CalHFA

California Housing Loan Insurance Fund

Biennial Report 2013

AUDITED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

EVERYDAY Heroes

California Housing Finance Agency

CALIFORNIA HOUSING FINANCE AGENCY

MORTGAGE INSURANCE SERVICES

BIENNIAL PROGRAM EVALUATION REPORT

Prepared by the
California Housing Finance Agency

November 1, 2014

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Introduction

This biennial program evaluation report on the California Housing Loan Insurance Fund (CaHLIF) Programs, administered by the California Housing Finance Agency (CalHFA), is submitted in accordance with the statutory reporting requirements of Section 51622 of the Health and Safety Code. The statute provides that the report shall discuss the program's effectiveness in relation to cost and include any recommendations and suggested legislation, if any, for improvement to its programs.

The Mortgage Insurance programs are funded by CalHFA's California Housing Loan Insurance Fund, a public enterprise fund. This fund is not in any way guaranteed by CalHFA or the State of California. As such, neither CalHFA nor the State of California is liable for any claims against CaHLIF.

This report discusses the economic forces that have negatively impacted the mortgage insurance industry as a whole since 2009. While the decline in housing prices has slowed, unemployment is still high in most California markets. There are signs of improvement, evidenced by the decreased number of REO properties in CalHFA's inventory. The sustained mortgage loan delinquencies and defaults, however, have stressed the finances of all mortgage insurers and changed their continued ability to hedge risk in the mortgage industry. Major private mortgage insurers across the country have been downgraded by credit rating agencies, and some have ceased doing business or have gone into receivership (taken over by a trustee to distribute the remaining assets equitably to creditors) as a result of massive claims on reserves. CaHLIF has suffered similar losses. While some mortgage insurers have seen their prospects improve over the last couple of years, CaHLIF's position is less tenable because its portfolio of insured loans is concentrated solely in the California market (where most mortgage insurers are able to diversify their risk geographically across the country) and it insures primarily CalHFA's loans for low and moderate-income, first-time homebuyers. Additionally, it has not had the capital to issue any new policies since 2009. Not only was this customer base more deeply affected, there has been no new insurance business to generate additional income and there has also been an increase in claim payments. Within this broader context, in August 2011 CaHLIF depleted its reserves and began operating at a deficit. As explained further in this report, with the exception of administrative costs, the proceeds from all insurance premiums paid into the fund now are used to pay claims in the order they are received.

Mortgage Insurance Industry
Overview & Trends

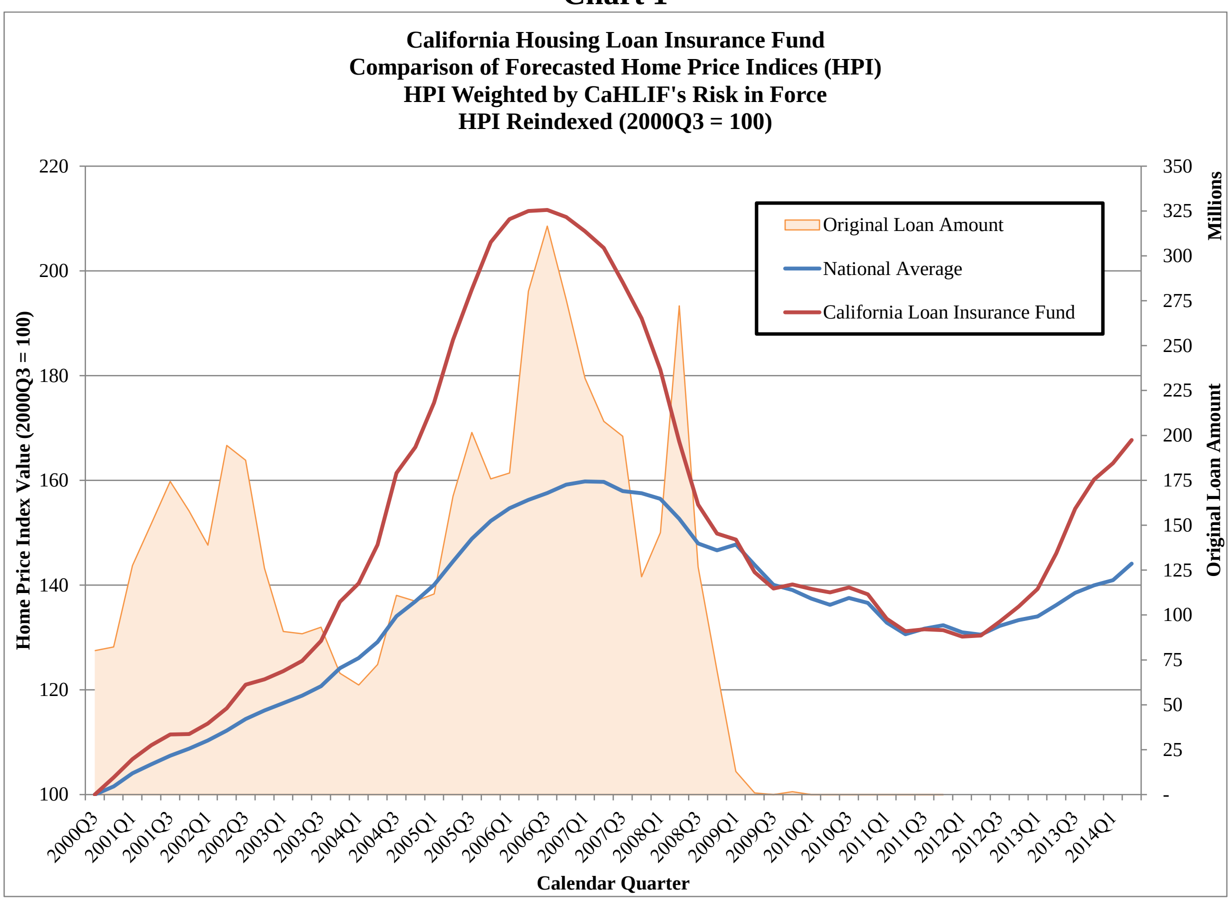
Mortgage insurance protects lenders and investors from potential financial loss should a borrower default on a mortgage. The mortgage insurance industry acts as a link between the primary mortgage originators and the capital markets, such as Fannie Mae, Freddie Mac or other Wall Street investment facilities. Mortgage insurance facilitates investment in high loan-to-value mortgages in the capital mortgage market and expands homeownership opportunities by enabling qualified borrowers to buy homes typically with 5% or 10% down payment, rather than more historically standard 20% of purchase price.

The mortgage insurance industry underwent substantial financial pressure following the run-up and peak in home prices during 2005, 2006 and 2007. California single-family house prices reached their lowest point in early 2012. Since our 2012 Biennial Program Evaluation Report to the Legislature, the real estate market, particularly the California housing market, has slightly rebounded from its low point, but still remains significantly below the peak of the market in 2006.

For loans in CaHLIF's portfolio, declines in average house prices in California were a major factor in the current performance of the portfolio. The portfolio has experienced an increased level of defaults and severity over the past several years compared to historical averages. A fall in average home prices increases both the frequency of defaults and the severity of loss given default.

CaHLIF's portfolio is concentrated in one of the states that experienced the greatest declines in house prices from 2007 through 2012. Federal Housing Finance Agency data shows the average house price in California dropped 42% from its peak in 2006 to its lowest point in 2012; the comparable figure at the national level is 18%. While California home prices have rebounded, average prices are still 32% below peak levels, as opposed to 10% nationally. Chart 1 below provides a visual of the average house price in CaHLIF's portfolio, the red line, compared to the national average, the blue line. The chart also shows CaHLIF's original loan volume by year in the orange area. CaHLIF's origination volume peaked as home prices peaked in 2006.

Chart 1



In addition to large declines in the average house price, CalHFA's portfolio was negatively impacted by increases in unemployment rates. The California Employment Development Department reported that the national unemployment rate reached its highest level of 10% in October 2009. It has dropped significantly since then to 6.2% in July 2014. However, the California unemployment rate was significantly elevated above the national trend, peaking at 12.4% in February 2010. Unemployment in the state has dropped significantly since its peak, measuring 7.4% in July 2014.

The rising home prices and decreasing unemployment rates have led to better performing mortgages. The Mortgage Bankers Association (MBA) reported that in the second quarter of 2014 the percentage of loans in foreclosure or delinquent was 8.53%, down from a peak of 13.52% for the third quarter of 2010. By the time the housing market began its recovery in 2012 CaHLIF had already fully depleted its assets and was no longer able to fully pay claims.

The private mortgage insurance industry has experienced results similar to CaHLIF. For the private mortgage insurance industry, negative economic trends have resulted in increased claim payments, straining available capital resources. During the housing downturn, most major private mortgage insurers received downgrades from rating agencies. Since 2012, some mortgage insurers have seen their credit ratings upgraded due to a better housing market outlook (see Chart 2). The downgrading of mortgage insurers increases the likelihood of default for mortgage insurers as their ability to raise private capital is commensurately diminished with weaker credit ratings.

