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California Housing Finance Agency; Single Family Whole Loan

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Credit Profile		
California Hsg Fin Agy home mtg rev bnds [unenhanced]		
Long Term Rating	A-/Stable	Upgraded
California Hsg Fin Agy home mtg rev bnds [var rate-GSE TCLP]		
Long Term Rating	AA+/A-1+/Stable	Affirmed
Unenhanced Rating	A-(SPUR)/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services raised its long-term- rating and underlying rating (SPUR) to 'A-' from 'BBB' on California Housing Finance Agency's (CalHFA) bonds issued under its home mortgage revenue bond (HMRB) indenture. The outlook is stable.

We have raised the rating due to the improved performance in CalHFA's HMRB indenture and sufficient assets to cover loan losses at the 'A-' rating level.

The rating reflects our opinion of the following strengths:

- Consolidated indenture cash flows that demonstrate sufficient assets and revenues to absorb projected loan losses at the 'A' level;
- Trend of increasing profitability and asset coverage in the indenture since 2010;
- CalHFA's success in reducing the indenture's exposure to variable-rate debt and swaps; and
- Declines in delinquency and foreclosure rates in the indenture, 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 following weaknesses:

- A loan portfolio that we consider to be of moderate to high risk, with approximately 36% of loans insured through a contract with Genworth Mortgage Insurance Corp. (B/Stable) to reinsure the California Housing Loan Insurance Fund (CaHLIF, 'N.R.'), and a significant portion of interest-only or 40-year loans;
- A high level of nonperforming assets relative to the state and CalHFA's peers; and
- Continued financial challenges resulting from the significant historical use of variable-rate debt and swaps.

We also affirmed our 'AA+/A-1+' rating on all of CalHFA's variable-rate demand bonds. The rating reflects credit and liquidity support in the form of credit and liquidity facilities provided by Fannie Mae and Freddie Mac.

Outlook

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

The stable outlook on CalHFA's TCLP-supported debt is based on the outlook of the U.S. government.

Asset Quality

We consider the single-family loan portfolio to be of significantly higher risk relative to that of other HFAs. As of June 30, 2013, 36% of loans were conventional loans insured by a nonrated mortgage insurer, CaHLIF. CaHLIF has a reinsurance contract with Genworth Mortgage Insurance Co. (BB+/Negative). However, since neither CaHLIF nor Genworth currently carry investment-grade ratings, we no longer assume any recoveries from CaHLIF or Genworth, in accordance with our criteria. As of June 30, 2013, no cash or investments were 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 rescinded less than 1% of claims historically.

In addition, approximately 20% of CalHFA's single-family loan portfolio consists of interest-only loans (consisting of both insured and uninsured loans), on which only interest is paid for the first five years and which then amortize over the next 30 years with the same interest rate. Another 5% of loans had 40-year terms rather than the standard 30-year term. Overall, in addition to the conventionally insured loans, approximately 28% of single-family loans were Federal Housing Administration-insured, 35% were uninsured, and 1.1% were Veterans Administration- or Rural Development-guaranteed as of June 30, 2013.

The portfolio's delinquency and foreclosure rates have shown a declining trend in the past several years from 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 Sept. 30, 2013, CalHFA reported a 60-day-plus delinquency and foreclosure rate of 8.47% for loans under the HMRB resolution, down slightly from 8.73% in the second quarter of 2013, and significantly lower than the third quarter of 2012 at 9.69%. Interest-only loans have continued to suffer higher delinquency and foreclosure rates, nearly twice that of 30-year, fully amortizing loans (13.6% versus 7.6% as of Sept. 30, 2013). Similarly, 40-year loans had a 60-day-plus delinquency rate of 12.6% as of Sept. 30, 2013, also significantly higher than the 7.6% rate reported for 30-year loans. Nonetheless, the portfolio has generally shown a downward trend in delinquency and foreclosure rates for all loan products since the peak of 13.98% in the first quarter of 2010. In addition, CalHFA's real estate owned (REO) inventory has declined significantly to 102 units, as of June 30, 2013, since its high of 1,110 units in 2011. Real estate-owned properties decreased $66.1 million to $20.1 million as of June 30, 2013 compared with $86.2 million as of June 30, 2012.

Compared with the Mortgage Bankers Assn.'s statistics for the state of California, CalHFA's delinquency and foreclosure rates have been higher for the past 19 consecutive quarters (through June 30, 2013), assuming a similar composition of prime loans, although the gap appears to be narrowing.

