S&P Global Ratings

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California Housing Finance Agency; Joint Criteria; Single Family Whole Loan

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Table Of Contents

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Credit Profile		
US$236.35 mil home mtg rev bnds ser 2016A due 08/01/2036		
Long Term Rating	AA-/Stable	New
California Hsg Fin Agy home mtg rev bnds [unenhanced]		
Long Term Rating	AA-/Stable	Upgraded

Rationale

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) to 'AA-' from 'A' on California Housing Finance Agency's (CalHFA) bonds issued under its home mortgage revenue bond (HMRB) indenture. At the same time, S&P Global Ratings assigned its 'AA-' long-term rating to CalHFA's HMRBs, 2016 series A (taxable). We also raised the various ratings on several of CalHFA's variable-rate demand bonds in the indenture. The raised ratings on CalHFA's variable-rate demand bonds reflect the joint credit and liquidity support from CalHFA and Bank of America N.A., Royal Bank of Canada, and Sumitomo Mitsui Banking Corp., based on our revised Joint Support criteria, published on May 23, 2016. The outlook, where applicable, is stable.

The ratings reflect our opinion of the following strengths:

- Significant increase in equity and parity without external support, from fiscal year 2014 to fiscal year 2015 to $282 million and 115%, respectively, following a multiyear trend of increasing profitability, equity, and parity in the indenture;
- Consolidated indenture cash flows that demonstrate sufficient assets and revenues to absorb projected loan losses at the 'AA' category;
- The high credit quality of the single-family mortgage loans in the resolution; and
- Substantial mitigation through CalHFA's proactive management of the past risks that plagued the HMRB indenture between 2009-2012, including a significant reduction in the indenture's variable rate, swap exposure, and counterparty risk; replacement of all expiring Temporary Credit and Liquidity Program (TCLP) credit and liquidity facilities with bank letters of credit; conversion of all of CalHFA's interest-only loan portfolio to fully amortizing, as well as significantly decreased exposure to 40-year loans; and a noteworthy decline in delinquency and foreclosure rates in the last two years as a result of improving California real estate market conditions and assistance from various loan modification programs.

The above factors are partly offset by our opinion of the agency's loan portfolio that we consider to be of moderate risk, with approximately 28% of loans insured through the California Housing Loan Insurance Fund (CaHLIF; not rated), of which approximately 16% are reinsured through a reinsurance contract with Genworth Mortgage Insurance Corp. (BB+/Stable), as of April 30, 2016.

Proceeds of the 2016 series A bonds are expected to be used, together with available revenues and income, to redeem all of the agency's outstanding 2006 series D, 2006 series E, 2006 series F, 2006 series I, 2006 series K, and 2006 series

M HMRBs. The refunded bonds were originally issued to provide moneys to enable the agency to make or purchase eligible mortgage loans or to purchase Fannie Mae mortgage-backed securities backed by mortgage loans or to refund bonds issued for such purposes. The 2016 series A bonds will be issued as fixed-rate taxable bonds and are subject to sinking fund redemption, optional redemption, and special redemption, as detailed in the official statement.

Outlook

The stable outlook reflects the improvement in parity and equity in the indenture, and our expectation that the loans and other collateral will perform at the 'AA' category. The outlook also reflects our expectation that the indenture will continue to perform sufficiently well, based on the agency's asset-to-liability position and CalHFA's proactive management of its single-family portfolio and debt structure. If the agency is able to continue to demonstrate sufficient excess assets to cover potential liquidity and credit shortfalls under various prepayment scenarios at the 'AA' category without support from external sources, and if fund balances improve, a positive rating action may be warranted. Conversely, if the indenture's fund balance and parity decline considerably or our loss assumptions increase, we may consider a negative rating action.

