MOODY'S
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Update

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# California Housing Finance Agency

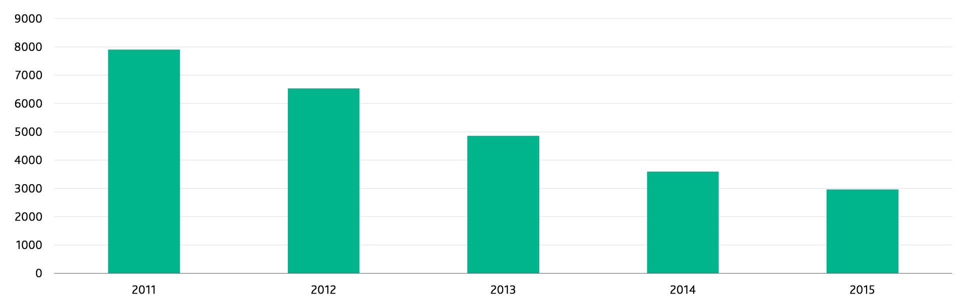
## Update - Moody's upgrades to A2 from A3 California Housing Finance Agency's Issuer Rating; outlook stable

### Summary Rating Rationale

Moody's Investors Service has upgraded the California Housing Finance Agency's issuer rating to A2 from A3. The outlook on the rating is revised to stable from positive. This action does not affect enhanced ratings on any of the Agency's variable rate demand bonds. No other ratings of the Agency are affected by this action, including the rating on the Multifamily Housing Revenue Bonds III.

The A2 rating is based on the continued improvement in financial performance, the improved quality of single family assets and strength of multifamily assets, enhanced performance in stress cash flows and subsiding pressure from variable rate debt and interest rate hedges.

Exhibit 1
**California Housing Finance Agency's Bonds Outstanding**
**(in billions)**




as of June 30
*Source: Moody's Investors Service adjusted issuer financial statements*

### Credit Strengths

- Strengthened financial performance, including increased program asset to debt ratio of 1.44 as of 6/30/15 (audited) and a rebound in profitability
- Asset quality: improved single family loan performance, and continued strong performance of multifamily program
- Management has demonstrated ability to be proactive in addressing financial risks

## Credit Challenges

- » High levels of variable rate debt bring interest rate risk and potential cash flow stress
- » Swap collateral posting poses potential stresses on liquidity, although the severity is diminishing

## Rating Outlook

The outlook is stable based on the improved financial position; however, the rating is constrained by the sizeable swap liability as well as the underlying volatility in the macro-economic conditions in the State of California.

## Factors that Could Lead to an Upgrade

- » Meaningful and sustained reductions in variable rate debt exposure
- » Continuation of improved financial performance, including growth of PADR and profitability
- » Increase in the single family and multifamily production programs
- » Improved liquidity position, with lower potential stress from collateral posting on interest rate swaps

## Factors that Could Lead to a Downgrade

- » Reversal of trends in financial performance, including lower asset to debt ratios and/or diminished profitability
- » Higher than anticipated losses from single family loans or decreases in performance of multifamily loans
- » Weakened liquidity position through collateral posting on interest rate swaps and/or variable rate debt repayment
- » Weaker performance in cash flows due to expiration of external liquidity facilities
- » Weakened macro-economic conditions in the State of California and the susceptibility of the rating to those macro changes

## Key Indicators

Exhibit 2
**California Housing Finance Agency**

| (Year Ending 06/30) | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|---|
| Total Bonds Outstanding | 2,964,546 | 3,590,526 | 4,853,741 | 6,535,689 | 7,906,400 | 8,976,396 |
| Asset to Debt Ratio | 144.00% | 135.53% | 126.20% | 119.55% | 117.74% | 117.54% |
| Margins | 0.17% | 0.10% | 0.12% | 0.02% | -0.02% | -0.12% |
| Variable Rate Debt as a % of Bonds Outstanding | 40.00% | 42.01% | 44.57% | 51.16% | 52.38% | 50.47% |
| Swapped Debt as a % of Variable Rate Debt | 109.28% | 100.55% | 89.43% | 68.89% | 67.77% | 75.65% |

*Source: Moody's Investors Service*

## Recent Developments

Recent developments are incorporated in the Detailed Rating Considerations.

## Detailed Rating Considerations

### Loan Portfolio

CalHFA maintains a large loan portfolio, primarily comprised of single family mortgage loans. The Agency's largest program is the Home Mortgage Revenue Bonds (HMRB) with $1.867 billion in bonds outstanding and 12,269 loans as of 6/30/15. At 6/30/15, 29% of

HMRB loans have FHA/VA insurance, which significantly reduces any exposure to the program. An additional 30% of the loans benefit from private mortgage insurance that continues to be reinsured by Genworth Mortgage Insurance Corporation (GMICO, Ba1 stable). However, the GMICO policies expire on the 10th anniversary of each covered vintage, and CalHFA has opted not to renew for the 2003, 2004 and 2005 vintages. The portfolio also contains 27% of uninsured loans with loan-to-values (LTVs) below 80% and 12% uninsured loans with LTVs above 80%. Serious delinquencies (loans 90+ days delinquent plus loans in foreclosure) for HMRB continued to show significant improvement, declining from 4.09% at 12/31/14 to 2.47% at 12/31/15, pointing to reduced levels of losses from missed payments and foreclosure.

