MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns A1 rating to California Housing Finance Agency's Multifamily Housing Revenue Bonds III 2015 Series A

Global Credit Research - 24 Mar 2015

Approximately $459 million in debt affected

CALIFORNIA HOUSING FINANCE AGENCY - MULTI-FAMILY HOUSING REVENUE BONDS III
State Housing Finance Agencies
CA

Moody's Rating

ISSUE	RATING
Multifamily Housing Revenue Bonds III, 2015 Series A (Taxable)	A1

Sale Amount	$174,180,000
Expected Sale Date	04/07/15
Rating Description	Mortgage: Multi-Family: FHA

Moody's Outlook STA

NEW YORK, March 24, 2015 --Moody's Investors Service has assigned a rating of A1 to the proposed California Housing Finance Agency's 174 million Multifamily Housing Revenue Bonds III 2015 Series A. In addition, the long-term underlying rating is affirmed at A1. The outlook on the rating is stable.

SUMMARY RATING RATIONALE

The rating is based on significant growth in the financial strength of the MFIII indenture, strong performance of the mortgage loans pledged to bond repayment, and performance on stress cash flow projections. The rating reflects the general obligation pledge of the Agency, and also reflects increased credit strength making the need for additional Agency support less likely. It balances these strengths with potential cash flow stress from a high level of variable rate debt and related interest rate swaps, which could lead to scenarios where Agency support is required.

OUTLOOK

The outlook on the rating is stable, based on financial performance, asset quality and ability to meet stress cash flow projections.

WHAT COULD MAKE THE RATING GO UP

Substantial progress in reducing the swap overhedge position

Further improvement in the financial position along with continued strong loan performance

WHAT COULD MAKE THE RATING GO DOWN

Weakened financial performance, with decreasing asset to debt ratios combined with decreasing profitability

Weaker performance of loan portfolio, including delinquencies and/or declining loan debt service coverage, leading to weaker risk-adjusted indenture net assets and higher potential loan losses

Increasing stress to cash flows from variable rate debt

Cash flows indicating direct Agency financial contributions may be needed to withstand stresses from variable rate debt or loan losses

STRENGTHS

Strong financial position: asset to debt ratio and profitability

Strong performance and credit characteristics of mortgage loan assets

Cash flow projections demonstrate ability to continue paying debt service in high and low interest rate scenarios, and repaying variable rate demand obligations under worst-case bank bond scenarios

Agency financial management

CHALLENGES

Complex portfolio of interest rate swaps causes counterparty and basis risk ; program is over-hedged, reducing profitability

High level of variable rate debt (54% including auction rate securities)

VRDBs supported by TCLP liquidity facilities ($72.45 million) that expire 12/23/15; however, the Agency expects to replace the TCLP facilities with a letter of credit from Citibank N.A. on April 22, 2015

RECENT DEVELOPMENTS: A portion of the program's variable rate demand bonds (48%) are currently supported by credit and liquidity facilities provided by Fannie Mae and Freddie Mac through the federal government's TCLP program. The Agency expects to replace these TCLP facilities with Letters of Credit from Citibank, N.A. (A2/P-1/Rating under review) on April 22, 2015.

DETAILED RATING RATIONALE

LOAN PORTFOLIO: Quality Mortgage Loans Exhibit Strong Performance

Under the indenture, the MFIII Bonds are supported by a pledge of revenues from the portfolio of mortgage loans financed with bond proceeds. The portfolio of 280 loans and mortgage-backed securities provides financing for 226 affordable multifamily rental developments in California. The portfolio demonstrates strong performance, with portfolio-wide debt service coverage of 1.5x and average occupancy at 97%. Thirty-one percent of the loans (by principal balance) benefit from FHA Risk Sharing Insurance, and 4% are securitized through Fannie Mae; the remaining 65% of the loans have no credit enhancement. The Agency expects future issuance to add mortgage loans with FHA Risk Sharing insurance. Delinquencies and defaults have been minimal, and currently the Agency reports no delinquencies more than thirty days among the loans.

FINANCIAL POSITION AND PERFORMANCE: Program's asset-to-debt ratio continues to strengthen

MF III's increased financial strength provides a cushion against potential losses and decreases the indenture's reliance on the external financial support from the Agency. MFIII's adjusted asset to debt ratio increased from 1.25x to 1.48x from 6/30/13 to 6/30/14. The increase in over-collateralization reflects the Agency's use of excess indenture revenues, and deposits from the Agency's general fund, in addition to proceeds of loan prepayments, to redeem bonds. Profitability is strong, with net revenues as a percentage of total revenues of 23%, 49% and 17% for FY 12, FY13 and FY14, respectively, reflecting the increased over-collateralization. The jump in net revenues in FY 13 reflected a high level of non-operating revenues from mortgage loan prepayment fees.

Going forward, we expect financial performance to remain stable or strengthen. The Agency permits loan prepayments (a shift from a long-standing policy of not allowing prepayments) as part of its housing preservation strategy; prepayments are applied to bond redemptions that increase asset- to- debt ratios. The Agency expects to issue additional bonds going forward, which we expect will contribute to revenue growth and profitability.