Assets

We have historically considered CalHFA's HMRB loan portfolio to be of higher risk compared to those of other HFAs, due to the relative concentration of speculative-grade mortgage insurance and, to a lesser extent, interest-only and 40-year loans. However, the proportion of 40-year loans has significantly declined in the last few years, to 4.8% of the portfolio, and interest-only loans have all converted to fully amortizing loans. In addition, the proportion of speculative-grade mortgage insurance relative to the overall portfolio has declined.

As of April 30, 2016, there were approximately 12,579 loans totaling $1.56 billion outstanding under the indenture. Approximately 28% of loans were conventional loans insured by an unrated mortgage insurer, CaHLIF. CaHLIF has a reinsurance contract with Genworth Mortgage Insurance Co. However, since neither CaHLIF nor Genworth currently carries an investment-grade rating, we no longer assume any recoveries from CaHLIF or Genworth in accordance with our criteria. As of April 30, 2016, there were no cash or investments remaining on CaHLIF's balance sheet to pay outstanding claims. Although we do not consider recoveries from Genworth based on our criteria, according to the agency, Genworth has continued to make full claim payments.

Overall, in addition to the conventionally insured loans, approximately 30% of single-family loans were Federal Housing Administration-insured, 41% were uninsured, and 1% were Veterans Administration- or Rural Development-guaranteed as of April 30, 2016.

As of the same date, 4.8% of loans had 40-year terms rather than the standard 30-year term. In addition, approximately 19.2% of CalHFA's single-family loan portfolio consisted of loans that were originated as interest-only but have been converted to fully amortizing loans. This compares to more than $1.3 billion of nonamortizing interest-only loans in 2010.

The portfolio's delinquency and foreclosure rates have shown a declining trend in the past several years compared to their previous record highs in 2009 and 2010. Assistance from the "Keep Your Home California" principal reduction program and loan modifications have ramped up since September 2012. As of the fourth quarter of 2015, CalHFA reported a 60-day-plus delinquency and foreclosure rate of 4.00% for loans under the HMRB resolution, down from 6.09% in the fourth quarter of 2014. This compares to the peak of 13.98% in the first quarter of 2010. In addition, CalHFA's real estate owned inventory has declined significantly to 28 units as of April 30, 2016, from 72 units in 2014 and the high of 1,110 units in 2011.

Compared with Mortgage Bankers Assn.'s statistics for the state of California, CalHFA's delinquency and foreclosure rates have been higher for the past 31 consecutive quarters (through Dec. 31, 2015), assuming a similar composition of prime loans, although the gap appears to be narrowing.