Chart 2
Standard and Poor's Industry Mortgage Insurance Company Ratings
Comparing 2008, 2010, 2012 and 2014 Ratings

MORTGAGE INSURER	2008	2010	2012	2014
UGC	AA+	BBB	BBB	A-
GENWORTH	AA-	BBB-	B	BB-
RMIC	A+	BBB-	Withdrawal requested by RMIC	Withdrawal requested by RMIC
MGIC	A	B+	B-	BB
PMI	A-	B+	In Receivership	In Receivership
RADIAN	BBB+	B+	B-	BB-

CalHFA Mortgage Insurance Overview & Performance

CalHFA was created in 1975 as California's affordable housing lender. In that capacity, the Agency provides affordable loan products for first time low- to moderate-income homebuyers and developers of affordable rental and special needs housing. In 1977, CalHFA was statutorily authorized to offer mortgage insurance programs for single family or multifamily loans and for construction loans where the underlying loan targets low-to-moderate income homeowners or renters, and to offer bond insurance.

The mission of CalHFA's Mortgage Insurance program has been to expand homeownership opportunities for eligible California homebuyers by providing low cost mortgage insurance programs specifically designed for first-time, low and moderate income homebuyers who often lack sufficient savings for a standard 20% down payment.

Since 1977, CalHFA Mortgage Insurance has insured 35,655 loans with an origination loan balance of $6.7 billion. Chart 3 shows the original amount of loans insured compared to the actual risk amount insured together with the insurance and risk currently covered. CaHLIF does not insure the entire balance of any given loan. CaHLIF typically insures a portion of the original loan amount, known as the coverage amount; therefore, CaHLIF's risk is less than the current balance of the insured loans. As of September 16, 2014 there were 3,667 loans insured for a balance of $986.3 million and a total insured risk, or risk-in-force, of $342.5 million. CaHLIF has mitigated a large share of possible losses by passing off approximately 69% of this risk under a reinsurance treaty with Genworth Mortgage Insurance.

Chart 3
California Housing Finance Agency
Mortgage Insurance Fund - Ever-to-Date Statistics
(Data as of 9/16/2014)

Year	Number of Policies Written	Amount of Insurance Written	Amount of Original Risk Written	Number of Policies Still In Force	Amount of Insurance Still In Force	Amount Risk Still In Force
2003 & Prior	23,285	$ 3,275,020,902	$1,489,404,945	118	$15,673,363	$7,392,028
2004	1,469	$ 351,545,471	$173,536,186	123	$25,901,626	$12,321,666
2005	2,378	$ 653,927,996	$257,539,572	448	$120,097,367	$45,342,912
2006	3,583	$1,050,211,559	$367,800,326	862	$254,078,754	$89,018,694
2007	2,574	$760,560,203	$54,932,984	942	$272,359,534	$89,968,377
2008	2,295	$613,993,809	$205,396,125	1,141	$292,069,163	$96,547,569
2009	71	$15,392,384	$5,054,626	33	$6,113,822	$1,932,091
2010	-	No New Insurance	-	-	-	-
2011	-	"	-	-	-	-
2012	-	"	-	-	-	-
2013	-	"	-	-	-	-
2014	-	"	-	-	-	-
Total	35,655	$ 6,720,652,324	$2,753,664,764	3,667	$986,293,629	$342,523,337

With the collapse of capital markets in 2008, and continuing to present day, traditional sources of funds for bonds were no longer available, particularly for tax-exempt housing bonds. At the same time, the State restricted the uses of the Pooled Money Investment Board (PMIB) fund so that it was no longer available as an interim source for CalHFA's line of credit. Consequently, CalHFA suspended purchasing mortgages due to the lack of bond financing and liquidity. These events impacted the CalHFA Mortgage Insurance program. CaHLIF had been the exclusive mortgage insurer of CalHFA single family conventional loans and consequently lost the major portion of its mortgage insurance business. In 2013, CalHFA started new single-family loan programs, but the programs do not use CaHLIF insurance. CalHFA is not taking loan loss risk on these new programs, but the loans are being insured by either Genworth Mortgage Insurance or the Federal Housing Administration (FHA).

The loss of a source of new business, combined with significant increases in delinquencies and paid claim losses had eroded CaHLIF's capital to the point that, by the fourth quarter of 2009, the California Housing Loan Insurance Fund's statutory surplus capital fell below that required to insure new loans. CaHLIF then withdrew as an insurer of new business. In the fourth quarter of 2011, CaHLIF had completely depleted its loss reserve and began scheduling its portion of claim settlement payments from premium funds as they were received. The remaining portion of claim settlements continues to be paid through a reinsurance risk quota share agreement with Genworth Mortgage Insurance.

Financial Summary

Annual Audited Financial Results 2013 -2012

The audited financial results of CaHLIF show that as of December 31, 2013 insurance in force decreased by $316.6 million, or 22%, to $1.16 billion, compared to $1.47 billion as of December 31, 2012. CaHLIF had an operating income of $30.2 million for 2013. Net operating results of the Fund improved by approximately $49.6 million in 2013, with an operating income of $30.2 million, compared to the operating loss of $19.4 million in 2012. This was primarily due to a decrease in loan loss reserves and net claim payments as delinquencies and foreclosures declined during 2013. The Fund had a net deficit balance of $81.0 million as of December 31, 2013, compared to a net deficit balance of $111.2 million on December 31, 2012. Home mortgage delinquencies declined during 2013, and the ratio for the insured portfolio decreased to 19.3% in December 2013 or $167.6 million, down from 21.2% or $276.8 million in December 2012. CaHLIF's reserves for loan losses decreased by $9.4 million in 2013 to $18.2 million as a result of the Fund's decrease in the number of delinquencies outstanding and the improving California housing market.

The Agency continues to monitor delinquencies closely and is proactive in its actions to mitigate losses. CalHFA has continued the reinsurance treaty and administrative services agreement with Genworth Mortgage Insurance. This reinsurance treaty cedes to Genworth a 75% quota share of the insurance risk for a percentage of the premium. This reinsurance expires after the tenth calendar year of the loan. During the third quarter of 2011, the funds available to pay claims and expenses of CaHLIF were depleted. CaHLIF continues to receive its share of premiums from policies still in force and will use the monthly premiums received along with any other available funds to pay the Fund's claims on a "first-in, first-out" basis in the order in which the claims are received, after paying monthly operating expenses.

Claim Paying Changes

Before December 2008 the total of ever-to-date claims paid was $17.4 million and CaHLIF's portion was $4.3 million. Claims peaked in 2010 and in the fourth quarter of 2011 CaHLIF began to schedule its portion of claim payments only when sufficient CaHLIF funds became available and after Genworth had paid its claim portion (Chart 4).

Chart 4
Claims Payment Schedule and Delinquency Rates (in millions)

Year	Total of Claims	CaHLIF's Share of Claims (Net of Genworth Reinsurance)	Amount of CaHLIF Claim Share Scheduled But Not Yet Paid	Delinquency Rate
1978 to 2008	$17.4	$4.3	-	
2009	$94.4	$24.0	-	22.0%
2010	$167.3	$43.1	-	20.7%
2011	$149.6	$38.9	$2.2	18.8%
2012	$99.7	$26.0	$26.0	18.2%
2013	$52.5	$13.6	$13.6	14.7%
6/30/2014	$13.0	$3.9	$3.9	11.4%
Totals as of 6/30/2014	$593.9	$153.7	$45.7	

CalHFA is not authorized to use its assets as at-risk capital in support of mortgage insurance programs. Rather, insurance programs are solely supported by the California Housing Loan Insurance Fund. As of June 30, 2014, the Agency's insurance fund had insurance in force of $1.0 billion, an operating income of $5.6 million, assets of $0.8 million and liabilities of $76.2 million, including loss reserves of $11.2 million, premium deficiency reserves of $18.7 and other liabilities that exceeded current assets resulting in a total unrestricted equity deficit balance of $75.4 million (Chart 5). For financial accounting purposes, reserves for loss are those funds that would be set aside for current delinquent loans based on their potential to become claims. Also, for financial accounting purposes, premium deficiency reserves are calculated on the difference between current and expected delinquencies that have the potential to become claims and operating expenses, compared to the premium income and other sources of funds over a ten year period.

