A, the downpayment assistance. And as we look at pricing out the FHA product and the conventional product, we're looking at being below market rate on both of those.

MR. SPEARS: With the U.S. Treasury program buying our bonds, that should result in a lower cost, lower rate.

MR. HUDSON: So a real number would be a mortgage broker can do a loan through us at a rate X, and then we turn around and sell it with a spread to Fannie and Freddie?

MR. BRAUNSTEIN: Well, a mortgage broker would go to one of our approved lenders through their wholesale channel.

MR. HUDSON: Right.

MR. BRAUNSTEIN: That lender would choose to use our lending program versus their own because the rate is lesser than what they can get themselves, A; or, B, the downpayment assistance opportunity that we provide, that they cannot provide, would also drive them to use our loan products.

MR. HUDSON: Okay, and then we -- so they originated the loan because it's cheaper, the pricing is lower. We have the bonds. But I thought we were delivering all this stuff to --

MR. SPEARS: No, not for cash. We're delivering for MBS.

MR. HUDSON: Oh, so the cash program we're portfolioing?

MR. SPEARS: In the past what we did, we used the bond proceeds to buy whole loans.

In this particular, we're going to use master servicers to package those loans, create a mortgage-backed security, which we buy with the bond proceeds. The loans go on to Fannie Mae and Freddie Mac and Ginnie Mae.

MR. BRAUNSTEIN: One more piece for clarity.

MR. HUDSON: Whoa, hold on. I'm not done yet.

So I'm a lender that works with CHFA, I get a rate -- so you issue a bond, you have these proceeds that you've invested in loans.

MR. SPEARS: Uh-huh.

MR. HUDSON: I have a borrower that wants to use your product. They qualify, but they don't get those bond proceeds?

MR. SPEARS: They qualified?

MR. HUDSON: Yes.

MR. SPEARS: The loan is closed.

MR. HUDSON: Yes.

MR. SPEARS: Funded.

MR. HUDSON: With whose money?

MR. SPEARS: With the bank's money.

MR. HUDSON: The bank's money? Yes.

MR. SPEARS: The bank's money.

The loan then is delivered to the master servicer, where they're pooled into securities. Then we use the bond proceeds to buy those securities from the master servicer.

MR. HUDSON: Yes, and so we hold those securities?

MR. SPEARS: Yes, right.

In the past, we held whole loans, which is the source of our previous conversations.

MR. HUDSON: And why is this advantageous to us to do it this way?

MR. SPEARS: Because for a guaranteed fee paid to the GSEs, they own the whole loan, take the risk, guarantee the income stream to the bondholders.

MR. HUDSON: So -- wait. So we buy these securities and then we pass them on to Fannie Mae?

MR. SPEARS: No, we hold them ourselves.

MR. HUDSON: Okay, then why do you say Fannie Mae -- how is Fannie Mae even involved in it if we hold them?

MS. JACOBS: Well, they get the loan -- the underlying loan; right?

MR. SPEARS: Yes.

MR. HUDSON: Oh, so the securitizing is sold to Fannie Mae?

MR. SPEARS: Yes, yes, yes.

MR. HUDSON: I thought -- ah.

I thought we were --

MR. SPEARS: We're buying Fannie Mae MBS securities and Ginnie Mae securities.

MR. HUDSON: Okay, so it's our rate, but Fannie Mae will securitize them and buy them at our rate, and then we turn around and buy them right back from Fannie Mae?

MR. SPEARS: Yes.

MR. HUDSON: And what that gives us is the protection of Fannie Mae?

MR. SPEARS: Yes, exactly. And Freddie Mac.

MS. PETERS: And no more real-estate risk.

MR. SPEARS: And Ginnie Mae.

MR. HUDSON: And we can design our own underwriting guidelines, as long as they're not more liberal than Fannie Mae; no? Yes?

MR. BRAUNSTEIN: Well, yes. For example, if the loan is -- for the conventional loan product that we're delivering to Fannie Mae, we would be following their underwriting guideline, or put on more restrictive guidelines, and our lenders would use the more restrictive underwriting guideline between our CalHFA underwriting guidelines or Fannie Mae's guideline.

MR. HUDSON: So why would we do 100 percent Fannie Mae LTVs?

MR. BRAUNSTEIN: Well, for one, this product newly offered by Fannie Mae is exclusive only to HFAs.

MR. HUDSON: Okay. You make it sound like they are giving us a bargain. Does that mean it's a bargain because they're only given to HFAs?

MR. BRAUNSTEIN: Well, yes, because the general public mortgage -- the general public and the mortgage lenders would not have access to this loan program, hence, they would not have access to 100 percent loan-to-value program with no M.I.

