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# Rating Action: Moody's affirms Baa2 rating for California Housing Finance Agency's Home Mortgage Revenue Bonds, outlook revised to positive; affirms A3 for issuer rating and Housing Program Bonds, outlooks revised to stable

Global Credit Research - 28 Feb 2014

New York, February 28, 2014 -- Moody's Investors Service has affirmed the long-term underlying rating on California Housing Finance Agency's Home Mortgage Revenue Bonds (HMRB- $3.017 billion outstanding at 6/30/13) at Baa2. The outlook on the rating is revised from negative to positive. Moody's has also affirmed the Agency's issuer rating at A3, and has at the same time affirmed the A3 ratings on the Housing Program Bonds (HPB - $69.7 million outstanding). The outlook on the issuer and HPB ratings is revised from negative to stable. 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.

RATINGS RATIONALE

The rating of HMRB, and the change in outlook from negative to positive, are based on the program's clear upward momentum demonstrated by increased balance sheet strength and profitability, declines in losses from single family mortgage loan delinquencies and foreclosures, improvements in the California housing markets, and cash flow projections that demonstrate improved ability to absorb stresses related to loan losses and variable rate debt. It also takes into account the upgrade of Genworth Mortgage Insurance Corporation (GMICO) to Ba1 (outlook positive), from Ba2 on February 5, 2014.

Our affirmation of the issuer rating and Housing Program Bonds, and the change in outlook from negative to stable, is based on the Agency's emerging recovery from the stresses of the mortgage crisis and recession, demonstrated by improved financial performance, reduced delinquencies and losses in single family loans, and declining, although still significant, pressure on cash flows and liquidity from variable rate debt and interest rate hedges. It further reflects strong actions by management to mitigate financial stress, continued strength of multifamily programs, federal support through TCLP liquidity facilities, NIBP bonds and Hardest Hit Funds, and a positive relationship with the State.

Strengths: HMRB

Improving financial performance: increases in adjusted asset- to- debt ratio (PADR) and profitability through the recent period of deleveraging

Mortgage insurance mitigates loan losses: FHA insurance on 28% of loans, Genworth Mortgage Insurance Corporation reinsurance on 35% of loans (GMICO, upgraded to Ba1 positive on 2/5/14)

Improved loan asset performance due to decreases in loan delinquencies/foreclosures and reduced losses on foreclosed loans

Federal resources, including external liquidity support for variable rate bonds and funds for mortgage loss relief, bolster HMRB performance

CalHFA support as net swap payments are paid by the Agency subject to reimbursement by HMRB

Strong management actions continue to improve program performance

Challenges: HMRB

Mortgage delinquencies, although down by half from peak levels, remain elevated compared to averages of rated peers and statewide benchmarks

GMICO reinsurance policies became subject to rollover on the 10th anniversary of each vintage (subject to reimbursement of accumulated reserves) reducing benefit of mortgage insurance; CalHFA decisions on renewal impacts coverage going forward

Unhedged portion of variable rate debt causes stress in rising interest rate cash flow scenarios

External Liquidity Facilities on VRDBs scheduled to expire on 12/23/15, and if not extended or replaced will result in higher interest rates on the bonds and accelerated repayment of bonds by 12/22, adding stress to cash flow scenarios

Strengths: issuer rating and HPB

Strengthened financial performance, including increased asset to debt ratio and strong rebound in profitability

Asset quality: improved single family loan performance, and continued strong performance of multifamily program

Federal resources, including external liquidity facilities for variable bonds, low-cost financing for bond debt and funds for mortgage relief, have helped to diminish key risks

Management has demonstrated ability to be proactive in addressing financial risks

Challenges: issuer rating and HPB

High levels of variable rate debt bring interest rate risk and potential cash flow stress due to expiration of external liquidity facilities (provided by federal TCLP program) at the end of 2015

Swap collateral posting poses potential stresses on liquidity, although the severity is diminishing

Single family mortgage loan performance, although improved, remains below State HFA and California statewide metrics

OUTLOOK

The outlook for the HMRB rating is revised from negative to positive based on improved financial and loan performance, progress in reducing stresses from variable rate debt, an improving state economy, and effective program management.

The outlook on the Agency's issuer rating (and the rating of the Housing Program Bonds) is changed from negative to stable, based on improved financial performance, progress in reducing stress from variable rate debt, improving asset quality, and effective management.

What Could Change the Rating Up -- HMRB

Continuation of the current trend of improved financial performance, including growth of PADR and profitability

Continued improvement in performance of mortgage loans, reflected in delinquency levels that are comparable to state and sector peers and continued declines in actual program losses.

Reduced risk of VRDBs subject to liquidity expiration or early redemption, through facility replacement/extension or repayment/refinancing of bonds, demonstrating improvement in cash flow projections

What Could Change the Rating Down -- HMRB

A reversal of the trend in financial performance, including reduced PADR and/or profitability

A reversal in improving trends or mortgage loan performance, through increased delinquencies or foreclosures leading to increasing losses

Increased risk of VRDBs subject to liquidity expiration/early redemption as expiration date for TCLP facilities approaches, pointing to increased stress in cash flow projections

What could change the rating up -- Issuer Rating and HPB Bonds

Improved financial performance; rising asset to debt ratios and improving profitability

Continued trends of improvement in single family loan performance and strong multifamily performance

Meaningful and sustained reductions in variable rate exposure to mitigate risks associated with expiration of external liquidity facilities

Improved liquidity position, with lower potential stress from collateral posting on interest rate swaps

What could change the rating down - Issuer Rating and HPB Bonds

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

RATING METHODOLOGIES

The principal methodology used in rating the Home Mortgage Revenue Bonds was U.S. Housing Finance Agency Single Family Programs published in February 2013. The principal methodology for the senior unsecured rating, and the Housing Program Bonds was Moody's Methodology for Assigning Issuer Ratings to Housing Finance Agencies published in May 2001. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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