Chart 5
Condensed Balance Sheet
California Housing Loan Insurance Fund 6/30/2014

ASSETS	For YTD Ended June 30, 2014	For YTD Ended June 30, 2013	Difference
Cash and cash equivalents	44,653.00	130,862.20	(86,209.20)
Investment in Surplus Money Investment Fund	5,000.00	0.00	(5,000.00)
Interest receivable	2.41	2.10	(0.31)
Due from CalHFA	0.00	0.00	0.00
Other assets	747,659.64	885,745.59	(138,085.95)
Total Assets	797, 315.05	1,016,609.89	(219,294.84)
LIABILITIES AND FUND EQUITY			
Liabilities			
Unpaid loss and loss adjustment expense reserve	11,213,094.98	21,763,767.40	(10,550,672.42)
Premium deficiency reserve	18,719,000.00	49,849,000.00	(31,130,000.00)
Unearned premiums	11,117.61	38,417.98	(27,300.37)
Reinsurance payable	237,644.30	326,522.80	(88.878.50)
Claims payable	45,137,047.33	39,494,450.35	5,642,596.98
Accounts payable and other liabilities	77.00	40,644.79	(40,567.79)
Compensated absences	58,685.75	109,796.29	(51,110.54)
Due to CalHFA	150,847.14	160,011.79	(9,164.65)
Due to other government entities	705,000.00	643,996.00	61,004.00
Total Liabilities	76,232,514.11	112,426,607.41	(36,194,093.29)
Fund Equity			
Invested in capital assets	11,616.61	15,616.76	(4,000.15)
Restricted	0.00	0.00	0.00
Unrestricted	(75,446,815.67)	(111,425,614.27)	35,978,798.60
Total Fund Equity	(75,435,199.06)	(111,409,997.51)	35,974,798.45
Total Liabilities and Fund Equity	797,315.05	1,016,609.90	(219,294.84)

Condensed Income Statement
California Housing Loan Insurance Fund 6/30/2014

REVENUES	For YTD Ended June 30, 2014	For YTD Ended June 30, 2013	Difference
Premium earned	3,832,637.16	4,721,385.82	(888,748.66)
Expired Book Revenue - Genworth	1.346.899.86	0.00	1,346,899.86
Investment income	4.73	7.01	(2.28)
Other revenues	3,600.00	3,900.00	(300.00)
Total Revenues	5,183,141.75	4,725,292.83	(457,848.92)
EXPENSES			
Loss and loss adjustment expenses	(3,097,142.15)	1,667,754.26	(4,764,896.41)
Operating expenses	2,698,806.63	3,248,874.95	(550,068.32)
Other expenses	25,444.69	25,409.03	35.66
Total Expenses	(372,890.83	4,942,038.24	(5,314,929.07)
OPERATING INCOME/(LOSS)	5,556,032.58	(216,745.41)	5,772,777.99
Fund Equity at the Beginning of Year	(80,991,231.64)	(111,193,252.10)	30,202,020.46
Fund Equity at the End of Year	(75,435,199.06)	(111,409,997.51)	35,974,798.45

Strategic Direction

It is not anticipated that CaHLIF will again reach statutory surplus capital requirements, and therefore, no new mortgage insurance will be written. CaHLIF's downgrade rating to CC- in September 2009 resulted in no benefit to either CalHFA's Home Mortgage Revenue Bond rating or CaHLIF as a mortgage insurer. Thus, CaHLIF withdrew from Standard & Poor's claims-paying rating analysis and report.

CalHFA will continue to work closely with Genworth Mortgage Insurance, which provides reinsurance for CaHLIF. Continuing the partnership with Genworth provides two important functions. First, under a reinsurance treaty, Genworth shares the risk of loss with CaHLIF. Each loan has reinsurance for 10 years from the year mortgage insurance was originated. During this time should a loan default and result in a claim, Genworth will pay 75% of the loss on reinsured loans. Claims received for payment by CaHLIF are placed in a payment schedule in the order in which they were received. CaHLIF's 25% share in a claim is paid subject to sufficient funds being accumulated from premium receipts. The reinsurance treaty continues to be reviewed and amended to reflect the changing business needs of both CaHLIF and Genworth. CalHFA's Mortgage Insurance Division and Genworth have worked together to implement loss mitigation programs to reduce the risk of default and claims. Such work includes maximizing the use of the U.S Treasury's Hardest Hit Fund administered in California as the Keep Your Home California program, with loan modification options focused on foreclosure avoidance and loss mitigation. The second function is the administrative services Genworth provides to CaHLIF through state of the art premium collection, default management and claims processing. An agreement between CalHFA and Genworth has been reached for Genworth to continue the administrative services on all of CaHLIF's mortgage insurance through 2018.

Challenges for CalHFA and its Insurance Program

There are two major obstacles affecting the viability of CaHLIF in its support of the CalHFA's single family program and other affordable housing finance initiatives:

- The depletion of capital resulting from paid claim losses due to delinquencies and foreclosures.
- The lack of available capital to support existing insurance obligations.

The decline in home prices and continued high unemployment rates are expected to result in continued defaults by borrowers, increased insurance claim payments and decreased income to CaHLIF due to fewer mortgage insurance premiums being paid. These factors, together with the already eroded capital, are causing delays in the payment of claims submitted to CaHLIF. The housing market is now improving, but it is too late to reverse the damage done to CaHLIF's financial position. CaHLIF received $3.4 million in net premiums from borrowers in 2013. This amount is decreasing each year as the loan count decreases and insurance is removed. In 2014, the premiums collected are expected to total $2.9 million. CaHLIF also received $38.9 million in 2013 in payments from Genworth Mortgage Insurance, under its reinsurance risk share agreement, to pay claims under the CaHLIF mortgage insurance master policy. The claim payments received from the Genworth reinsurance have decreased along with the drop in foreclosures. In 2014, this number is projected to drop to $18 million.

CaHLIF's reserves for losses have been depleted. Beginning August 2011 CaHLIF's primary claims have exceeded the pace at which CaHLIF receives monthly premiums to pay CaHLIF's 25% share of the claims. To manage this shortfall, since August 2011 payment on claims owed by CaHLIF have been placed in a queue and will be paid by CaHLIF to the extent there are sufficient monthly premiums. It is expected that CaHLIF will receive premiums in excess of operating expenses through 2019 and that there will only be sufficient net premiums for CaHLIF to pay its share of claims placed in the queue through December 19, 2011. Even if CaHLIF is unable to meet its obligations to pay its share of mortgage insurance claims, it is currently expected that HMRB and other CalHFA bond indenture will be able to withstand the losses and meet all debt obligations.

Recommendations

As described above, because of the unprecedented financial crisis, beginning in August 2011 CaHLIF's revenues were not sufficient to pay its portion of all claims submitted under its policy for mortgage insurance. Consequently, CaHLIF has implemented a payment plan that is impartial and ensures fairness to all insureds (i.e., beneficiaries), whether the insured is Fannie Mae, CalHFA itself, or another third party. The claim payment process is as follows:

1. Approved claims are placed in a queue in the order in which they have been received from Genworth. Genworth will continue to pay its 75% share of the claim, even after CaHLIF funds are exhausted.

2. Because CaHLIF expects to continue to receive monthly premium payments in the approximate amount of $200,000, each month CaHLIF will have funds to pay some of the claims in the queue. As these funds are received, CaHLIF will pay, in full, as many claims as possible in the queue, on a "first-received, first-paid" basis. No partial claim payments will be made. To maximize the number of claims paid, interest will not accrue on any claims in the queue.

3. To maintain the orderly administration of the fund, CaHLIF's administrative and operating expenses, while minimal, will continue to be paid prior to the payment of claims in the queue. In addition, CaHLIF has contracted with Genworth to administer all mortgage insurance services for CaHLIF through 2018.

4. CalHFA will periodically review this claim payment plan and may make changes as it deems necessary or advisable.

As CalHFA continues to pursue new sources of revenue and sustainable business models, there will be new lending programs for single family borrowers. Most likely those new loan products will require mortgage insurance. While we will continue to be vigilant in our stewardship of the existing fund – making sure claims are paid as cash becomes available – it is our expectation that when new policies of mortgage insurance are written, the policy(s) will be issued in a manner which is not related to CaHLIF.

CALIFORNIA HOUSING LOAN INSURANCE FUND
Sacramento, California

FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
Years Ended December 31, 2013 and 2012

CliftonLarsonAllen LLP
www.cliftonlarsonallen.com

Independent Auditors' Report

Board of Directors
California Housing Finance Agency
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of the California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency (the Agency), a component unit of the State of California, which comprise the statements of net position as of December 31, 2013 and 2012, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of December 31, 2013 and 2012, and the changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Fund will continue as a going concern. As discussed in Note 2 to the financial statements, the Fund is experiencing difficulty in generating sufficient cash flow to meet its obligations and sustain its operations. These conditions raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 - 11 are presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 29, 2014 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Bellevue, Washington
April 29, 2014

CALIFORNIA HOUSING LOAN INSURANCE FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS YEARS ENDED DECEMBER 31, 2013 AND 2012

The California Housing Finance Agency ("Agency") was created in 1975 by an act of the California Legislature and commenced operations in 1976. The Agency is a component unit of the State of California ("State") and is included in the State's Comprehensive Annual Financial Report. The Agency is authorized to administer the activities of the California Housing Loan Insurance Fund (the "Fund"), the California Housing Finance Fund ("Housing Finance Fund") and two state general obligation bond funds. The Agency is governed by a Board of Directors which consists of 11 voting members and three non-voting members. Of the 11 voting members, six are appointed by the Governor, three are ex-officio and two are appointed by the Legislature. The statutory role of the Board is to: 1) enact the annual financing resolutions that permit the issuance of bonds and 2) enact the Agency's operating budget and business plan. Subject to the supervision of the Board, the Agency's day-to-day operational authority statutorily resides with the Agency's Executive Director. The annual audited financial statements of both the Fund and the Housing Finance Fund are available on the Agency's website - www.calhfa.ca.gov.