The Agency also has 2 other single family programs: Residential Mortgage Revenue Bonds MBS (RMRB MBS) and the Residential Mortgage Revenue Bonds 2009 A-5 (RMRB 2009 A-5). RMRB MBS (Aaa/stable) has approximately $129 million outstanding as of June 30, 2015; the security is provided by GNMA mortgage backed securities. RMRB 2009 A-5 (Aa3/positive) has approximately $261 million outstanding as of June 30, 2015. The single family loans are backed by insurance from FHA/VA (38%), mortgage backed securities (9%), private mortgage insurance (PMI) (15%) and 22% are uninsured with loan to value ratios below 80% and 16% with LTVs above 80%. The PMI loans benefit from reinsurance provided by Genworth Mortgage Insurance Corporation (GMICO, Ba1/stable).

The improved performance of single family loans benefits the Agency as a whole, as the single family lending has been the Agency's largest activity and is a key driver of profitability and fund balances.

In addition, the Agency's portfolio of approximately 232 multifamily mortgage loans continues to demonstrate strong performance and is a source of credit strength. Agency data demonstrates project occupancy averaging 96%, and portfolio average debt service coverage is approximately 1.50x as of June 30, 2015. Delinquencies have been minimal. The multifamily bond programs provided 23% of the Agency's operating revenues in FY15 and were highly profitable, with total net revenues of 31% of total revenues.

## Financial Position and Performance

Despite several years of severe stress from the combined effects of single family mortgage losses and high levels of variable rate debt, CalHFA's balance sheet has remained stable, and profitability has rebounded. Assets and liabilities have declined significantly since 2008 as the Agency has reduced new single family lending activity. However, the adjusted combined fund balance was $1.067 billion at 6/30/15, an increase over $1.029 billion at 6/30/14, with the ratio of assets to debt increasing from 1.36 to 1.44. Total net revenues as a % of total revenues improved to 17.5% at 6/30/15 from 9.8% at 6/30/14.

Improved performance of HMRB is a factor in our assessment of the Agency's issuer rating. Although the HMRB Bonds are not a general obligation of CalHFA, HMRB is CalHFA's largest activity by volume (accounting for $1.867 billion of the Agency's total bonds outstanding of $3.0 billion as of June 30, 2015) and thus is a key driver of the Agency's fund balances and profitability. The practice of reimbursing swap payments from HMRB to the Operating Account provides another key linkage; if HMRB's net revenues declined, decreased swap reimbursements could impact general fund liquidity.

### LIQUIDITY

Cash flow projections on all of the Agency's programs demonstrate that the program exhibits sufficient liquidity to meet all debt service obligations.

## Risk Profile

CalHFA is highly sensitive to a variety of risks including rollover and counterparty risk as a result of its variable rate debt profile. Variable rate debt accounts for 40% of CalHFA's outstanding debt as of 6/30/15 (22% are variable rate demand bonds, and 18% are variable rate bonds with no tender), all concentrated in HMRB and in the Multifamily III (MF III) program. CalHFA's variable rate demand bonds are currently supported by direct-pay letters of credit, effective July, 2015.

### DEBT STRUCTURE

The total outstanding debt for CalHFA as of June 30, 2015 is $2,964,545,000, of which $1,778,580,000 is fixed rate, and $1,185,965,000 is variable rate.

#### DEBT-RELATED DERIVATIVES

CalHFA's large portfolio of interest rate swaps poses potential liquidity challenges. Approximately 109% (as of 6/30/15) of CalHFA's variable rate bonds are hedged with interest rate swaps, used as hedges for HMRB and MFIII Bonds. The swaps are diversified among 12 counterparties.

The Agency has steadily reduced its swap exposure by exercising par termination options purchased at swap inception; the notional amount of swaps has declined from $3.43 billion at 6/30/10 to $1.29 billion at 6/30/15.

Cash Flow Projections Demonstrate Ability to Withstand Stresses

Moody's has reviewed cash flow projections for both single family and multifamily programs, demonstrating the ability of all indentures to withstand stresses in line with the rating assigned. The cash flows, prepared in accordance with Moody's methodology, include high (3-year average life) and low (30%) prepayment speeds in both high and low interest rate environments as well as bank bond scenarios.

#### PENSIONS AND OPEB

Pensions and OPEB are not a major factor in the methodology.

### Management and Operating Environment

We believe CalHFA's management is strong and well positioned to sustain the Agency's financial position and program initiatives. 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 substantially enhanced its single family asset management function and reduced timelines for moving defaulted loans through the pipeline.

The Agency also improved the Agency's balance sheet to address the combined effect of the mortgage decline and the financial crisis. Actions 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 reopened its mortgage origination business through loan sales to the secondary market and an increased focus on multifamily loans.

## Use of Proceeds

Not applicable.

## Obligor Profile

CalHFA is an agency of the State of California, created in 1975. The Agency is governed by a Board of Directors with 13 voting members. The Agency shares certain functions with the State's housing department but has independent authority as to its bonds and housing loan programs.

The Agency's primary activities are the financing of single family mortgage loans to low and moderate income borrowers and the financing of loans to developers of affordable apartment developments. The Agency also administers certain programs separately funded by the State.

## Methodology

The principal methodology used in this rating was U.S. Housing Finance Agency Issuer Rating Methodology published in May 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

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