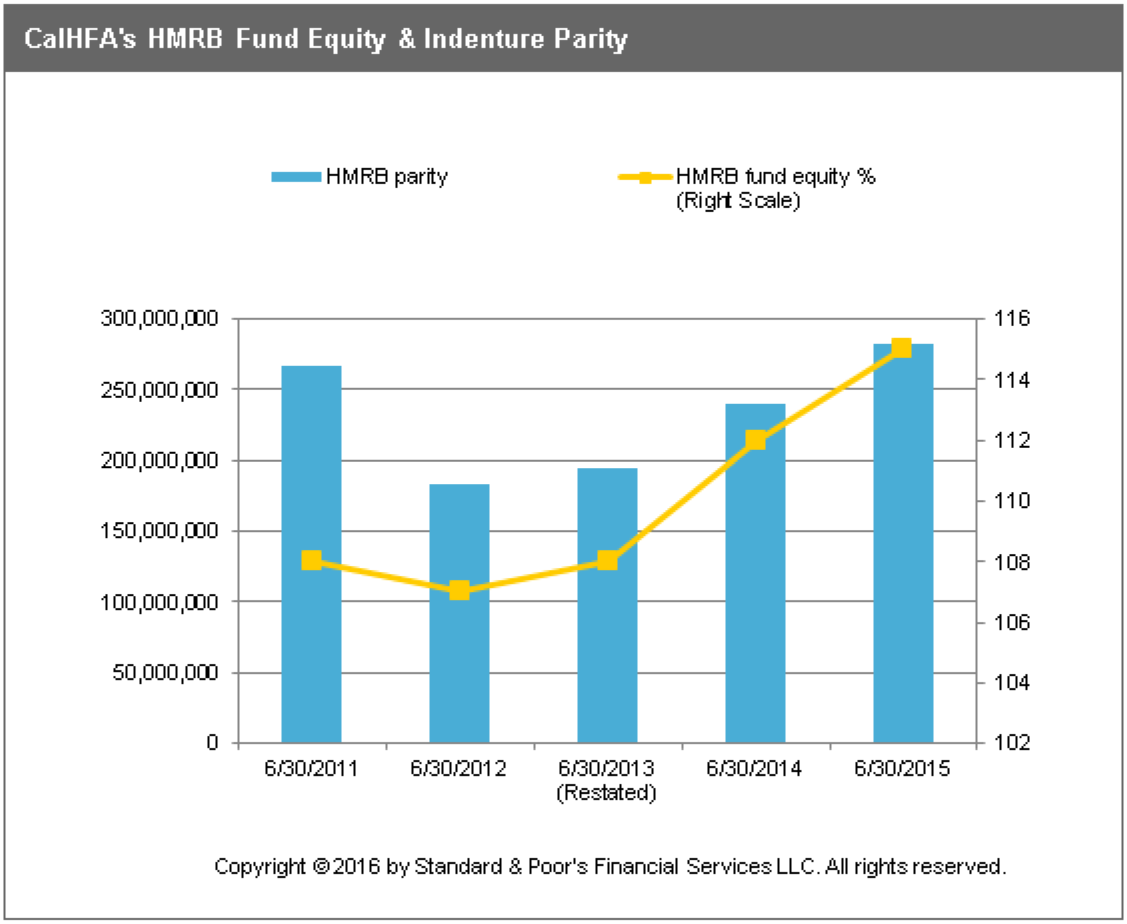
All loans under CalHFA's HMRB indenture were required to carry at least 50% insurance coverage on the balance of each loan. Under the terms of the conventional loan insurance provided by CaHLIF, CaHLIF covered the first 35% of mortgage principal, plus lost interest and foreclosure costs, upon the filing of insurance claims for defaulted HMRB loans. CalHFA covered the remaining 15% for CaHLIF-insured loans, plus the full 50% for uninsured loans, through "gap" insurance, up to a cap of $135 million. In August 2011, the agency reached the cap and the aggregate total of $135 million in gap claim payments was made so that any future losses that otherwise would have been covered by gap insurance are now being absorbed by the HMRB resolution. CalHFA has a gap insurance loss reserve, in addition to a reserve to cover the anticipated shortfall for loans insured by CaHLIF, which are both held under the HMRB indenture. The total net allowance for loan losses under the HMRB indenture was $25.9 million.

In our opinion, the decline in exposure to unrated or speculative-grade insurance providers, the decline in higher-risk loans, and the decline in delinquencies and foreclosure rates as of fiscal year 2015 are all testaments to CalHFA's proactive management of the portfolio. As a result, the HMRB indenture is now performing in line with other HFA single-family indentures rated in the 'AA' category.

Financial strength

The HMRB indenture's equity position has improved over the last three years, mainly due to reductions in debt outstanding. This led to an improvement in asset coverage (parity) in the HMRB indenture during this time period as well (see chart 1). Based on audited financials, the indenture's net equity improved by 18% to $261.7 million in fiscal year 2015 from $240.1 million in fiscal year 2014. In addition, the indenture experienced consecutive profits of $21.6 million in fiscal year 2015 and $44.9 million in fiscal year 2014.

Chart 1



As noted above, we currently do not assume recoveries from CaHLIF or Genworth due to the lack of a rating for the former and a speculative-grade rating for the latter. Based on our methodology, our projected loan losses (net of insurance recoveries) under HMRB are currently $119 million, or 6.29% of loans as of fiscal year 2015.