MS. PETERS: More borrowers would come to us rather than when they went to subprime lenders.

MR. HUDSON: Oh, that part I get. That part I get.

But as a lender, I'd say you can have all that market. I'll take the market that --

MS. JACOBS: As a down payment.

MR. HUDSON: Yes, as a down payment.

MS. JACOBS: Yes. But it removes the risk to CalHFA the way these are being booked; right?

MR. SPEARS: Yes, the real-estate risk.

MS. JACOBS: Yes.

MR. HUDSON: Because Fannie Mae had it?

MR. SPEARS: Yes.

MR. HUDSON: Do you believe Fannie Mae is going to be around for it? You've underwritten Fannie Mae. Do you believe Fannie Mae is going to be here?

MR. SPEARS: My personal feeling is that Fannie Mae and Freddie Mac will exist as a combined organization somewhere down the road.

MR. HUDSON: Okay.

MR. BRAUNSTEIN: Another point of reference is, our typical borrower as a first-time homebuyer for low- and moderate-income families typically will have a lesser down payment available to them. So the higher loan-to-values, such as an FHA loan product or the new Fannie Mae product at 100 percent without mortgage insurance, becomes a unique product capable of benefiting our current borrower base for our mortgage lenders who target that type of low- and moderate-income family in California.

MR. HUDSON: And so you've distinguished this from subprime lending because it's -- you verified incomes and you verified they can make the monthly payment and it's amortized?

MS. PETERS: And the FICO score.

MR. BRAUNSTEIN: 30-year amortized loans. They're all underwritten to a Fannie Mae MyCommunityMortgage loan product, underwritten model, with debt service and the necessary verification of income, assets, et cetera, and FICO scores that are dictating the underwriting component of this particular product.

So the conventional loan product that you probably are most familiar with at 80 percent or below with no mortgage insurance, or a conventional product with mortgage insurance included, we would still have that product available in the bullet -- the second bullet under where it says, "conventional loans." That's still an 80 percent to 90 percent loan-to-value conventional product with outside private mortgage insurance, underwritten to Fannie Mae underwritten guidelines.

The 100 percent new loan-to-value product by Fannie Mae is, again, geared off of their underwriting model at 100 percent loan-to-value.

MR. HUDSON: Everything we're doing is going to be securitized in Freddie Mac and Fannie Mae?

MR. SPEARS: Yes, sir, Fannie or Freddie or Ginnie.

MR. HUDSON: Right, okay.

MR. SPEARS: Right.

MS. PETERS: Everything, or just this new 100 percent product?

MR. SPEARS: Everything.

MS. PETERS: Everything?

MR. SMITH: And even if Fannie and Freddie are not around, it's not our liability.

MR. HUDSON: Well, yes, it is. It's not our liability, but --

MR. SMITH: Our stock would be worthless.

MR. HUDSON: -- we're like a bondholder.

MR. SMITH: Yes, our stock would be worthless.

MR. HUDSON: If they don't send us those monthly payments, we've got a big problem.

MR. SPEARS: That is correct.

It's better than holding whole loans, but it does take on additional --

MR. HUDSON: That's what our bondholders said about us.

MR. SPEARS: Yes, sir.

Okay, the next slide, unless someone has another question about the homeownership.

On the multifamily side, the MHSA program for the newer bondholders is the Mental Health Services Act, which was a proposition on the ballot in -- I want to say 2004; right? -- and dedicates a certain amount of money for housing for the chronically mentally ill homeless.

Jonathan has personal experience with this because when we went to his office to brief him, he had a nice, big opening -- or tombstone, I guess is the word for it -- in the corner of his office.

It's a terrific program. We are the administrator of these funds. We had another additional -- we had an additional $350 million this year to do that. We mentioned that before in the financial statements. We're going to continue with that. But also focus on new loans through this newish -- new bond program from the U.S. Treasury. It provides us $380 million in commitments to buy CalHFA bonds.

But here again, we're not going to take 100 percent risk on multifamily loans on a going-forward basis. We're going to do risk-share because we don't believe that we can take 100 percent risk on our balance sheet.

What that means on the profitability side is, if we do risk-share, we're going to have to share the profit with someone else, and that will be a little more expensive down the road. But that's the situation we find ourselves in.

For the time being, we're just cutting back on the real-estate risk on the balance sheet.

The final item there, the final bullet, is the Tax Credit Allocation Committee was given administration responsibilities on two programs under our -- a tax credit of --

MS. JACOBS: Exchange.

MR. SPEARS: -- exchange program. But there's also the TCAP program.

The tax-credit market has basically not collapsed, but substantially declined. And many projects that planned on tax-credit equity now find themselves with a planned-on price in the low 90 percent range, they're down in the 70 percent range, they need -- gap financing does that. But also, they can turn in tax credits that were allocated before in exchange for cash to be used on projects.

