California Housing Finance Agency; Single Family Whole Loan

16-May-2011

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

Rationale

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

The lowered ratings reflect our opinion of:

- A loan portfolio that we consider to be of moderate to high risk, with approximately 42% of loans insured through a reinsurance contract with Genworth Mortgage Insurance Corp. (BB+/Negative) with the California Housing Loan Insurance Fund (CaHLIF, 'NR'), and a significant portion of loans composed of either interest-only or 40-year loans;
- The weak California housing market, which has contributed to high nonperforming assets; and
- Financial challenges facing CalHFA resulting from the significant use of variable-rate debt and swaps.

The above factors are partially offset by our opinion of consolidated cash flows that demonstrate sufficient assets and revenues to absorb projected loan losses without reliance on cash contributions by CalHFA from other funding sources. In addition, participation in the U.S. Treasury's Temporary Credit and Liquidity Program has allowed to the agency to refinance some of its high interest and variable-rate debt.

Outlook

The stable outlook reflects our expectation that the loans and other collateral will perform sufficiently well, based on the agency's adequate asset-to-liability position and CalHFA's active 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, we would consider an upgrade. If the indenture's fund balance declines considerably, loss assumptions increase, or CalHFA is unable to find a replacement for the Temporary Credit and Liquidity Program support, negative rating action could be warranted.

Asset Quality

As of June 30, 2010 there were $5.41 billion in mortgages outstanding under the HMRB indenture. We consider the single-family loan portfolio to be of moderate to high risk relative to other housing finance agencies: As of Dec. 31, 2010, 42% of loans were conventional loans insured by CaHLIF, and 23% were interest-only loans (consisting of both insured and uninsured loans), on which interest is paid for the first five years and which then amortize over the next 30 years with the same interest rate. Another 4% of loans had 40-year terms, rather than the standard 30-year term. Overall, in addition to the conventionally insured loans, approximately 29% of single-family loans were Federal Housing Administration-insured, 28% were uninsured, and 1% were Veterans Administration- or Rural Development-guaranteed as of Dec. 31, 2010.

All loans with private mortgage insurance under CalHFA's HMRB indenture must carry 50% coverage for the outstanding balance of each loan. Under the terms of the conventional loan insurance provided by CaHLIF, CaHLIF covers the first 35% of mortgage principal, plus lost interest and foreclosure costs, upon the filing of insurance claims for defaulted HMRB loans. CalHFA covers the remaining 15% through its gap insurance, to a maximum of $135 million. HMRB has received $100 million in claim support from the CalHFA gap insurance, leaving a balance of $35 million. As referenced above, CaHLIF is not rated by Standard & Poor's, but the insurance fund has a reinsurance contract with Genworth Mortgage Insurance Corp. (BB+/Negative). Due to the recent downgrade of Genworth to non-investment grade on Feb. 2, 2011, Standard & Poor's no longer assumes any payment of claims by Genworth in accordance with our criteria. While we assume no recovery from CaHLIF or Genworth on the first 35% of the loans, we incorporate CalHFA's payments into our assumptions. We subtract our estimate of CalHFA's obligations under this "gap" insurance from the agency's equity balance in our capital adequacy analysis. The total estimated charge to capital against CalHFA's balance sheet for projected loan losses under its homeownership portfolio and gap insurance coverage currently stands at approximately $420 million under a 'BBB' stress scenario, according to our calculations.

In our view, CalHFA continues to face challenges stemming from the weak California real estate market although the delinquency of the agency's loans seems to have hit a plateau. HMRB posted a rate of loans that were at least 60 days delinquent or in foreclosure of 13.11% on June 30, 2010 and has since improved to 12.51% as of March 31, 2011. Interest-only loans have continued to suffer higher delinquency than other loan products, with 18.49% of such loans that were 60 or more days delinquent as of Feb. 28, 2011. Similarly, 40-year loans had a 60-plus delinquency rate of 16.94% as of Feb. 28, 2011, compared with 9.43% for standard 30-year loans. Compared to MBA statistics for California, CalHFA's delinquency and foreclosure rates have been higher than the state's for the last 11 quarters, assuming a similar composition of prime loans.

CalHFA recorded $16.4 million in losses on the sale of foreclosed properties (net of insurance) during fiscal 2010, plus a $26.5 million write-down on the remaining foreclosed properties. Actual gap insurance claims paid by CalHFA during fiscal 2010 totaled approximately $45 million. Total losses to CalHFA were, therefore, approximately $88 million, a moderate 1.8% of a portfolio that now stands at $4.8 billion.