We received cash flows with a basis date of July 1, 2015. The cash flows included variable-rate debt and reinvestment assumptions consistent with our current criteria, at the 'AA' rating category. Previously, the agency had deposited funds into the indenture to cover the projected losses at various prepayment speeds; however, the indenture has exhibited healthier financial strength for two consecutive years without the assistance of external funds from the agency.

In all of the various prepayment scenarios, there were sufficient excess assets and revenues available to absorb the loan losses and still make timely payments of debt service. Beginning asset-to-liability parity as of July 1, 2015, was 115.1%, with asset coverage of approximately $282 million. Based on these cash flows, we believe that at this time that there are sufficient excess assets under the HMRB resolution to cover our current projection of loan losses at the 'AA' rating category.

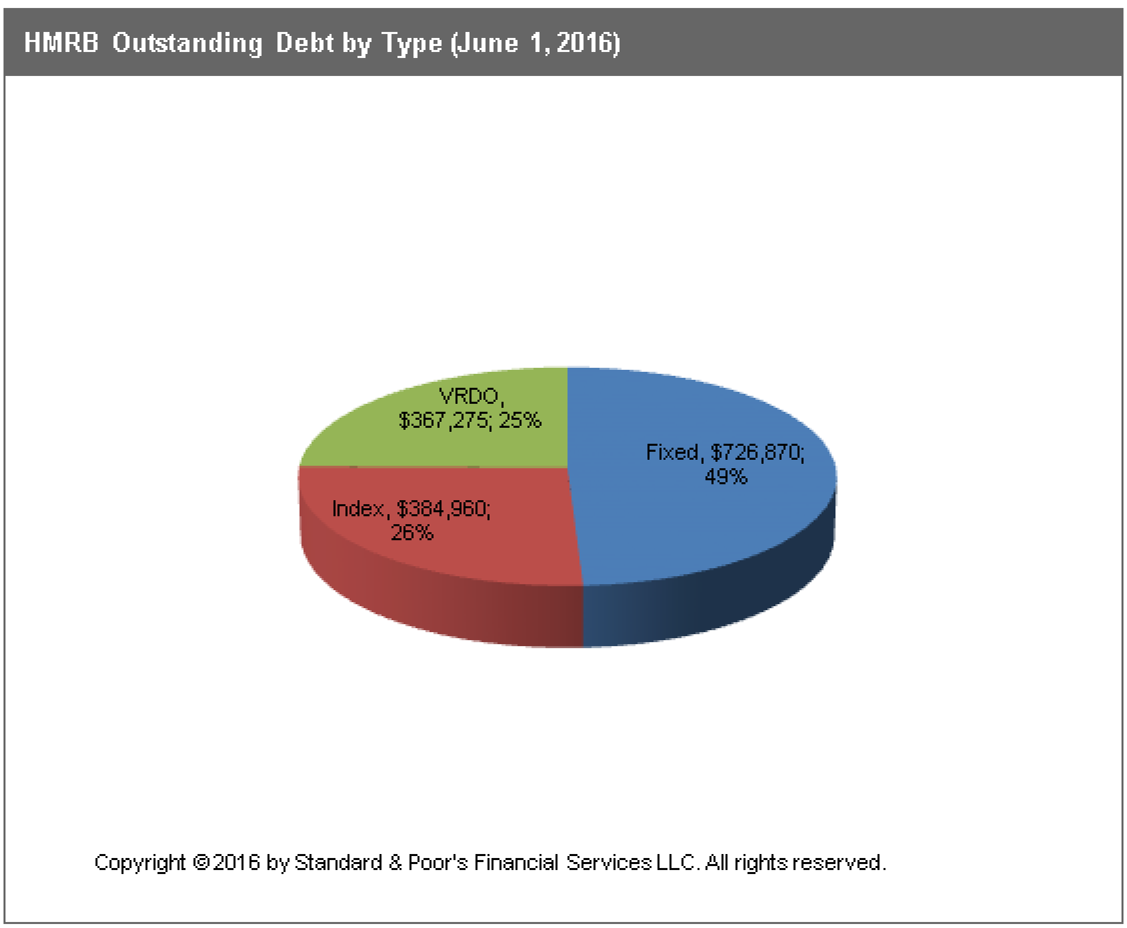
Reserves And Investments

As of March 31, 2016, there was approximately $234 million in funds on deposit under the HMRB indenture. These reserves were part of $393 million in nonmortgage assets contained in HMRB, which include guaranteed investment contracts, federal agency securities, and cash holdings. The majority (61.5%) of CalHFA's investments under the HMRB indenture were invested in the state's Surplus Money Investment Fund, with other funds invested in investment agreements (14.0%), federal agency securities (24.0%), and money market funds or certificates of deposits (0.5%). All of HMRB's investment agreements are with providers rated 'A' or above.

Debt

As of June 1, 2016, there were $1.48 billion of bonds outstanding under the HMRB indenture, a 58% decline from $2.3 billion as of fiscal year 2014. Of this amount, $752 million, or approximately 51%, was variable or index rate. Of the variable-rate bonds outstanding as of June 1, 2016, approximately 81% were hedged with interest rate swaps, with swap counterparties rated 'BBB+' or higher.

Chart 2



In our opinion, the risks associated with the heavy use of variable-rate debt and swaps exposed the agency to a number of challenges between 2008 and 2012. Among them are swap basis mismatch, swap termination payments, counterparty risk, swap collateral postings, the shortage of liquidity, higher liquidity costs, bank bonds, and higher reset rates on its variable-rate debt.