The Tax Credit Allocation Committee does not have staff that do that sort of thing. They've asked CalHFA if they would help out.

So we are assisting, for a fee, to approve these on behalf of the Tax Credit Allocation Committee and send them back over.

We already have 35 of these projects. We've already turned around four or five of them, and so that work has already started. So that's an additional fee revenue source for us in the future.

Speaking of which, on to the next -- I'm sorry, Jon?

MR. HUNTER: It may just be me fantasizing when I was reading the descriptions of this. But the $380 million, is there any chance that that could be structured in a way that would help with construction loans, to move some of these stalled projects?

MR. DEANER: Unfortunately, no. I've got real strong connections with Fannie Mae. I used to be a Fannie Mae DUS lender. And the way they've structured this program, Fannie and Freddie -- because, again, they're the overseers of this money, it goes through them and Treasury buys the bonds -- they're structuring a program where there's no construction risk. And what that means is, they want a letter of credit from a bank to back the bonds during construction. That's their typical model.

We've been a construction perm lender, and that's what we prefer to do. But they will not take our general obligation as -- almost like a letter of credit. I've asked them, "Would you take our G.O. as the letter of credit so we can be the construction perm lender?" Their answer is, "No, because this program is for all HFAs, and it said such that we want a letter of credit to back during the construction phase."

What that really means is, the letter of credit is in favor of Fannie Mae. In the event the deal doesn't convert, they collapse the bonds and they get paid off. And so they do want letters of credit. That's going to be the biggest stepping-stone in this program, is getting banks to step up and provide letters of credit on construction deals.

MR. SPEARS: Asset Management is the next slide.

The great thing about Margaret's division is that their work keeps increasing. As loans are closed in Bob's division, those properties move over and Margaret has more and more work to do all the time for her. And we now have about 500 properties that they inspect, they audit, they oversee.

The problem, though, is that the portfolio is aging. We have projects that need rehab, recapitalization. We need to work out a prepayment policy, which we've been debating and debating and debating. We're trying to get a rational way to do that. And we're working on that right now.

But one thing that actually HUD has expressed interest in us doing, even though it's an open contract competition, and that is to participate in the Performance-Based Contract Administration. We are responding -- in the process of responding to an RFP -- or that doesn't come out until January, I'm sorry.

MS. ALVAREZ: Not until January.

MR. SPEARS: We've sent out an RFP for someone to help us with that.

MS. ALVAREZ: Right.

MR. SPEARS: But that takes us to Item 9.

Is that right, Mr. Chairman? Do we move on?

MS. JACOBS: You haven't done anything on 8; right?

MR. SPEARS: It's just an update. Obviously, we'll have much more to talk about in January, when all of the federal program is in place.

Gary's work is done and Bob's work is done on the new loan products.

CHAIR CAREY: We'll plan on a long meeting then.

MR. SPEARS: Right, right.

MS. JACOBS: Yes, instead of a short one like this one.

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Item 9. Discussion, recommendation, and possible action regarding the bidding for a contract to perform Performance-Based Contract Administration (PBCA) services on behalf of HUD

MR. SPEARS: So this Performance-Based Contract Administration is Margaret's baby. It is something that HUD specifically expressed interest in us doing. It is now going to be open for rebidding through an RFP process in January. And we are coming to the Board for authority to pursue this program.

It's an additional revenue source. So we're in a bit of a quandary about whether this comes to the Board or not.

Contracts where we spend more than a million dollars a year come to the Board. We weren't sure about contracts that bring in more than a million dollars a year. So we played it safe and decided to bring it in.

So, Margaret, do you want to make a couple of comments about this, and go show your slides, and we'll get the resolution?

MS. ALVAREZ: Sure.

As a contract administrator, our Agency has been a contract administrator for HUD since 1975, when we came into existence with the Section 8 program.

There's two different Section 8 programs under

HUD for housing. One is the voucher program that is transportable that go to an individual. We're not talking about the voucher program at all. We don't do anything at all with vouchers. This is all project-based Section 8, where the actual apartment community gets the HUD subsidy, and then the contract administrator oversees it.

So we're right now what you call a "traditional contract administrator," which all the housing finance agencies are termed that. And that simply means that we have the contract administration obligations for those properties where we are also the lender.

The PBCA program, you become the contract administrator for everybody else's properties where you are not the lender. So that's where the distinguishings are.

Our overall duties as a contract administrator is that you oversee the use of the subsidy that HUD gives to the lower-income tenants for the rents or that they use for that.

We make sure the tenant compliance is met. We do physical inspections and also the financial review on behalf of HUD, which means the rent increases, budget approvals, annual audits, owner distributions, capital improvements -- all that type of work. So in general, that's what a contract administrator does.