The following Management Discussion and Analysis applies only to the activities of the California Housing Loan Insurance Fund and should be read in conjunction with the Fund's financial statements and the notes to the financial statements. The Agency is entirely self-funded and does not draw upon the general taxing authority of the State. The Agency is authorized to use the Fund's assets as at-risk capital in support of mortgage insurance programs which finance the acquisition, new construction, or rehabilitation of residential structures in California. The Fund insures loans made by the Agency; loans made by lenders for securitization by the Federal National Mortgage Association ("FNMA"), and Federal Home Loan Mortgage Corporation ("FHLMC"); and loans made by localities, nonprofit agencies, and the California State Teachers' Retirement System. In conducting business the Agency is authorized to reinsure any risk undertaken by the Fund.

While the Fund is subject to the same statutory requirements as private mortgage insurance companies with respect to the maintenance of policyholders' surplus, the Fund is exempt from regulatory control by the State Department of Insurance. The Fund is currently unrated.

Underwriting, acquisition, and issuance expenses are charged directly to the Fund as well as loss and loss adjustment expenses. Certain administrative and operating expenses, including office space, business services and supplies, legal services, accounting services, information technology support, and human resource support services, are provided by the Agency and indirectly charged to the Fund. The basic financial statements of the Fund include the statement of net position, statement of revenue, expenses and changes in net position and statement of cash flows.

FINANCIAL RESULTS 2013 – 2012

- The Fund had an operating income of $30.2 million for 2013. Net operating results of the Fund improved by approximately $49.6 million in 2013 when compared to the operating loss of $19.4 million in 2012. This was primarily due to the $31.1 million decrease in Premium Deficiency Reserve and the $12.3 million decrease in net claim payments during 2013. The Fund has a net deficit balance of $81.0 million at December 31, 2013, compared to a net deficit balance of $111.2 million at December 31, 2012.

- Insurance in force decreased by $316.6 million, or 22 %, to $1.16 billion as of December 31, 2013, compared to $1.47 billion as of December 31, 2012. The Fund ceased committing to insure new loans in September 2009.

- The number and amount of insured delinquencies declined from 999 or $276.8 million in 2012 to 642 or $167.6 million in 2013. Gross insurance claim payments were $52.5 million and $99.6 million in 2013 and 2012, respectively, before reinsurance.

- The Fund's reserve for loan losses decreased by $9.4 million in 2013 to $18.2 million as a result of the Fund's decreased number of delinquencies outstanding and improving California housing market. The Agency continues to monitor delinquencies closely and is proactive in its attempts to mitigate losses.

- The Fund continued the reinsurance treaty and administrative services agreement with Genworth Financial ("Genworth"), previously known as GE Mortgage Insurance Corporation ("GEMICO"). This insurance treaty cedes to Genworth a 75% quota share of the insurance risk and 64.5% of the premium collected for most loans insured by the Fund. The treaty was amended for loans insured on or after May 1, 2008 to 67% of premium collected and amended again on April 1, 2009 to 69% of premium collected on loans insured on or after that date.

- Each month, the Fund continues to receive its share of premiums from policies still in force and uses the monthly premiums received along with any other available funds to pay the Fund's claims on a "first-in, first-out" basis in the order in which the claims are received after paying the monthly operating expenses of the Fund (see Note 2). The Fund continues to remain dependent upon the ability of the Fund's reinsurer to pay its share of the claims. (see Note 5).

- Moody's Investor Services ("Moody's") rating of Genworth Mortgage Insurance Corporation remained at "Ba2" during the year.

2013 COMPARED TO 2012

CONDENSED STATEMENTS OF NET POSITION

The following table presents condensed statements of net position for the Fund as of December 31, 2013 and 2012, and the change from year to year (dollars in thousands):

	2013	2012	Change
ASSETS			
Cash, cash equivalents, and investments	$ 159	$ 208	$ (49)
Other assets	823	946	(123)
Total assets	$ 982	$ 1,154	$ (172)
LIABILITIES			
Reserves for unpaid losses and loss adjustment expenses	$ 18,178	$ 27,577	$ (9,399)
Premium deficiency reserve	18,719	49,849	(31,130)
Unearned premiums	33	75	(42)
Accounts payable and other liabilities	45,043	34,846	10,197
Total liabilities	$ 81,973	$ 112,347	$ (30,374)
NET POSITION			
Net investment in capital assets	14	18	(4)
Unrestricted	(81,005)	(111,211)	30,206
Total net position	$ (80,991)	$ (111,193)	$ 30,202

Assets - Total assets of the Fund were $982 thousand as of December 31, 2013, a decrease of $172 thousand or 15% from December 31, 2012. Of the Fund's assets, 16% are represented by cash and investments. The Fund does not have a significant investment in capital assets.

Cash, cash equivalents, and investments were $159 thousand as of December 31, 2013, a decrease of $49 thousand from December 31, 2012. The Agency invests the Fund's cash in the State's Surplus Money Investment Fund ("SMIF"). SMIF provides the Fund a variable rate of return and complete liquidity. Cash invested in SMIF is deposited within the State's Centralized Treasury System and managed by the State Treasurer.

Other assets were $823 thousand as of December 31, 2013, a decrease of $123 thousand or 13% from December 31, 2012. The decrease is primarily due to having a lower accounts receivable from Genworth as the number of active policies has declined.

Liabilities - The Fund's liabilities were $82 million as of December 31, 2013, a decrease of $30.3 million or 27% from December 31, 2012.

The reserve for unpaid losses and loss adjustment expenses was $18.2 million as of December 31, 2013, a decrease of $9.4 million from December 31, 2012. The premium deficiency reserve decreased $31.1 million to $18.7 million in 2013. As of December 31, 2013, 706 insured loans with balances aggregating $184.4 million were either reported as delinquent by the lender or assumed delinquent but not reported. As of December 31, 2012, 1,099 insured loans with balances aggregating $304.5 million were either reported as delinquent by the lender or assumed delinquent but not reported.

Unearned premiums were $33 thousand as of December 31, 2013, a decrease of $42 thousand from December 31, 2012. The decrease was due to policy adjustments between the servicer and reinsurer. The expected trend of this account is to decrease over time due to a change in premium collection practices. Beginning in 1996, management adopted the mortgage insurance industry norm of collecting monthly premium payments in arrears for newly established loan insurance products as compared to past practices of collecting annual premiums in advance. As a result, each year a greater percentage of insured loans require monthly premium payments, which are earned when received, rather than annual payments, which are received in advance and recorded as earned over a one-year period.

Accounts payable and other liabilities were $45 million as of December 31, 2013, an increase of $10.2 million from December 31, 2012. Genworth is only paying their 75% share of the claim payment and the Fund is paying 25% share of the claim payment. Since the Fund's cash is temporarily depleted each month, an accounts payable is being set up for the Fund's share of the claim payments that have not yet been paid.

Net Position - The Fund's net position is classified as unrestricted or net investment in capital assets. Total net position of the Fund increased by $30.2 million as a result of this current year's operations.

CONDENSED STATEMENTS OF REVENUES AND EXPENSES

The following table presents condensed statements of revenues and expenses for the Fund for the years ended December 31, 2013 and 2012, and the change from year to year (dollars in thousands):

	2013	2012	Change
OPERATING REVENUES:			
Premiums earned	$ 9,038	$ 10,683	$ (1,645)
Expired book revenue - reinsurer	422	-	422
Investment income	-	-	-
Other revenues	7	1	6
Total operating revenues	9,467	10,684	(1,217)
OPERATING EXPENSES:			
Loss and loss adjustment expenses	4,221	17,895	(13,674)
Premium deficiency reserve expenses	(31,130)	4,206	(35,336)
Salaries and general expenses	6,130	7,876	(1,746)
Other expenses	44	111	(67)
Total operating expenses	(20,735)	30,088	(50,823)
OPERATING INCOME(LOSS)	$ 30,202	$ (19,404)	$ 49,606

Operating Revenues - Operating revenues were $9.5 million during 2013 compared to $10.7 million during 2012, a decrease of $1.2 million or 11%.

Premiums earned in 2013 decreased by $1.6 million or 15% compared to premiums earned in 2012. The decrease in premiums earned corresponds with the decrease in insurance in force. Insurance in force was $1.16 billion and $1.47 billion as of December 31, 2013 and 2012, respectively.

As the 10 year reinsurance expires for a book year, the Fund receives the reinsurer's reserves set aside for that book year. In 2013, the Fund received $422 thousand for the 2003 book year.

The Fund invests its cash in SMIF only. SMIF interest rates for the past two years are shown in the following table:

Interest Payment Periods	Fiscal Year 2013	Interest Payment Periods	Fiscal Year 2012
January — March	0.275%	January — March	0.374%
April — June	0.246%	April — June	0.361%
July — September	0.249%	July — September	0.349%
October — December	0.248%	October — December	0.316%

Other revenues increased by $6 thousand to $7 thousand in 2013 from $1 thousand in 2012. Recoveries made on amounts owed from defendants in certain litigation increased from last year.