CalHFA has spent the past six years responding to these challenges while also implementing numerous initiatives to reduce its variable-rate debt exposure under its HMRB indenture. In addition, CalHFA has reduced its swap exposure by terminating swaps in the HMRB indenture, exercising its cancellation options as they become available. Total notional amount of swaps outstanding in the HMRB indenture as of June 1, 2016, was $612.6 million, down from $821.8 billion in June 30, 2015, and significantly lower than the notional amount of $2.9 billion as of January 2010.

We believe that CalHFA's participation in the U.S. Treasury's TCLP and New Issue Bond Program eased some of the pressures on its balance sheet and the HMRB indenture from 2009 to 2015. CalHFA was the largest participant in the TCLP among HFAs. The agency adopted a TCLP exit strategy to include solicitation of new facilities, conversion into index-floaters, or refundings to fixed-rate bonds. In July 2015, just shy of six months prior to the expiration of the TCLP program, the agency replaced all of its TCLP within and outside of the HMRB indenture with bank facilities. In our view, this is a significant milestone in the agency's financial recovery and speaks to the deliberate planning and strengths of the agency's management and strategy.

Economic Indicators

According to IHS Global Insight, despite slower rate of expansion, that state's payroll gains continue to be higher than the country's. California's economy is large, dynamic, and capable of faster-than-average growth but prone to periodic downturns that can be severe. The current economic expansion is mature but shows little sign of fatigue. The state's labor market was hit hard during the recession, which saw the loss of 1.3 million nonfarm payroll jobs, or 8.6% of the total. As of February 2014, California's nonfarm payroll jobs had surpassed the previous peak (in July 2007). Payroll gain stood at 2.8%, slightly below the previous year's gains (3.0%). Over the next five years, payrolls are expected to average 1.4% per year (marginally over the nation, at 1.2%). According to IHS, as the state inches toward full employment, the rate of job growth will be more in line with the nation's. Job generation in the state was propelled primarily by the construction, services, and technology sectors. Furthermore, IHS believes that the technology sector will remain the engine for growth and will continue to create high-wage jobs in information and professional/technical services. IHS estimates that California's GDP expanded at a robust 3.8% in 2015 and should continue to grow in 2016, albeit at a slower, 2.7%, rate.