We already get paid as a traditional contract administrator. Our fees annually are about $1.6 million for the 130 properties that we oversee. So all this PBCA that I'm going to be talking about is a new program in addition to our traditional contract administration duties.

So the PBCA program started in 2000, like the slide shows. And at that time, our Agency did not pursue being the PBCA. I wrote a memo in the Board binder that kind of explains our reasons why.

But the Federal Government created the PBCA program hopefully as a cost-saving to the Federal Government, and also to standardize the oversight, so that everybody was doing it the same.

One of the by-products of the PBCA program is that the traditional contract administrators have been more and more required to act as if they were a PBCA. We no longer kind of do things our way and PBCAs do things their way. It's all pretty much done the PBCA way. So already, we're kind of doing it, if you will.

So as the program was envisioned, all 50 states have a PBCA -- and the District of Columbia. And 33 state housing finance agencies signed up in 2000 to be PBCAs. And the 17 states that didn't do it, most of us are bidding for it now in this next round.

So when we were considering the PBCA, one of the things that we realized is that we really need to partner with an outside organization.

I would point out that we don't really know from HUD what their RFP is exactly. It gets published in January. There's been a lot of rumblings of what it will include and what the duties will be required and what the fees will be. But it's really not known until their RFP comes out in January. So some of this, we just have to take our best guess.

And the other thing I would point out is that a public housing agency has to be a PBCA. So if we don't do it, another housing finance agency from another state would likely come and ask to do it for California or a local housing finance -- local housing authority, that type of thing.

But it's really proven to be a very good resource for the housing finance agencies who did sign up for it and been really quite a good financial resource for creating other programs through the Agency with the fees that they earn from the program.

So like I said, we would partner with an outside organization. We have sent out our own RFP, asking for someone to partner with us.

As best we can tell now by looking at the current PBCA contract, it's about 1,300 contracts, almost 90,000 units. And the base fee would be somewhere in the ballpark of $14 million a year. So, obviously, that's the gross fee. We would have to pay our vendor some split of that. And all that's unknown until we get further down the road.

So our RFP hopes to engage a vendor sometime in the month of December, so that in January, when the RFP gets published by HUD, we can hit the ground running and our vendor can help us put that application together.

The application period to HUD, we understand, will be sometime in March. And then they, by September of 2010, would notify the successful bidders. And then you have until the end of 2010 to ramp up, to start the actual work, which would begin on January 1st, 2011. And it's to be a five-year contract with some one-year renewals.

So that's what we know.

And I would just point out that, in closing, that we already perform this work, so this is something that we can very easily oversee with the vendor.

We would have the vendor do all 100 percent of the work of the PBCA. Some states, housing finance agencies, do the work themselves. It's clearly a much smaller business in those states. Some do some of it with the vendor and some of it on their own. And other states, like Michigan, contract out the whole shebang. And we would probably take that model and contract out the whole shebang.

And, again, it would provide money for our much-needed financial programs for affordable housing.

And if we don't do it, another HFA will. For instance, Georgia is likely to be one of our bidders on this with the RFP process. But I personally wouldn't be surprised if they also bid for the contract.

So it's not a done deal that if we bid, we would get it. There will be many, many people wanting this contract because at $14 million, it's the biggest PBCA contract in the country, and it's a plum prize. And I would expect many, many agencies and HFAs will also be bidding for the work.

I'm happy to answer any questions.

CHAIR CAREY: Lynn?

MS. JACOBS: I think it's great. I have no problem with you guys doing it.

Since we act as the housing authority for a number of counties, I would like it if you would coordinate with our housing department to make sure you cover our stuff.

Okay, we're the Section 8 administrator, and it's mostly vouchers, which I know you'd love to take if you could. But some of it is project-based, so I want to make sure that we get in your --

MS. ALVAREZ: Oh, okay.

MS. JACOBS: -- you know, make sure that you cover us. Okay?

MS. ALVAREZ: All right.

CHAIR CAREY: Other questions?

MR. HUDSON: $14 million is the gross number.

What would be the net number to us?

MS. ALVAREZ: I can't answer that. I think you had stepped out when I answered that HUD hasn't published their RFP. It comes out sometime in January.

This last ten-year period, it was a 1 percent base fee, which is where we get the $14 million. And then each of the PBCAs could earn an additional 1 percent on top of that as an incentive fee. So it actually was more like $28 million these last ten years.

Every one of the PBCAs got the 1 percent incentive fee. So, in essence, everybody was earning 2 percent of the contract amount.