Operating Expenses - Total operating expenses were negative $20.7 million during 2013 compared to $30.1 million during 2012, a decrease of $50.8 million or 169%.

Loss and loss adjustment expenses decreased by $13.7 million in 2013 while the premium deficiency reserve expenses decreased by $35.3 million in 2013. The decrease in premium deficiency reserve expense is attributable to a lower expected future paid losses amount on unexpired business on the books as of December 31, 2013.

The Fund's salaries and general expenses were $6.1 million during 2013 compared to $7.9 million during 2012, a decrease of $1.7 million or 22%. The decrease is primarily a result of lower ceded premiums to the reinsurer due to lower insurance in force.

Operating Income - Operating income for 2013 was $30.2 million compared to an operating loss of $19.4 million in 2012, an increase of $49.6 million in income. The increase is primarily a result of the decreasing premium deficiency reserve balance and a decreasing reserve for unpaid losses in 2013.

FINANCIAL RESULTS 2012 – 2011

- Insurance in force decreased by $365.5 million, or 19.9 %, to $1.47 billion as of December 31, 2012, compared to $1.84 billion as of December 31, 2011. The Fund ceased committing to insure new loans in September 2009.

- The Fund had an operating loss of $19.4 million for 2012. Net operating results of the Fund decreased by approximately $21 million in 2012 compared to the operating income of $1.6 million in 2011. This was primarily due to losses incurred during 2012 and the $4.2 million increase to the Premium Deficiency Reserve during 2012. The Fund has a net deficit balance of $111.2 million at December 31, 2012, compared to a net deficit balance of $91.8 million at December 31, 2011.

- The number and amount of insured delinquencies declined from 1,278 or $356 million in 2011 to 999 or $276.8 million in 2012. Gross insurance claim payments were $99.6 million and $149.8 million in 2012 and 2011, respectively, before reinsurance.

- The Fund's reserve for loan losses decreased by $8 million in 2012 to $27.6 million as a result of the Fund's decreased number of delinquencies outstanding. The Agency continues to monitor delinquencies closely and is proactive in its attempts to mitigate losses.

- The Fund continued the reinsurance treaty and administrative services agreement with Genworth. This insurance treaty cedes to Genworth a 75% quota share of the insurance risk and 64.5% of the premiums collected for most loans insured by the Fund. The treaty was amended for loans insured on or after May 1, 2008 to 67% of premiums collected and amended again on April 1, 2009 to 69% of premiums collected on loans insured on or after that date.

- Each month, the Fund continues to receive its share of premiums from policies still in force and uses the monthly premiums received along with any other available funds to pay the Fund's claims on a "first-in, first-out" basis in the order in which the claims are received after paying the monthly operating expenses of the Fund (see Note 2). The Fund continues to remain dependent upon the ability of the Fund's reinsurer to pay its share of the claims. (see Note 5).

- During 2012, Moody's Investor Services ("Moody's") rating of Genworth remained unchanged at "Ba1" and Standard and Poor's ("S&P") rating of Genworth remained unchanged at "B".

2012 COMPARED TO 2011

CONDENSED STATEMENTS OF NET POSITION

The following table presents condensed statements of net position for the Fund as of December 31, 2012 and 2011, and the change from year to year (dollars in thousands):

	2012	2011	Change
ASSETS			
Cash, cash equivalents, and investments	$ 208	$ 170	$ 38
Other assets	946	1,197	(251)
Total assets	$ 1,154	$ 1,367	$ (213)
LIABILITIES			
LIABILITIES:			
Unpaid losses and loss adjustment expenses	$ 27,577	$ 35,591	$ (8,014)
Premium deficiency reserve	49,849	45,643	4,206
Unearned premiums	75	119	(44)
Accounts payable and other liabilities	34,846	11,803	23,043
Total liabilities	$ 112,347	$ 93,156	$ 19,191
NET POSITION			
Net investment in capital assets	18	23	(5)
Unrestricted	(111,211)	(91,812)	(19,399)
Total net position	$ (111,193)	$ (91,789)	$ (19,404)

Assets - Total assets of the Fund were $1.2 million as of December 31, 2012, a decrease of $0.2 million or 16% from December 31, 2011. Of the Fund's assets, 18% are represented by cash and investments. The Fund does not have a significant investment in capital assets.

Cash, cash equivalents, and investments were $208 thousand as of December 31, 2012, an increase of $38 thousand from December 31, 2011. The Agency invests the Fund's cash in the State's Surplus Money Investment Fund ("SMIF"). SMIF provides the Fund a variable rate of return and complete liquidity. Cash invested in SMIF is deposited within the State's Centralized Treasury System and managed by the State Treasurer.

Other assets were $946 thousand as of December 31, 2012, a decrease of $251 thousand or 21% from December 31, 2011. The decrease is primarily due to having a lower accounts receivable from Genworth as the number of active policies has declined.

Liabilities - The Fund's liabilities were $112.3 million as of December 31, 2012, an increase of $19.2 million or 21% from December 31, 2011.

The reserve for unpaid losses and loss adjustment expenses was $27.6 million as of December 31, 2012, a decrease of $8 million from December 31, 2011. However, the premium deficiency reserve increased $4.2 million to $49.8 million in 2012. As of December 31, 2012, 1099 insured loans with balances aggregating $304.5 million were either reported as delinquent by the lender or assumed delinquent but not reported. As of December 31, 2011, 1406 insured loans with balances aggregating $391 million were either reported as delinquent by the lender or assumed delinquent but not reported.

Unearned premiums were $75 thousand as of December 31, 2012, a decrease of $44 thousand from December 31, 2011. The decrease was due to policy adjustments between the servicer and reinsurer. The expected trend of this account is to decrease over time due to a change in premium collection practices. Beginning in 1996, management adopted the mortgage insurance industry norm of collecting monthly premium payments in arrears for newly established loan insurance products as compared to past practices of collecting annual premiums in advance. As a result, each year a greater percentage of insured loans require monthly premium payments, which are earned when received, rather than annual payments, which are received in advance and recorded as earned over a one-year period.

Accounts payable and other liabilities were $34.8 million as of December 31, 2012, an increase of $23 million from December 31, 2011. This increase is due to the change in claim payments process by Genworth and the increase in unpaid claims. Genworth is only paying their share of 75% claim payment and the Fund is paying 25% share of the claim payment. Also, the Fund's cash is temporarily depleted each month so an accounts payable was set up for CaHLIF's share of the claim payments that have not yet been paid.

Net Position - The Fund's net position is classified as unrestricted or net investment in capital assets. Total net position of the Fund decreased by $19.4 million as a result of this current year's operations.

CONDENSED STATEMENTS OF REVENUES AND EXPENSES

The following table presents condensed statements of revenues and expenses for the Fund for the years ended December 31, 2012 and 2011, and the change from year to year (dollars in thousands):

	2012	2011	Change
OPERATING REVENUES:			
Premiums earned	$ 10,683	$ 12,914	$ (2,231)
Investment income	-	37	(37)
Other revenues	1	4	(3)
Total operating revenues	10,684	12,955	(2,271)
OPERATING EXPENSES:			
Loss and loss adjustment expenses	17,895	25,066	(7,171)
Premium deficiency reserve expenses	4,206	(22,983)	27,189
Salaries and general expenses	7,876	9,380	(1,504)
Other expenses	111	(80)	191
Total operating expenses	30,088	11,383	18,705
OPERATING INCOME(LOSS)	$ (19,404)	$ 1,572	$ (20,976)

Operating Revenues - Operating revenues were $10.7 million during 2012 compared to $13.0 million during 2011, a decrease of $2.3 million or 18%.

Premiums earned in 2012 decreased by $2.2 million or 17% compared to premiums earned in 2011. The decrease in premiums earned corresponds with the decrease in insurance in force. Insurance in force was $1.5 billion and $1.8 billion as of December 31, 2012 and 2011, respectively.

Investment income decreased to $77 dollars in 2012 from $37 thousand in 2011. This decrease was due to the decrease in interest rates and decrease in investment in SMIF. SMIF interest rates for the past two years are shown in the following table:

Interest Payment Periods	Fiscal Year 2012	Interest Payment Periods	Fiscal Year 2011
January — March	0.374%	January — March	0.508%
April — June	0.361%	April — June	0.480%
July — September	0.349%	July — September	0.377%
October — December	0.316%	October — December	0.378%

Other revenues decreased by $3 thousand to $1 thousand in 2012 from $4 thousand in 2011. Recoveries made on amounts owed from defendants in certain litigation decreased from last year.

Operating Expenses - Total operating expenses were $30.1 million during 2012 compared to $11.4 million during 2011, an increase of $18.7 million or 164%.

Loss and loss adjustment expenses decreased by $7.2 million in 2012 while the Premium deficiency reserve expenses increased by $27.2 million in 2012. The increase in Premium deficiency reserve expenses is attributable to the increase in required reserves to cover potential losses, and claims payable.