Although the state boasts strong income and wealth indicators, it's also plagued by an above-average poverty rate. These structural imbalances are more evident in the state's real estate market, where a chronic shortage of affordable housing, especially, in its large metropolitan areas, undercuts the business climate. It is estimated that taxpayers with the top 1% of incomes paid over 45% of the state's personal income tax. Another major concern in the state in the strained water supply, which could be a potential impedance in the long-term growth of the state. Furthermore, according to IHS Global Insight, the fifth year of extreme drought is believed to have a devastating impact on the agriculture sector.

Housing prices in the state continue to be higher than the national average, with an average price of $457,000 (single-family units) in the fourth quarter of 2015. Additionally, home prices in the state have been growing at a higher rate than nationally. Although the pace has been decelerating, it is still higher than the income growth rate and inflation rate. IHS projects housing starts to grow by 10.3% in 2016. As vacancy rates reach historically low levels, a housing crunch is expected over the near term. The share of total loans in foreclosure was 0.7% (the U.S. average was 1.8%) for the fourth quarter of 2015. During the same period, subprime loans in foreclosure averaged 3.9% (the U.S. average is 7.8%), ranking the state 37th across the nation.

Related Criteria And Research

Related Criteria

- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- USPF Criteria: Single-Family Whole Loan Programs, June 14, 2007
- Criteria: Methodology For Assessing Mortgage Insurance And Similar Guarantees And Supports In Structured And Public Sector Finance And Covered Bonds, Dec. 7, 2014
- USPF Criteria: Assumptions: Update to Cash Flow Analysis for Public Finance Housing Bonds, March 3, 2009
- Structured Finance Criteria: U.S. Interest Rate Assumptions Revised For May 2012 And Thereafter, April 30, 2012
- Criteria: U.S. Government Support In Structured Finance And Public Finance Ratings, Sept. 19, 2011
- General Criteria: Methodology And Assumptions: Approach To Evaluating Letter Of Credit-Supported Debt, Feb. 20, 2015
- General Criteria: Methodology And Assumptions For Rating Jointly Supported Financial Obligations, May 23, 2016
- Structured Finance Criteria: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
- Criteria: Methodology For Revisions To Standard & Poor's Stressed Reinvestment Rate Assumptions For Fixed-Rate U.S. Debt Obligations, May 20, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- Global Framework For Assessing Operational Risk In Structured Finance Transactions, Oct. 9, 2014

Ratings Detail (As Of June 15, 2016)		
California Hsg Fin Agy home mtg rev bnds (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy home mtg rev bnds [Ambac]		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy home mtg rev bnds [FGIC]		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy home mtg rev bnds [Natl Pub Fin Gty Corp]		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds		
Long Term Rating	AAA/A-1+	Upgraded
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds		
Long Term Rating	AA+/A-1	Upgraded

Ratings Detail (As Of June 15, 2016) (cont.)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds		
Long Term Rating	AAA/A-1+	Upgraded
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds		
Long Term Rating	AAA/A-1+	Upgraded
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds		
Long Term Rating	AAA/A-1+	Upgraded
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds RMTKD 6/17/15 ser 2000N due 08/01/2031		
Long Term Rating	AA+/A-1/Watch Pos	Upgraded
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds RMTKD 6/17/15 ser 2005A due 08/01/2035		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds RMTKD 6/17/15 ser 2005B due 08/01/2035		
Long Term Rating	AA+/A-1/Watch Pos	Upgraded
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds RMTKD 6/17/15 ser 2006C due 08/01/2037		
Long Term Rating	AA+/A-1/Watch Pos	Upgraded
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
California Hsg Fin Agy var rate home mtg rev bnds RMTKD 6/17/15 ser 2007H due 02/01/2042		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.