All loans under CalHFA's HMRB indenture are 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, both of which are held under the HMRB indenture. As of June 30, 2013, the allowance for loan loss reserve was $109.1 million, a decline from $117 million in fiscal 2012. This includes a reserve amount of $59.3 million to cover shortfalls insured by CAHLIF.

Based on our loan-loss projections, the estimated charge to capital for projected losses under CalHFA's homeownership loan portfolio stands at approximately $241 million under an 'A' stress level for 2013, a decline from $294 million at a 'BBB' stress level in our last review.

Financial Strength

Profitability and asset coverage in the indenture has improved over the last four years, with parity at approximately 108% in fiscal year 2013, compared to 107% in the prior two fiscal years, and a low of 105% in fiscal year 2010.

As noted above, we currently assume no recoveries from CaHLIF nor Genworth due to the lack of a rating for the former and a non-investment grade rating for the latter. Based on our methodology, our projected loan losses (net of insurance recoveries) under HMRB are currently $241 million, or 8.91% of loans.

We received economic stress cash flows with a basis date of June 30, 2013 that incorporated our projected level of loan losses at the 'A' level. The cash flows assumed a $10 million one-time transfer from the Housing Assistance Trust (HAT), effective on Jan. 1, 2014 to cover any potential shortfalls as a result of the losses and also included variable-rate debt and reinvestment assumptions consistent with our current criteria.

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 June 30, 2013, was 108.325%, with a fund balance of approximately $251 million. Based on these cash flows, we believe that, at this time, there are sufficient excess assets under the HMRB resolution to cover our current projection of loan losses at the 'A' rating level.

Debt

As of June 30, 2013, there were $3.02 billion in bonds outstanding under the HMRB indenture. Of this amount, $1.7 billion, or approximately 57%, was variable rate. Of the variable-rate bonds, approximately $1.38 billion, or 80%, were hedged with interest-rate swaps. In our opinion, the risks associated with the heavy use of variable-rate debt and swaps have exposed the agency to a number of challenges since the start of the financial market crisis in 2008. 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 five years responding to these challenges while also implementing numerous initiatives to reduce its variable-rate debt exposure under its older indentures. The total notional amount of swaps outstanding as of Aug. 1, 2013 was $1.7 billion, down from the $3.6 billion as of Jan. 1, 2010. Because interest rates are generally lower than the rates in effect at inception of the swap agreements, the agency's fixed-payer swap agreements had an aggregate negative fair value of $217.7 million as of June 30, 2013 compared with $324.2 million as of June 30, 2012. The agency has benefitted from reduced swap collateral posting requirements over the past year as a result of reduced notional amounts and rising interest rates, having posted $53 million as of August 2013 versus the highest collateral posting of $132 million in February 2012.

We believe that CalHFA's participation in the U.S. Treasury's Temporary Credit and Liquidity Program (TCLP) and New Issue Bond Program (NIBP) has also eased some of the pressures on its balance sheet and the HMRB indenture. The addition of large amounts of fixed-rate debt under NIBP has helped to reduce CalHFA's variable-rate debt exposure significantly. CalHFA is the largest participant in the TCLP among HFAs. The agency's participation in TCLP enabled the agency to replace bank liquidity facilities on all of its variable-rate demand obligations (VRDOs) with credit and liquidity facilities from Fannie Mae and Freddie Mac, resulting in the elimination of all CalHFA's bank bonds and reduction in VRDO remarketing rates.

As of Nov. 1, 2013, management reported remaining TCLP liquidity outstanding of $1.2 billion, $912 million (76%) of which is under the HMRB indenture. To date, the agency has surpassed all of its benchmarks for liquidity amounts outstanding, established by the renewed TCLP program. As of Nov. 1, 2013, the agency met its benchmarks through calendar year2014 and projects that it will have approximately $610 million in TCLP liquidity outstanding in fiscal 2015. The agency has adopted a TCLP exit strategy to include solicitation of new facilities, conversion into index floaters, or refundings to fixed-rate bonds. Management has presented this strategy to the U.S. Treasury and continues to update it given market conditions and trends in financial performance.

Reserves And Investments

As of June 30, 2013, there was approximately $98.5 million on deposit in reserve funds under the HMRB indenture, or approximately 3.5% of loans outstanding. These reserves were part of $545 million in non-mortgage assets contained in HMRB, which includes guaranteed investment contracts, federal agency securities, and cash holdings. The majority (65%) 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 (16%), federal agency securities (18%), and money market funds (1%). All investment agreements are with providers rated 'A' or above by Standard & Poor's.