The Fund's salaries and general expenses were $7.9 million during 2012 compared to $9.4 million during 2011, a decrease of $1.5 million or 17%. The decrease is primarily a result of lower ceded premiums to the reinsurer due to lower insurance in force.

Operating Loss - Operating loss for 2012 was $19.4 million compared to operating income of $1.6 million in 2011, a decrease of $21 million. The decrease is primary a result of increasing the premium deficiency reserve balance in 2012 rather than decreasing the premium reserve balance as in 2011.

Contact Information - If you would like additional information on the California Housing Loan Insurance Fund, please visit www.calhfa.ca.gov.

Request for Information - Questions concerning any of the information presented in this financial report or requests for additional information should be addressed to:

CalHFA Financing Division
500 Capitol Mall, Suite 1400
Sacramento, CA 95814
Phone: 916.326.8650
Fax: 916.322.1464
financing@calhfa.ca.gov

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF NET POSITION
DECEMBER 31, 2013 AND 2012

	2013	2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 153,485	$ 195,629
Investment in Surplus Money Investment Fund	5,000	12,000
Interest receivable	2	12
Other current assets	809,813	928,840
Total current assets	968,300	1,136,481
NONCURRENT ASSETS — Other assets	13,553	17,681
Total assets	$ 981,853	$ 1,154,162
LIABILITIES		
CURRENT LIABILITIES:		
Reserves for unpaid losses and loss adjustment expenses	$ 18,177,904	$ 27,576,790
Premium deficiency reserve	18,719,000	49,849,000
Unearned premiums	32,512	74,850
Reinsurance payable	282,021	364,839
Claims payable	43,825,725	33,499,477
Accounts payable and other liabilities	553	117,861
Compensated absences	56,855	94,546
Due to CalHFA	202,515	175,051
Total current liabilities	81,297,085	111,752,414
NONCURRENT LIABILITIES — OPEB	676,000	595,000
Total liabilities	81,973,085	112,347,414
CONTINGENCIES (Note 8)		
NET POSITION		
Net investment in capital assets	13,553	17,681
Unrestricted	(81,004,785)	(111,210,933)
Total net position (deficit)	$ (80,991,232)	$ (111,193,252)

See notes to financial statements.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
OPERATING REVENUES		
Premium earned	$ 9,037,652	$ 10,682,849
Expired book revenue - reinsurer	422,252	-
Investment income	12	77
Other revenues	7,500	900
Total operating revenues	9,467,416	10,683,826
OPERATING EXPENSES		
Loss and loss adjustment expenses - net of recoveries	4,221,060	17,894,768
Premium deficiency reserve expenses	(31,130,000)	4,206,000
Salaries and general expenses	6,129,916	7,876,511
Other expenses	44,420	110,798
Total operating expenses	(20,734,604)	30,088,077
OPERATING(LOSS)/INCOME	30,202,020	(19,404,251)
NET POSITION - Beginning of year	(111,193,252)	(91,789,001)
NET POSITION - End of year	$ (80,991,232)	$ (111,193,252)

See notes to financial statements.

CALIFORNIA HOUSING LOAN INSURANCE FUND

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013 AND 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$ 9,114,342	$ 10,859,056
Payments to suppliers	4,305,560	15,464,349
Payments to employees	(387,338)	(653,824)
Payment to other government entities	108,464	276,471
Other payments	(13,190,193)	(25,908,687)
Net cash provided by (used in) operating activities	(49,165)	37,365
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of investments	7,000	88,000
Purchase of investments	-	(74,000)
Interest on investments	21	79
Net cash provided by investing activities	7,021	14,079
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(42,144)	51,444
CASH AND CASH EQUIVALENTS — Beginning of year	195,629	144,185
CASH AND CASH EQUIVALENTS — End of year	$ 153,485	$ 195,629
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Operating income (loss)	$ 30,202,020	$ (19,404,251)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest on investments	(12)	(77)
Unpaid loss and loss adjustment expenses	(9,398,886)	(8,014,818)
Premium deficiency reserve expense	(31,130,000)	4,206,000
Depreciation expense	4,128	4,906
Unearned policy acquisition expense	-	25,280
Effects of changes in certain operating assets and liabilities:		
Other assets	119,028	220,016
Unearned premiums	(42,338)	(43,809)
Reinsurance payable	(82,818)	(107,114)
Compensated absences	(37,691)	85,294
Claims payable	10,326,248	22,727,648
Accounts payable and other liabilities	(117,308)	61,819
Due to CalHFA	27,464	(9,089)
Due to CalPERS - OPEB	81,000	285,560
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ (49,165)	$ 37,365

1. AUTHORIZING LEGISLATION AND ORGANIZATION

The California Housing Finance Agency (“Agency”) was created in 1975 by an act of the California Legislature and commenced operations in 1976. The Agency is a component unit of the State of California (“State”) and is included in the State’s Comprehensive Annual Financial Report. The Agency is authorized to administer the activities of the California Housing Loan Insurance Fund (the “Fund”), the California Housing Finance Fund (“Housing Finance Fund”) and two state general obligation bond funds. The Agency is governed by a Board of Directors which consists of 11 voting members and three non-voting members. Of the 11 voting members, six are appointed by the Governor, three are ex-officio and two are appointed by the Legislature. The statutory role of the Board is to: 1) enact the annual financing resolutions that permit the issuance of bonds and 2) enact the Agency’s operating budget and business plan. Subject to the supervision of the Board, the Agency’s day-to-day operational authority statutorily resides with the Agency’s Executive Director. The annual audited financial statements of both the Fund and the Housing Finance Fund are available on the Agency’s website - www.calhfa.ca.gov.

The California Housing Loan Insurance Fund (the “Fund”) is one of two continuously appropriated funds administered by the California Housing Finance Agency (the “Agency”). These funds allow the Agency to carry out its purpose of meeting the housing needs of persons and families of low and moderate income within the State. The Agency is authorized to insure mortgage loans and to issue bonds, notes, and other obligations to fund loans to qualified borrowers for single-family houses and multifamily developments. The Agency has no taxing power and is exempt from federal income taxes and state franchise taxes.

The accompanying financial statements are the statements of the Fund and do not include the financial position or the results of operations of the Agency. As of June 30, 2013, the Agency had total assets of $6.78 billion and fund equity of $1.42 billion (not covered by this independent auditors’ report).

The Agency is also authorized to use the Fund to provide mortgage insurance for loans made by the Agency and others which finance the acquisition, new construction, or rehabilitation of residential structures in California. Total risk in-force was $405.6 million and $519.6 million at December 31, 2013 and 2012, respectively. Of the insured first mortgage loans outstanding at December 31, 2013, 87.3% have loan-to-value ratios, measured as of the funding date of the loan, greater than 90%.

The Fund’s reserve for loan losses decreased during 2013 as a result of the improved California housing market and decrease in the number of insured California home mortgage delinquencies. The Fund is currently unrated. In 2013, Moody’s rating of Genworth Mortgage Insurance Corporation remained unchanged at ”Ba2”.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Accounting - The Fund is accounted for as an enterprise fund. Accordingly, the accompanying financial statements have been prepared using the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America (hereinafter referred to as "Generally Accepted Accounting Principles"), which differ from statutory accounting practices followed by insurance companies in reporting to insurance regulatory authorities. This fund is reported using the flow of economic resources focus.

The financial statements of the Fund were prepared using generally accepted accounting principles that are applicable to a going concern. Management of the Fund has concluded that there is substantial doubt as to the Fund's ability to continue to fully meet its designated purpose of paying claims and expenses. The financial statements of the Fund do not include any adjustments that might result from the outcome of this uncertainty. As of December 31, 2013, the Fund's cash and cash equivalents are not sufficient to meet the Fund's total anticipated cash requirements to pay its obligations over the next twelve months. Management believes that attempts to raise any additional capital will be unsuccessful and does not believe that, under the terms of the agreement with the CHFF, the Fund will be able to draw on the interfund credit agreement (see note 6). Subsequent to that event, the Fund will continue to receive its share of premiums from policies still in force and will use the premiums received along with any other available funds to pay the Fund's obligations on a "first-in, first-out" basis in the order in which the claims are received after paying the monthly expenses of the Fund. Further, management of the Fund is actively managing the Fund and continuously reviewing the reinsurance agreement with Genworth to determine the best course of action for both the expiring (unreinsured) and reinsured books of business.

Accounting and Reporting Standards - The Fund follows the Standards of Governmental Accounting and Financial Reporting, as promulgated by the Governmental Accounting Standards Board (GASB). The Fund has adopted the GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,* which incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants' (AICPA) pronouncements issued on or before November 30, 1989, that does not conflict with or contradict GASB pronouncements.

Use of Estimates - The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents - The Fund considers cash on hand and cash on deposit with the State Controller's office other than the investment in the State's Surplus Money Investment Fund (SMIF) to be cash and cash equivalents.