HUD has decided, we think -- we don't know yet because the RFP has not come out -- but they've decided to not give the incentive fee but to, instead, give a disincentive penalty if you do something wrong. So they're going to --

MR. HUDSON: If we're getting 14 -- you're talking about outsourcing it; right?

MS. ALVAREZ: Yes.

MR. HUDSON: So we would net. What's the net then?

MR. SPEARS: Do we know yet?

MS. ALVAREZ: We don't know yet.

MR. SPEARS: The RFP is out right now to the contractors. So we're finding out what that price would be.

MR. HUDSON: But I'm assuming if you outsource the whole nut, it's not at big numbers to us? I mean, I assume they would take 80 to 90 percent of it, or do you think it would be less?

MS. ALVAREZ: I am reluctant to say because the RFP is out and these minutes are public. So I do not want to give away what we would give away. But, you know, my staff asked that question, too, and we kicked that around.

MR. HUDSON: Okay.

MS. ALVAREZ: Anything more than what we make, is more than what we make.

MR. HUDSON: Very true. I like your math.

MR. SPEARS: We do have a Board action item on this.

MS. JACOBS: Move approval of the recommended item.

May I or not?

CHAIR CAREY: You may.

MR. HUNTER: Second.

CHAIR CAREY: It's been moved and seconded.

Before we act, is there anyone in the public who would like to comment on this action item?

(No response)

CHAIR CAREY: Seeing none, we'll take roll call.

MS. OJIMA: Thank you.

Ms. Peters?

MS. PETERS: Yes.

MS. OJIMA: Mr. Gunning?

(No response)

MS. OJIMA: Mr. Hudson?

MR. HUDSON: Yes.

MS. OJIMA: Mr. Hunter?

MR. HUNTER: Yes.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Yes.

MS. OJIMA: Ms. Carroll?

MS. CARROLL: Yes.

MS. OJIMA: Mr. Smith?

MR. SMITH: Yes.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Yes.

MS. OJIMA: Resolution 09-15 has been approved.

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Item 10. Discussion, recommendation, and possible action regarding a refinancing of a portion of the multifamily loan portfolio

CHAIR CAREY: And we're on to Item 10, multifamily's loan portfolio.

MR. GILBERTSON: Thank you, Mr. Chairman. I think we can do this relative quickly.

In front of you is Resolution 09-16. This would authorize the Agency to enter into a form of a refinancing of certain of the multifamily loans.

Let me just step back and give you a little bit of background. We've been in front of the Board several times this year regarding loan sales of different things.

At one point, we presented to you the concept that we were considering doing a much larger loan sale on the multifamily side. And it was this, you know, TEBS transaction that Citigroup was in the middle of helping us with. This would have been a securitization thing with Freddie Mac. It ultimately wasn't something that we wanted to proceed once we became more aware of costs and related elements.

But out of that came this notion because Citi had actually received an entire loan tape for all of our multifamily loans, they were looking for CRA credits. And so they identified approximately $105 million of our loans that they would be interested in acquiring in one form or another so that they could meet their ongoing CRA needs in the state. Ultimately, that led to more serious discussions with them.

We've bifurcated that portfolio into two pieces: A $70 million component and a $35 million component. The reasons behind all that really relate to business terms that we felt that we needed because we were uncertain where our borrowers would go as far as requesting prepayment under their loan with us over time.

So we're very comfortable giving a five-year lock-out to Citi for the $70 million piece.

The $35 million piece, we've told Citi that we couldn't honor that same business term. We would have to have the ability to prepay our loan from them on any day. Okay, so there would be no form of a lock-out.

The purpose of this is really to do a couple of simple things: One is, in large part, these loans are financed with those variable-rate demand obligations that we spent a lot of time talking about today. If we refinance it in a new form with Citi, it would be a fixed-rate obligation, we would be able to use the proceeds from the sale to redeem bonds, and we'd lessen that total that we have outstanding.

It would pay us an ongoing servicing fee because Margaret and her crew would still have the Asset Management oversight, because we were the original lender to the borrower, and we would service the loans. The same rules that we play today. We'd receive the 20-basis-point fee for that purpose.

Certain of the loans -- a relatively small amount, I believe it's $15 million -- are unencumbered today. So we'd be raising converting loans to cash, increasing the liquidity of the Agency by approximately $15 million.

The resolution in front of you is just to make clear that we have full authority to enter into a binding agreement with Citi between now and February. It's expected to close probably by mid to late February. It's very similar to some of the other authorizations, but it has a little -- a slight difference. It's always best to come back to the Board and making sure that we're fully explaining this to you.

With that, I'll stop and see if there's any questions that I can respond to.

CHAIR CAREY: Questions from the Board?

MS. PETERS: Move to adopt Resolution 09-16.

CHAIR CAREY: Thank you.