Financial Strength

As noted above, we currently assume recoveries from neither 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 $373 million, or 7.2% of loans.

We received economic stress cash flows with a basis date of July 1, 2010 that incorporated our projected level of loan losses at the 'BBB' level. The cash flows also included variable-rate debt 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 July 1, 2010, was 105.89%, with a fund balance of approximately $365 million. The cash flows did not require any future cash infusions from CalHFA in order to avoid revenue shortfalls. Based on these cash flows, we believe that at this time that there are sufficient excess assets under the HMRB resolution to cover our current projection of loan losses at the 'BBB' rating level.

Debt

As of June 30, 2010, there were $6.22 billion in bonds outstanding under the HMRB indenture. Of this amount, $3.7 billion, or approximately 60%, were variable-rate bonds. Of the variable-rate bonds, approximately $2.8 billion, or 76%, were hedged with interest rate swaps. In our opinion, the heavy use of interest rate swaps has exposed the agency to a number of risks, including basis mismatch, which has been prevalent in many of the agency's older swaps. Basis mismatch -- the difference between the actual interest rates paid to bondholders on floating-rate securities (variable-rate demand obligations, or VRDOs, and auction rate securities) and the variable rates received from swap counterparties on swaps -- reduced HMRB's operating income by $12 million in fiscal 2010.

Despite these losses, HMRB experienced significant relief from the financial pressures resulting from holding variable-rate debt in the second half of fiscal 2010. In December 2009 and January 2010, CalHFA participated in the U.S. Treasury's Temporary Credit and Liquidity Program (TCLP). Under the TCLP, CalHFA was able to terminate and replace the liquidity facilities on all variable-rate bonds under HMRB, as well as other bond programs, with master irrevocable standby temporary credit and liquidity facilities (TCLFs) issued by Fannie Mae and Freddie Mac to support the 57 series of bonds. At that time, we raised the ratings to 'AAA/A-1+' and assigned SPURs of 'AA-/WatchNeg' to each series of affected bonds. The TCLFs provide both credit and liquidity support for both tenders and scheduled bond payments. According to management, the new support is scheduled to expire in December 2012 and does not allow for extension.

We believe that the TCLP, along with the New Issue Bond Program, another federal program in which CalHFA is participating that will enable it to refund at least a portion of its high-interest, variable-rate, and auction-rate debt, has eased some of the pressures on CalHFA's balance sheet and the HMRB indenture.

Reserves And Investments

As of June 30, 2010, there was approximately $189 million on deposit in reserve funds under the HMRB indenture, or approximately 3.6% of loans outstanding. These reserves were part of $1.2 billion in non-mortgage assets contained in HMRB, which includes guaranteed investment contracts, federal agency securities, and cash holdings. The majority (59%) 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 (21%) or federal agency securities (18%). All investment agreements are with providers rated 'A' or above.

Housing Market

In our view, recent data indicate that the current housing decline continues to severely affect California's housing market: According to the Federal Housing Finance Authority, home prices in California have continued to decline in the last year and have performed worse than average U.S. home prices. As reported by the Federal Housing Finance Authority in the fourth quarter of 2010, California's home prices decreased by 4.73% from the fourth quarter of 2009, which followed a 6.0% decline from fourth quarter 2008 levels. U.S. national average home prices declined by 3.95% during 2010 and 5% the previous year.

Related Criteria And Research

- USPF Criteria: Single-Family Whole Loan Programs, June 14, 2007
- USPF Criteria: Housing Finance Agencies, June 14, 2007

Ratings Detail (As Of 16-May-2011)

California Hsg Fin Agy home mtg rev bnds (Ambac)		
Unenhanced Rating	BBB(SPUR)/Stable	Downgraded
California Hsg Fin Agy home mtg rev bnds (AGM)		
Unenhanced Rating	BBB(SPUR)/Stable	Downgraded
California Hsg Fin Agy home mtg rev bnds (Natl Pub Fin Gty Corp)		
Unenhanced Rating	BBB(SPUR)/Stable	Downgraded
California Hsg Fin Agy home mtg rev bnds (Natl Pub Fin Gty Corp]		
Unenhanced Rating	BBB(SPUR)/Stable	Downgraded

California Hsg Fin Agy home mtg rev bnds [FGIC]

Unenhanced Rating	BBB(SPUR)/Stable	Downgraded

Many issues are enhanced by bond insurance.

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