Investments - The Agency invests the Fund's excess cash in SMIF, which represents a portion of the State's Pooled Money Investment Account (PMIA). These PMIA funds are on deposit within the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters, and maximum maturity of investments. Investments in SMIF are recorded at fair value. The Office of the State Treasurer of California issues a Pooled Money Investment Board Report with information on the PMIA's portfolio composition. A copy of that report may be obtained from the Office of the State Treasurer, 915 Capitol Mall, Room 106, Sacramento, CA 95814 or via the internet at www.treasurer.ca.gov.

Other Current Assets - The Fund considers current accounts receivable as other current assets.

Claims Payable - The Fund establishes claims payable for claims received but not yet paid. As of December 31, 2013, the Fund's claims payable were $41,116,984 and $2,708,741 for CHFF and other external parties, respectively. The claims payable as of December 31, 2012 were $31,701,719 and $1,797,758 for CHFF and other external parties, respectively.

Reserves for Unpaid Losses and Loss Adjustment Expenses - The Fund establishes reserves for losses and loss adjustment expenses, to recognize the estimated liability for potential losses and related loss expenses in connection with borrower default on mortgage payments. The liability for unpaid losses and loss adjustment expenses resulting from mortgage insurance is an estimate based upon the unpaid delinquent balance on mortgage loans reported by lenders as of the close of the accounting period, estimates of incurred but not reported (IBNR) claims, and historical and expected frequency and loss severity information.

There is a high level of uncertainty inherent in the evaluation of the required loss and loss adjustment expense reserves. Management has selected frequency of claims paid and severity loss ratios that it believes are reasonable and reflective of anticipated ultimate experience. The ultimate costs of claims are dependent upon future events, the outcomes of which are affected by many factors. The Fund's claim reserving procedures and settlement practices, economic inflation, court rulings, real estate market conditions, and many other economic, scientific, legal, political, and social factors all can have significant effects on the ultimate cost of claims.

Changes in operations and management practices may also cause actual developments to vary from past experience. Since the emergence and disposition of claims are subject to uncertainties, the net amounts that will ultimately be paid to settle the liability may vary significantly from the estimated amounts provided for in the accompanying financial statements. Any adjustments that may be material to reserves are reflected in the operating results of the periods in which they are made.

Premium Deficiency - The Fund establishes reserves for a premium deficiency wherein future paid losses and expenses on unexpired business exceed the related premium revenue for such business, along with the current loss reserves. A premium deficiency is therefore recognized in the balance sheet as an accrued liability, recorded as a Premium Deficiency Reserve for the excess amount. The liability for the premium deficiency reserve is an estimate based upon the delinquent balance on mortgage loans reported by lenders as of the close of the accounting period, historical claim payment and loss incurred pattern development, future estimated premium, and future estimated losses on currently performing mortgage loans.

Net Position - Fund net position is classified as invested in capital assets, restricted equity or unrestricted equity. Invested in capital assets represents investments in office equipment and furniture net of depreciation. Restricted net position represents net position that is restricted pursuant to the Agency's enabling legislation. Unrestricted net position represents net position not restricted for any purpose. There was no restricted net position at either December 31, 2013 or 2012.

Operating Revenues and Expenses - The Fund's primary operating revenue is derived from premiums earned on private mortgage insurance written. The primary expenses are the expenses associated with the underwriting, acquisition, issuance, administration, and the reinsurance of private mortgage insurance products and policies, as well as the losses associated with these products and policies.

Recognition of Premium Income - Primary mortgage insurance policies are contracts that are generally non-cancelable by the insurer and provide payment of premiums on a monthly, annual, or single basis. Premiums written on a monthly basis are earned as coverage is provided. Premiums written on an annual basis are recorded as unearned premiums and amortized on a monthly pro rata basis over the year of coverage. Primary mortgage insurance premiums written on policies covering more than one year are referred to as single premiums. A portion of single premiums is recognized immediately in earnings, and the remaining portion is recorded as unearned premiums and amortized over the expected life of the policy.

Reinsurance - Effective March 1, 2003, the Fund entered into a reinsurance treaty and administrative services agreement with Genworth. This agreement cedes to Genworth a 75% quota share of the insurance risk for most loans insured by the Fund and provides for certain administrative services to be performed by Genworth. The Fund uses reinsurance to reduce net risk in force and optimize capital allocation.

Recently Adopted GASB Pronouncements - In 2011, GASB issued GASB 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB 65, *Items Previously Reported as Assets and Liabilities*. These statements clarify the reporting for deferred inflows and deferred outflows and other reporting issues in governmental financial statements and re-define the definitions and reporting of assets and liabilities. The requirements of GASB 63 are effective for years beginning after December 15, 2011 and for GASB 65, for years beginning after December 15, 2012. The Fund has adopted GASB 63 during the year ended December 31, 2012 and adopted GASB 65 for the year ended December 31, 2013. The implementation of this new standard resulted in a change in terminology on the Statement of Net Position for 2013.

New GASB Pronouncements - In 2012, GASB also issued GASB No. 68, *Accounting and Financial Reporting for Pensions- An Amendment of GASB Statement No. 27*. The primary objective of GASB 68 is to improve accounting and financial reporting by state and local governments for pensions, the statement is effective for fiscal years beginning after June 15, 2014, and the Fund will adopt GASB 68 for the year ending December 31, 2015. In 2013, GASB issued GASB No. 69, *Government Combinations and Disposals of Government operations,* and GASB Statement No. 71, *Pension Transition for Contributions made subsequent to the Measurement date- An Amendment of GASB Statement No. 68*. The Fund will adopt Statement No. 69 for financial reporting periods beginning January 1, 2014, and adopt Statement No. 71 for financial reporting period beginning January 1, 2015 as required. GASB No. 69 establishes accounting and financial reporting standards related to government combinations and disposals of government operations. GASB No. 71 addresses an issue regarding application of the transition provisions of Statement No. 68.

3. CASH, CASH EQUIVALENTS, INVESTMENTS AND INVESTMENT RISK FACTORS

The Fund utilizes a cash and investment pool maintained by the State Treasurer's office. Each account's portion of this pool is included in investment on the statement of net position.

Cash and Cash Equivalents - At December 31, 2013 and 2012, all cash and cash equivalents, totaling \$153 thousand and \$196 thousand, respectively, were covered by federal depository insurance or collateral held by the Agency's agent in the Agency's name.

Investments - Investment of funds is restricted by the Act, generally, to certain types of investment - securities, including direct obligations of the U.S. Government and its agencies, the State Treasurer's Pooled Money Investment Account, and other financial instruments.

There are many factors that can affect the value of investments. Some, such as credit risk, custodial credit risk, concentration of credit risk, and interest rate risk, may affect both equity and fixed-income securities. Equity and debt securities respond to such factors as economic conditions, individual company earning performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates. It is the investment policy of the Fund to invest substantially all of its funds in fixed income securities, which limit the Fund's exposure to most types of risk. For the investments in the Surplus Money Investment Fund cost approximates market.

Investments by type at December 31, 2013 and 2012, consist of the following:

	2013	2012
Surplus Money Investment Fund — State of California	$ 5,000	$ 12,000

Credit Risk - Fixed income securities are subject to credit risk, which is the risk that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. At December 31, 2013, the Fund does not have any investments exposed to credit risk.

Custodial Credit Risk - Custodial credit risk is the risk that in the event of the failure of the custodian, the investments may not be returned. At December 31, 2013, the Fund did not have any investments exposed to custodial credit. All investments are held by the State of California.

Concentration of Credit Risk - Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the Fund to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. At December 31, 2013, the Fund does not have any investments exposed to concentration of credit risk.

Interest Rate Risk - Interest rate risk is the risk that the value of fixed income securities will decline due to decreasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. At December 31, 2013, the Fund does not have any debt investments that are highly sensitive to changes in interest rates.

4. RESERVES FOR UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

The following tables summarize the changes in the reserves for unpaid losses and loss adjustment expenses for the years ended December 31, 2013 and 2012. The first table presents reserves on a gross basis (before reinsurance) and the second table presents the reserve on a net basis (after reinsurance). The total net reserve for loss and loss adjustment is reflected in the financial statements.

Gross	**2013**	**2012**
Gross reserve for loss and loss adjustment — beginning of year balance	$ 104,856,756	$ 133,389,854
Incurred (recovered) related to:		
Provision attributable to the current year	41,526,212	85,157,449
Change in provision attributable to prior years	(30,090,724)	(14,134,629)
Total incurred	11,435,488	71,022,820
Payments related to:		
Current year	(6,091,613)	(14,749,505)
Prior years	(46,364,139)	(84,806,413)
Total payments	(52,455,752)	(99,555,918)
Gross reserve for loss and loss adjustment — end of year balance	$ 63,836,492	$ 104,856,756

Net of Reinsurance	**2013**	**2012**
Net reserve for loss and loss adjustment — beginning of year balance	$ 27,576,790	$ 35,591,608
Incurred (recovered) related to:		
Provision attributable to the current year	11,471,562	21,921,908
Change in provision attributable to prior years	(7,250,502)	(4,027,140)
Total incurred	4,221,060	17,894,768
Payments related to:		
Current year	(1,487,107)	(3,730,522)
Prior years	(12,132,839)	(22,179,064)
Total payments	(13,619,946)	(25,909,586)
Net reserve for loss and loss adjustment — end of year balance	$ 18,177,904	$ 27,576,790

The change in provision attributable to prior year (net of reinsurance) decreased by $7.3 million for the year ended December 31, 2013 due to a decrease in loan delinquencies from the year ended December 31, 2012, while the change in provision attributable to prior year (net of reinsurance) decreased by $4.0 million for the year ended December 31, 2012 from the year ended December 31, 2011 is also due to a decrease in loan delinquencies.