MS. JACOBS: I have a question. I'm happy to --

CHAIR CAREY: Let's have a second, and then --

MS. JACOBS: I'll second and ask a question.

CHAIR CAREY: Sure.

MS. JACOBS: It says "executive director" all the way through this. Do we have to add "acting"?

MR. HUGHES: We continue to use the "executive director" term. The Board has delegated to Steve all the powers of the executive director. If they were appointed ones, we'd use the same term.

MS. JACOBS: Okay, thanks.

CHAIR CAREY: Okay, it's been moved and seconded.

Is there any further discussion from the Board?

(No response)

CHAIR CAREY: This is an action. If there is anyone in the audience who wishes to speak to this item, please indicate.

(No response)

CHAIR CAREY: Seeing none, let's call the roll.

MS. OJIMA: Thank you.

Ms. Peters?

MS. PETERS: Yes.

MS. OJIMA: Mr. Hudson?

MR. HUDSON: Yes.

MS. OJIMA: Mr. Hunter?

MR. HUNTER: Yes.

MS. OJIMA: Ms. Jacobs?

MS. JACOBS: Yes.

MS. OJIMA: Ms. Carroll?

MS. CARROLL: Yes.

MS. OJIMA: Mr. Smith?

MR. SMITH: Yes.

MS. OJIMA: Mr. Carey?

CHAIR CAREY: Yes.

MS. OJIMA: Resolution 09-16 has been approved.

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Item 11. Budget update

CHAIR CAREY: Okay, we're up to the update on the budget, a brief update on the budget.

MR. SPEARS: A brief update on the budget, just to let you know how we finished last year and how we're doing so far this year.

So, first of all, the operating budget that was adopted for last fiscal year, 2008-09 was $46.2 million. 311 positions not all filled. And actual expenditures wound up $7 million under that, attributable to the fact that we did not spend as much on strategic projects, including systems work that we've been talking about, deferred to later times. Impact of the furlough plan, at least through February to June, at I think pretty much a two-day-a-month pace.

MR. IWATA: Yes.

MR. SPEARS: Increased staff vacancies over what we thought there would be.

But we did do a lot of soul-searching about who went to what conference, what travel was involved, and cut back on that substantially.

The next slide, in July 2009, this Board approved a $47.9 million budget. Again, 311 positions. That assumed a two-day-a-month furlough plan. It assumed 30 staff positions would remain vacant until we knew more about the federal plan, and then at that point, then we would come back to the Board and let you guys know what we thought was going to happen volumewise in lending and staffing and that sort of thing.

The actual results are as follows:

We've spent, in the first 25 percent of the year, only 17 percent of the budget, $8 million. But there are a lot of contracts on deliverables for the strategic projects and other things that had not been billed at September 30. And instead of having 30 vacant positions at this point, we have 44. And some of that is due to retirements, which I'm sure, Lynn, you've had some of the same experiences of people who have said because of the furlough program, we're contributing to the state instead of our retirement, so we're going to retire.

The exam process, though, has been difficult. And I understand the State Personnel Board exams system was down for some time, which hampered us --

MS. JACOBS: And nobody noticed.

MR. SPEARS: We noticed because we were trying to fill some positions and could not.

So now I would go to this last bullet here with a little bit of caution.

Based on our spending so far, if we kept doing what we are doing today, we would spend about $38.5 million for the entire year of the $47.9 million. But that's not taking into account additional lending that we will do, now that we know that the federal plan is in place. So I take that with kind of a grain of salt, if you will. And we can move on to the next slide.

We pretty much talked about this. So I don't think there's a lot more to be said. But the additional lending opportunities that are possible with the federal program will mean that we are doing all the things that we've talked about on loan servicing, loan modifications, loss mitigation, REO management; and add to that new lending.

So all the people that we moved from loan production over to those other activities while we were not lending, will now have to go back, and we will now have to take a look at filling positions and doing this work.

MR. HUDSON: So you're not going to shrink Asset Management, Loss Mitigation?

MR. SPEARS: No, sir. We'll have to fill vacancies as we go along.

Here again, I don't --

MR. HUDSON: Because the future of the Agency is based more on what we do with our loss mitigation than what we do with our production?

MR. SPEARS: Yes, it is. Yes, it is. We will not lose sight of the fact that that basket of assets that we have in the form of loans has got to be managed, and it has got to be managed in a very, very attentive way.

MR. HUDSON: And if you ask the Board for an increase in that staffing, there's nothing that the

State's doing that could impact that; right? I mean, could you do that?

MR. SPEARS: Other than the furlough plan?

MR. HUDSON: Other than the furlough plan.

MR. SPEARS: No, they are not throwing up any roadblocks to that.