Housing Market

According to Global Insight, California's economy continues to expand at a moderate but steady pace. Housing starts bottomed out in 2009 and have since increased to 68,000 units in the second quarter of 2013 and are forecasted to reach 165,687 by 2016; however, they are still below their pre-recession peaks. Global Insight reports that the home prices are appreciating at a good pace, ranking California second in the country in terms of annual home price growth. According to the Federal Housing Finance Agency's purchase-only home prices index, prices were up by 5.6% from the previous quarter and up by 19.1% from the previous year and down by just 1.9% over the past five years. According to the Mortgage Bankers Assn., 5.9% of California's subprime loans entered foreclosure (compared with 11.2% nationally), while 1% of prime loans entered foreclosure (compared with 2% nationally) during the third quarter of 2013.

Standard & Poor's anticipates that the 30-year mortgage rate will hover between 4.0% and 4.5% through 2014 in a baseline scenario, or reach 5.4% in an upside scenario. We do not anticipate that CalHFA will issue mortgage revenue bonds under this indenture for the purpose of originating new loans in the near future. Rather, most near-term issuance, if any, will likely be for refunding or restructuring purposes.

2013-2014 Industry Economic Outlook for U.S. Public Finance Single-Family Housing

(As of December 2013)

	Forecast/Scenarios						**Actual**
	Downside		**Baseline**		**Upside**		
	2013	**2014**	**2013**	**2014**	**2013**	**2014**	**2012**
Macroeconomic indicators							
30-year fixed mortgage rate (%)	3.99	4.09	3.96	4.56	3.98	5.40	3.66
10-year Treasury note yield (%)	2.28	2.00	2.32	2.93	2.37	4.18	1.80
Unemployment rate (%)	7.47	7.59	7.45	6.87	4.35	6.05	8.08
Real GDP (% change)	1.53	0.58	1.68	2.55	1.78	4.13	2.78
Total nonfarm payrolls (% change)	1.61	0.75	1.64	1.63	1.66	2.46	1.70
CPI (% change)	1.38	0.80	1.44	1.43	1.50	2.13	2.08
Households (mil.)	121.36	122.84	121.41	123.09	121.44	123.29	119.99
Median single-family existing-home price ($000s)	194.95	190.80	195.57	201.75	195.58	202.09	175.78
Median new-homes sale prices ($000s)	260.75	261.67	264.53	270.29	264.73	263.72	242.11
Existing single-family home sales (mil. units)	4.46	4.42	4.52	4.80	4.56	5.22	4.13
Single-family housing starts (mil. units)	0.61	0.56	0.62	0.81	0.65	1.04	0.54
Federal government spending	(4.70)	(3.00)	(4.70)	0.40	(4.30)	0.90	(1.40)

Standard & Poor's U.S. economic team's forecasts are constructed using the Global Insight model of the U.S. economy. Forecasts are from the "u.S. Economic Forecast: Two Economies Diverged In A Wood," published Dec. 5 on RatingsDirect. CPI--Consumer Price Index.

Related Criteria And Research

Related Criteria

- USPF Criteria: Single-Family Whole Loan Programs, June 14, 2007
- USPF Criteria: Housing Finance Agencies, June 14, 2007
- USPF Criteria: New Discounts Reflect Changes To Mortgage Insurer Rating Assumptions In The Municipal Housing Sector (As Of Sept. 2, 2010), Sept. 15, 2010
- USPF Criteria: Assumptions: Update to Cash Flow Analysis for Public Finance Housing Bonds, March 3, 2009

- RMBS Criteria: U.S. Interest Rate Assumptions Revised For May 2012 And Thereafter, April 30, 2012
- General Criteria: Revised Minimum Reinvestment Rate Assumptions For Fixed-Rate U.S. Structured Finance And Municipal Housing Bonds, June 7, 2010

Ratings Detail (As Of December 12, 2013)		
California Hsg Fin Agy home mtg rev bnds (AGM)		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
California Hsg Fin Agy home mtg rev bnds [Ambac]		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
California Hsg Fin Agy home mtg rev bnds [FGIC]		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded
California Hsg Fin Agy home mtg rev bnds [Natl Pub Fin Gty Corp]		
Unenhanced Rating	A-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.