Reserves for loss and loss adjustment expenses relate to delinquent loans, net of reinsurance. Such estimates were based on historical experience, which management believes is representative of expected future losses at the time of estimation. As a result of the extended period of time that may exist between the report of a delinquency and claim payment thereon, significant uncertainty and variation exist with respect to the ultimate amount to be paid because economic conditions and real estate markets will change.

5. REINSURANCE

Effective March 1, 2003, the Fund entered into a 75% quota share reinsurance agreement with Genworth to reinsure most (currently, approximately 93%) of the Fund's portfolio. Under the terms of this agreement, the reinsurer will indemnify the Fund for 75% of all losses paid on the insured loans to which the Fund cedes 64.5% of the related premiums. The treaty was amended for loans insured on or after May 1, 2008 to cede 67% of premiums collected and amended again on April 1, 2009 to cede 69% of premiums collected on loans insured on or after that date. However, there are no loans currently ceded at 69%. The Fund's reinsurance agreement typically provides for a recovery of a proportionate level of claim expenses from the reinsurer. The Fund remains liable to its policyholders if the reinsurer is unable to satisfy its obligations under the reinsurance agreement. The amount of earned premiums ceded to Genworth for the years ended 2013 and 2012 was $5.8 million and $7.4 million, respectively.

According to the terms of the reinsurance agreement, Genworth's reinsurance is for a period up to the end of the tenth calendar year for each existing book year. Therefore, insurance policies issued in 2003 book year had reinsurance through December 31, 2012. The Agency elected not to renew the reinsurance on the expiring 2003 book. If the reinsurance is not renewed after the expiration date, the Fund receives 100% of the related premiums, pays for 100% of any related claims, and receives Genworth's reserves set aside for the related book year. In 2013, the Fund received $422 thousand for book year 2003.

6. ARRANGEMENTS WITH THE CALIFORNIA HOUSING FINANCE FUND

Certain administrative and operating expenses charged to the Fund are provided by the Agency. These expenses, initially paid from the CHFF, include office space, business services, legal services, accounting services, information systems support, and human resource support services. The Fund is charged monthly for these expenses and a payable is recorded. For the years ended December 31, 2013 and 2012, total expenses allocated to the Fund by the Agency were $496,736 and $573,538, respectively.

As part of CalHFA's Loan Modification Program, Genworth remits pre-claim advance payments to the Fund. The payments received are remitted directly to the CHFF. The total pre-claim advance payments due to CHFF were $70,145 and $67,487 at December 31, 2013 and 2012, respectively.

The Agency Board of Directors approved Resolution 03-19 on March 20, 2003, authorizing the Agency to utilize the resources of CHFF to support the mortgage guaranty insurance programs of the Agency in the following two ways: (1) the Executive Director of the Agency is authorized to create one or more supplementary reserve accounts within the Supplementary Bond Security Account of CHFF to indemnify the Mortgage Insurance Fund for losses incurred or to pay claims against the Mortgage Insurance Fund in connection with loans financed by the Agency and (2) the Executive Director of the Agency may establish an interfund credit agreement by which the Fund may borrow such sums from CHFF as may be required to maintain the claims paying rating of any credit rating service.

Initially, the Agency Executive Director established an interfund credit agreement in the amount of $100,000,000 in which the Fund may borrow from CHFF as needed for the purpose of paying claims arising out of policies of mortgage guarantee insurance and costs and expenses related to the payment of such claims. The amount by which the fund may borrow was reduced to $10,000,000 from $100,000,000 during 2009. Interest rates and repayment terms are determined upon receipt of a request to draw on this credit facility. Pursuant to the terms of the Board Resolution and the interfund credit agreement, the credit line is no longer legally available to the Fund. The credit agreement stipulates that the amount of credit is determined to be an amount necessary to maintain or improve the claims paying rating of the Fund, which at the time was "A+", and such amount shall not impair or adversely affect the Agency credit rating or any CHFF bond credit rating. The claims paying rating of the Fund was "A+" until July 2009 when it was lowered to "BBB" and subsequently fell as low as "CCC-" during 2010. In September 2010, management of the Fund decided to withdraw the rating. Consequently, there is no credit line currently available under the interfund agreement as there is no rating to support and the $10 million would not resurrect the "CCC-" claims paying rating back to "A+".

7. PENSION PLAN AND POST RETIREMENT BENEFITS

The Fund contributes to the Public Employees' Retirement Fund (PERF) as part of the State of California, the primary government. The PERF is a cost-sharing multiple-employer defined benefit pension plan administered by the California Public Employment Retirement System (CalPERS). CalPERS provides retirement, death, disability, and postretirement health care benefits to members as established by state statute. CalPERS issues a publicly available Comprehensive Annual Financial Report (CAFR) that includes financial statements and required supplementary information for the Public Employees' Retirement Fund. A copy of that report may be obtained from CalPERS via the internet at www.calpers.ca.gov.

For the CalPERS fiscal years ended June 30, 2013, 2012, and 2011, the employer contribution rates were as follows:

	Jun-13	**Dec-12**	**Jun-12**	**Dec-11**
State Miscellaneous Member First Tier	20.503 %	20.503 %	18.175 %	18.175 %
State Miscellaneous Member Second Tier	20.457	20.457	17.025	17.025

The Fund's contributions to the PERF for the years ended December 31, 2013, 2012, and 2011, were $82,097, $335,203, and $189,984, respectively, equal to the required contributions for each year.

Required contributions are determined by actuarial valuation using the individual entry age normal cost method. The most recent actuarial valuation available is as of June 30, 2012, which actuarial assumptions included (a) 7.5% investment rate of return compounded annually, (b) projected salary increases that vary by duration of service, and (c) overall payroll growth factor of 3% annually. The overall payroll growth factor included a new price inflation component of 2.75% and a 0.25% per annum real wage inflation assumption.

The most recent actuarial valuation of the PERF indicated that there was an unfunded actuarial accrued liability. The amount of the underfunded liability applicable to each Agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due, are presented in the June 30, 2013, CalPERS CAFR.

GASB Statement 45 requires states and local governments to publicly disclose the future dollar amount of their obligations to pay for Other Postemployment Benefits (OPEB), like healthcare, that are provided to retired employees, including retired public employees. The OPEB is a cost-sharing multiple-employer defined benefit healthcare plan administered by CalPERS. State Controller's Office sets the employer contribution rate based on the annual required contribution of the employers (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed thirty years. The State Controller's Office estimated the Fund's unfunded OPEB costs to be $676,000 and $595,000 for the years ended December 31, 2013 and 2012, respectively, and this liability was added to Personal Services in the respective year. CalPERS issues a publicly available CAFR that includes financial statements and required supplementary information for the OPEB.

8. LITIGATION

On June 14, 2002, the Agency filed a complaint in the case of California Housing Finance Agency (CalHFA) v. Hanover California Management and Accounting Center Inc., (HC) et al, Orange County Superior court #02CC10634 (Action). The trial in this matter has concluded and the Agency prevailed on all causes of action. The jury awarded $6.7 million in damages, prejudgment interest of $1 million, and finally the jury found that the defendants acted with malice, and awarded total punitive damages of $1.5 million. The defendants appealed the judgment and the Court of Appeal issued a decision affirming the judgment in full. The decision is now final.

The amounts received from the defendants were $7,500 and $900 during the years ended December 31, 2013 and 2012, respectively which is recorded as other revenue in the accompanying Statements of Revenues, Expenses, and Changes in Net Position. To date, the Agency has received approximately $2.9 million. It is highly unlikely that any additional amounts will be received and as such no gain contingency has been recorded.

Certain other lawsuits and claims arising in the ordinary course of business have been filed or are pending against the Fund. Based upon information available to the Agency, its review of such lawsuits and claims and consultation with counsel, the Agency believes the liability relating to these actions, if any, would not have a material adverse effect on the Fund's financial statements.

9. SUBSEQUENT EVENTS

In February 2014, Moody's upgraded the ratings on Genworth Mortgage Insurance Corporation to "Ba1" from "Ba2".

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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
California Housing Finance Agency
Sacramento, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the California Housing Loan Insurance Fund (the Fund), which is administered by the California Housing Finance Agency (the Agency), as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated April 29, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

A *deficiency in internal* control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Bellevue, Washington
April 29, 2014

CalHFA℠
California Housing Finance Agency

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