We have additional ability that other agencies and the state departments don't have a hiring of temporary employees, of authorizing overtime, that sort of thing, because of our operational independence.

MR. HUDSON: I was just asking the question.

MR. SPEARS: Yes, right.

So we have ability to fill these vacancies -- we'll have to do it through the exam process and the civil-service process, and it does take time. But what I'm hoping is that we can all time this correctly to meet the increased demand for lending.

For example, with Gary's folks, he's going to need folks back to start dealing with the increased volume. I'm thinking that's probably going to happen towards the latter part of the calendar year next year, not right off the bat. So that will give us some time to manage the staffing.

MR. HUDSON: You know, I make the assumption, which may be wrong, that if asset quality continues to trend negative, that putting more resources towards it is a responsible thing to do.

MR. SPEARS: Yes. Yes, sir.

MR. HUDSON: Okay.

MR. SPEARS: So I don't know if there are any questions at this point on where we are.

MR. HUDSON: Is this a typical budget update, that just talks about expenses and staffing?

MR. SPEARS: On the operating budget, yes, sir.

MR. HUDSON: The operating budget?

Isn't there an income side of the operating budget?

MR. SPEARS: That's an excellent question.

Because this is a quasi state agency -- it is a state department -- there has been an emphasis on adopting a budget in the way that other state departments do.

The review of the financial statements and the management of the balance sheet -- my experience has been, since I've been here, it has been a separate discussion.

MR. HUDSON: Yes, but I assume we use this budget -- this is a budget not only to manage our fiscal, but it's also to manage the expectations of management; right?

MR. SPEARS: Yes.

MR. HUDSON: So regardless of what the State does, it seems like there ought to be some tracking of what we think we're going to do in terms of asset quality, what we actually do, or what we do in terms of collections and what we thought we were going to do in terms of collections, or some other, other than how we're doing with our expense reduction, which is excellent, I must say.

MR. SPEARS: Well, I made the point before, that we could be under operating budget, and that's a bad thing because we're not -- for example, not putting the kind of resources we need to into the Asset Management of the loss mitigation and those sort of activities.

We could be under budget because we're not doing any lending. That's not a good thing. So I understand what you're talking about.

Just the fact that we're over/under operating budget isn't necessarily a reflection of performance of the group.

CHAIR CAREY: Lynn?

MS. JACOBS: Since everyone here knows I'm getting old, I thought that we asked to get quarterly budgets, quarterly budget updates, income and expense, so we could see if we were ahead of budget or behind budget. That might have been when I was younger. But that's something that I would like to see in the future in the packet. It doesn't have to be necessarily a big agenda item.

MR. SPEARS: Income?

MS. JACOBS: Yes. Income and expense -- quarterly --

CHAIR CAREY: Quarterly financials.

MS. JACOBS: Quarterly financials, yes, income and expense.

MR. SPEARS: Well, if I had September 30th financials, I would be happy to share them with you. We don't have those yet. When we arrive in January --

MS. JACOBS: So we'd like to continue to receive the quarterly --

MR. SPEARS: The quarterly that you got this time --

MS. JACOBS: We saw the June -- well, we saw the June --

MR. SPEARS: -- was for June 30th.

MS. JACOBS: -- which is the annual, which is fine.

MR. SPEARS: Yes.

MS. JACOBS: I didn't know whether the September 30th was ready or not.

MR. SPEARS: No. I see what you mean.

MS. JACOBS: But we would like to see those because --

CHAIR CAREY: And that was agreed to.

MS. JACOBS: Yes. Okay, see, age doesn't totally destroy you.

MS. PETERS: No, no, you're younger than you think.

MS. JACOBS: That would be nice.

MR. HUDSON: I think I'm going to say this one more time.

So we don't have a budget that -- our only budget -- we're only tracking this $46.2 million, is the only thing we're tracking?

MS. JACOBS: Oh, no, we have a whole budget. You just don't have it in there.

MR. HUDSON: Oh, okay.

CHAIR CAREY: This is really a follow-up from the last meeting, at which we had a fair amount of discussion about how we should be meeting the current demands.

MR. HUDSON: Got it, okay. Thank you.

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Item 12. Office relocation update

MR. SPEARS: On the same lines, operationally, we've been talking for some time, again for the benefit of the new Board members, about office relocations. One is to relocate the loan servicing; and the other was to consolidate the Sacramento headquarters.

We are in two buildings in Sacramento: The old Senator Hotel and the Meridian Building. And we'd like to get into one location.

So first, the loan servicing. We have a five-year lease on the location in West Sacramento. Estimated move-in date is January 25. It will give us a lot of room to expand and take on our own servicing over the years to come.

One of the biggest things is, it means better facilities, better ability to answer the phones, and respond to borrower requests, and that sort of thing. And when we get to the new location, we're going to expand hours as well.