Liquidity: Cash flow projections demonstrate that the program exhibits sufficient liquidity to meet all debt service obligations.

LEGAL FRAMEWORK, COVENANTS, AND DEBT STRUCTURE: Variable Rate Debt and Swaps Are Key Challenges

Debt Structure: The total outstanding debt for MFIII as of February 1, 2015 is $459,205,000, of which $213,845,000 is fixed rate, and $245,360,000 is variable rate.

Debt-Related Derivatives:

MFIII's high level of variable rate debt poses potential medium-to-long term challenges to cash flows. As of 2/1/15, 53.43% of bonds were variable rate ($245.360 million par amount), including 32% that are VRDBs and 21% with no bondholder tender features.

Approximately 52% of the VRDBs are supported by direct-pay letters of credit with JPMorgan Chase Bank, N.A. (Aa3/P-1 RUR). The remaining VRDBs are supported by credit and liquidity facilities provided by Fannie Mae and Freddie Mac through the federal government's TCLP program that was instituted in 2009 to provide liquidity support for state HFA VRDBs. The facilities provide liquidity for bondholder tenders. The TCLP facilities currently expire on or before December 23, 2015. If the facilities are not renewed or replaced by that date, remaining VRDBs will become bank bonds bearing interest at elevated rates, and must be repaid in full by 12/22/23 (although there is no fixed term-out of principal as is usually required in liquidity facilities from private-sector financial institutions). The Agency expects to replace the remaining TCLP facilities with letters of credit from Citibank, N.A. on April 22, 2015.

The variable rate bonds are combined with interest rate swaps that provide a hedge against interest rate risk. The swaps had a notional amount as of 2/1/15 of $474.175 million. The swaps are general obligations of the Agency. Regularly-scheduled net swap payments are required to be paid from the MFIII Indenture on par with bond interest. Following redemptions of VRDBs towards reduction of the potential TCLP exposure, the Indenture is over-hedged (swap notional is greater than variable rate par outstanding). The notional amount of swaps will decrease over time according to scheduled reductions built into the swaps.

Swap payments other than regular payments, including any collateral posting or termination payments, generally may be paid from indenture funds only to the extent of amounts available for withdrawal by the Agency free and clear of the Indenture, protecting the Indenture from exposure to mark-to-market payments. The swaps are diversified among eight counterparties with ratings ranging from Baa2 to Aa2.

Cash Flow Projections Demonstrate Ability To Withstand Stress Factors

We have reviewed cash flow projections for MFIII, including stress projections that include high- and low-interest rate scenarios according to our methodology, combined with repayment of bank bonds. The cash flows demonstrate that MFIII can pay debt service through the term of the bonds under all scenarios without external support, which is a factor supporting a rating that is higher than the rating of the Agency's senior unsecured rating.

Pensions and OPEB: Not a material factor for this rating action.

MANAGEMENT AND GOVERNANCE: Management Actions Improve Program Performance

Since 2008, CalHFA's management has taken effective steps to improve the Agency's finances and demonstrated management focus on reducing financial stress. The Agency has substantially enhanced its single family asset management function and reduced timelines for moving defaulted loans through the pipeline. The Agency has also worked proactively to improve the Agency's balance sheet to address the combined effect of the mortgage decline and the financial crisis. Actions have included mortgage loan sales, bond purchases at a discount, refinancing of multifamily projects to reduce risk to the Agency, negotiation of more favorable terms for swap collateral posting, refunding to reduce variable rate debt, and exercise of par swap termination options to reduce exposure. The Agency has taken steps to revive its lending programs, including reopening its mortgage origination business (through securitization of whole loans) and increasing its focus on multifamily loans.

KEY STATISTICS:

- Total Bonds Outstanding (as of February 1, 2015): $459,205,000

- Asset-to-Debt Ratio (as of June 30, 2014): 1.48

- Profitability (as of June 30, 2014): 17.48%

- Delinquent Loans: None

- Variable rate debt as % of bonds outstanding: 53% (including auction rate securities)

- Swapped debt as % of variable debt: 193%

OBLIGOR PROFILE:

MFIII was the Agency's active multifamily financing program from its creation in 1997 until 2008. Bonds were issued to finance mortgage loans for affordable rental housing developments in California, under a parity indenture with all of the bonds secured equally by all of the mortgage loans. The Agency issued $38.9 million of MFIII bonds in April, 2014, which was the first issuance since 2008. The Agency expects future issuance to add mortgage loans with FHA Risk Sharing insurance.

LEGAL SECURITY:

The bonds are secured by a first-lien pledge on the financed mortgage loans, as well as by a general obligation pledge of the California HFA- Issuer Long Term Rating (A3, positive outlook). The legal structure provides for deposit of revenues with the trustee, to be applied (after payment of fiduciary fees) to pay bond interest and principal, meet reserve requirements (if any) and fund redemptions of mortgage loans. After satisfaction of these requirements, funds can be released free and clear of the Indenture lien only upon filing of an Officer's Certificate demonstrating that future debt service obligations can be met and assets will exceed liabilities.

USE OF PROCEEDS: Proceeds of the bonds will be utilized to effectuate an economic refunding of existing fixed rate bonds.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Housing Finance Agency Multifamily Methodology published in September 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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