State of California

MEMORANDUM

To Board of Directors
CALIFORNIA HOUSING FINANCE AGENCY

Date: July 12, 2011

From: L. Steven Spears, Chief Deputy Director
CALIFORNIA HOUSING FINANCE AGENCY

Subject: ITEM 7 – Update on the Status of U.S. Treasury's New Issue Bond Program and Temporary Credit and Liquidity Program

In October 2009 the Obama Administration announced an initiative for state and local housing finance agencies (HFAs) comprised of a new bond purchase program to support new lending by HFAs and a temporary credit and liquidity program (TCLP) to improve access of HFAs to liquidity for outstanding variable rate bonds. Many state and local HFAs around the country participated in these financial assistance programs. CalHFA received $5 billion in assistance consisting of a TCLP allocation of more than $3.5 billion and a New Issue Bond Program (NIBP) allocation of approximately $1.4 billion.

*corrected to $144 million at Board Meeting

Status of the Programs

In early 2010, staff reported to the Board that the Agency had issued more than $1 billion of single family bonds and $380 million of multifamily bonds as part of the HFA Initiative sponsored by the U.S Treasury Department, Fannie Mae and Freddie Mac. All NIBP bond proceeds were initially held in escrow until a participating HFA requested the release of proceeds to finance loans. As of June 30, 2011, the Agency has released nearly $193 million of its multifamily proceeds to finance twenty affordable rental housing loans and * ~~$96~~ million of single family proceeds to finance the purchase of loans made to first-time homebuyers. All of the remaining multifamily NIBP bond proceeds are expected to be utilized by the December 31, 2011 expiration date. Current projections are that only another $50 to $100 million of single family proceeds will be released by year end and that approximately $800 million of the single family NIBP allocation will go unused without another extension of the program expiration date or program modification.

In January 2010 staff also reported to the Board that the Agency had closed a series of transactions that would provide for the substitution of standby bond purchase agreements enhancing all outstanding Variable Rate Demand Obligations (VRDOs) with credit and liquidity facilities made available through TCLP. By the end of January 2010, all $3.5 billion of CalHFA VRDOs were supported by TCLP. With liquidity and credit support from the federal government, the performance of CalHFA VRDOs has been impressive.

Over the past sixteen months, the weekly interest rate resets have averaged 0.24% or 24 basis points (an average of 2 basis points less than SIFMA) and the basis mismatch between the variable rate payments made to bondholders and the variable rate received from swap counterparties for VRDOs hedged with an interest rate swap has improved dramatically. In calendar year 2009, basis mismatch on hedged VRDOs amounted to more than $30 million of additional interest expense to CalHFA and in the sixteen months of TCLP enhancement, anticipated interest expense has been reduced by approximately $2.5 million. Total savings under the TCLP has amounted to almost $35 million.

In addition, remarketing agents' have reported interest rate resets this week as low as 4 basis points (0.04%). These are the lowest interest rates ever paid on a bond in CalHFA history.

Proposals for Amendment and Modification of the HFA Initiative Programs

NIBP - Most HFAs that have exhausted their NIBP allocation from U.S. Treasury are reporting limited amounts of lending this year. Federal government support for the mortgage market has driven mortgage spreads to U.S. Treasuries to record lows and made the benefit of tax exemption in HFA mortgage revenue bond programs inconsequential. For single family programs, only HFAs that can subsidize their loan rate or offer subordinate loans for closing cost or down payment assistance have generated much loan volume. Most HFA multifamily lending programs are generally limited to conduit issuance activity.

In an attempt to improve their lending capabilities state and local HFAs have proposed several ideas to amend the existing NIBP program beyond 2011 or modify the program in an attempt to fully utilize the original allocations. There has also been a flurry of activity to propose possible approaches to provide a second round of NIBP among the housing finance agency circles including the National Council of State Housing Agencies and the National Association of Local Housing Finance Agencies. While nothing has been announced by U.S. Treasury as of this writing, CalHFA is and will be very supportive of these ideas and proposals.

Among the proposals being discussed is a modification to allow unused single family NIBP allocation to be used for multifamily lending purposes. Considering that we will not use all of our remaining single family allocation by year's end this would be a significant boost to the financing of affordable rental housing in California. The biggest impediment will be the timing of an announcement and the relatively short time frame to release NIBP dollars from escrow before the end of this year.

TCLP – At the end of calendar year 2010; 11 of the 13 HFAs participating in TCLP remained in the program and $7.4 billion of the original $8.2 billion allocation was still outstanding. As of August 1, 2011 CalHFA's utilization of TCLP will have been reduced by more than $700 million to approximately $2.8 billion. TCLP has been extremely beneficial for HFAs, like CalHFA, that issued VRDOs and had few options in 2009 to replace private sector credit and liquidity facilities as a result of the financial crisis and market downturn. Unfortunately, CalHFA is still unable to access alternative credit and liquidity support to replace TCLP and the program is scheduled to expire in December 2012.

Extension Request for TCLP -- Early this year Agency management requested the GSEs and U.S. Treasury to consider an extension and modification of TCLP for up to five additional years. Agency financial staff was instrumental in providing analysis for Treasury and their financial advisor as the terms of extension and modification were being developed. We understand that an announcement to extend TCLP is pending policy approval within Treasury.

Moody's Investors Service is carefully observing the Agency's ability to manage the scheduled expiration of TCLP through extension or modification of existing facilities, replacement of the facilities or redemption of the VRDOs.