So it is moving from $2.60 space to $0.83 space in a call-center-type environment as opposed to a class A or high-rent district offices right across the street from the Capitol where lobbyists would love to pay a premium price to be. It makes a lot of sense. It's free parking for the staff and an easier commute.

Maybe we could go to the next slide.

Here's our new space, which doesn't match the address that I gave you at some point. So just in case you Google Earth the address, it will not come up with that building.

MR. IWATA: The address is 1040 Riverside Parkway, West Sacramento.

MR. HUDSON: Why wouldn't we consolidate everything in one place?

MR. SPEARS: That's a second phase.

One thing is, if we go to the next slide, I think it's part of the answer.

This is slide 59.

Our agency headquarters has to be located in the city limits -- within the city limits of Sacramento, by law.

MR. HUDSON: West Sacramento is not in the city limits?

MR. SPEARS: No, sir. It's an unincorporated --

MS. JACOBS: No. It's another city.

MR. HUDSON: We're foreigners, sorry.

MS. JACOBS: It's got a mayor and everything.

MR. SPEARS: We suggested this as legislation. It was not approved. And it is what it is. We're going to find a location.

Our goals are to consolidate --

MR. HUDSON: That whole independent thing is quasi-independent.

MR. SPEARS: I believe I said that.

MR. HUDSON: Okay.

MR. SPEARS: We're shooting for a cost in the $2.10 range. We're looking for a free rent period, which various folks are offering at this point.

And because we're able to move the loan servicing folks out, we're no longer looking for 100,000 to 120,000 square foot; we're looking for 80,000 to 85,000. And, of course, parking and commute and public transit considerations are high on the list.

We could stay where we are and renew our leases in the two buildings. It's dysfunctional. It's tough on staff during the summertime, when they're moving back and forth between buildings and the heat, or in the wintertime, during the cold and rain.

555 Capitol Mall is a place that we've been looking at, and we're in serious conversations with.

700 I Street is an old Bank of America building.

And we've just received a proposal from 2020 L Street, which is unfortunately a long ways from light rail and some other convenient transit facilities. So that's not high on the list.

But these are some of the options that we look at. We need to bring this to closure fairly quickly.

One possibility is -- Howard, stop me if I'm wrong -- but the conversations with 555 have been fairly serious. If we were to get them to the point where they were willing to sign on the dotted line on something that was very beneficial to the Agency, I'm afraid that I would ask for a special meeting in December, possibly.

MR. HUDSON: "Very beneficial," meaning like a dollar a square foot or something?

MS. JACOBS: Well, no. $2.10 a square foot is really good.

MR. HUDSON: $2.10?

MS. JACOBS: Yes.

MR. SPEARS: And what we had talked about before is, T.I.'s were very generous. Enough to pay for a move, free rent, things like that.

MR. HUDSON: Got it.

MR. SPEARS: And if they were to come through on some terms like that and they said, "Well, it's now or never," I may be ringing up the Chair and asking for an emergency meeting.

MS. JACOBS: I know you guys don't do phone meetings.

MS. PETERS: Is it possible to give you some authority that is just a skosh above what you think you can get that space for and avoid a second meeting?

MS. JACOBS: It's not agendized.

MR. SPEARS: It's not agendized, so the answer is no.

MS. JACOBS: But it's a great idea.

CHAIR CAREY: We never have taken any action on this specifically. We talked about it last July, but we didn't take action.

MR. SPEARS: I believe some action was taken to at least give us the power to enter into serious talks, not to finalize negotiations.

MR. HUGHES: Right. It was preliminary, and we were supposed to bring a deal back. We don't have a deal yet.

MR. HUDSON: I thought under the Brown Act, some people could call in if you give the address where they are, and --

MR. HUGHES: We're not subject to the Brown Act; we're subject to the Bagley-Keene Act. There actually is a provision for teleconference meetings. There are a lot of challenges to it, and we haven't done them generally. They are very difficult to make under the legal requirements.

CHAIR CAREY: We tried it once or twice, and it created great difficulty for us.

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Item 13. Reports

CHAIR CAREY: Okay, with that, are there any reports that aren't self-explanatory?

MR. SPEARS: I believe at one time or another, that we have referred to every report that's in the back. I would urge the Board members to take those home for interesting and exciting bedtime reading. But I don't believe that we're going to spend more time on it today.

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Item 15. Public Testimony

CHAIR CAREY: With that, this is the moment we set aside for public testimony.

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

(No response)

CHAIR CAREY: Seeing none, our next meeting is January 21st in Burbank.

And with that, we are adjourned.

(The meeting concluded at 3:08 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 9th of December 2009.

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