Agenda Item 5 – Resolution authorizing a new investment policy

March 14, 2012
Existing investment policy

- Was adopted in 1995

- Sovereign debt rating requirement:
  - The sovereign debt of the home country of any foreign financial institutions who provides investment agreements to the Agency shall be rated triple-A by at least one credit rating agency
  - As of 12/31/11, the Agency has $200Mn deposited with investment agreement providers.
    - France (AA+/Aaa): $94Mn (47%)
    - U.S. (AA+/Aaa): $70Mn (35%)
    - Germany (AAA/Aaa): $23Mn (11%)
    - Netherlands (AAA/Aaa): $13Mn (7%)
Highlights of the new investment policy

- Adoption of the prudent investor standard
  - A decision-making process based on what is known and unknown at the time of the decision:
    - the expected risk and reward of the investment
    - the needs of the beneficiaries
    - the benefits of diversification
  - A prudent investment will not always turn out to be a good investment because no one can predict with certainty what will happen with any investment decision.
    - For example, it would not be a prudent decision to “invest” all of one’s money in one lottery draw, regardless of the outcome. Even winning the lottery does not make the decision prudent.
Highlights of the new investment policy

- Formation of the Investment Oversight Committee to
  - approve new credit counterparties
  - monitor and review the Investment Policy

- Scope
  - all non-conduit bond proceeds
  - Agency’s G-O accounts

- General objectives
  - Safety, liquidity, and return on investment
Highlights of the new investment policy

- Investment risks
  - credit
  - interest-rate
  - reinvestment

- Classes of investments:
  - GICs (lowered sovereign debt rating requirement to at least one double-A)
  - MBS
  - money market funds
  - U.S. Bank N.A. Open Repurchase Agreement
  - SMIF
Agenda Item 6 –
Resolution authorizing interaccount borrowing from the Earned Surplus Account
CalHFA repaid its loan from the PMIA

- The loan was originally established in 1994
  - The purpose of the loan is to warehouse single-family loans prior to bond issuances
  - The initial loan amount was $50Mn
  - In 2006, the loan amount peaked at $350Mn
  - The final repayment, in the amount of $10Mn, was made on March 6, 2012

- CalHFA currently has no outstanding
  - Warehousing facilities
  - Line of credits
What are the Earned Surplus Funds?

HOUSING FINANCE FUND

- Bond Indentures
- Operating Account
- Housing Assistance Trust (HAT)
  - Earned Surplus
  - FAF Savings
  - Unencumbered Assets
- Emergency Reserve
- Contract Administration
What are the Earned Surplus Funds?

- California Health and Safety Code Section 51206 stipulates:
  - Earned Surplus Funds ("Funds") are:
    - Net Operating Income from Section 8 projects
    - Subtracting allowable (accrued) owner distributions
    - Subtracting reserve set-asides
  - Ownership of the Earned Surplus Funds:
    - Pre-1980: CalHFA owns the Funds
    - Post-1980: Funds are remitted to HUD
  - Statutory use of the Funds:
    - To reduce rents
Accumulation of the Earned Surplus Funds

- The Earned Surplus Funds have accumulated in recent years for two reasons:
  - The regulatory requirements attached to the use of the Funds are more restrictive.
  - As the Agency paused its multi-family lending program, the use of the Funds in conjunction with new financings also paused.

- Approximate current account balance: $57Mn.
  - In 2010, used $2Mn
  - In 2011, used $400K
Interaccount borrowing can help the Agency

- Manage its liquidity demands:
  - The combination of meeting: i) swap collateral posting requirements; ii) swap net payments (on behalf of HMRB) can deplete the Agency's G-O liquidity base for a short period of time.

- Restructure its liabilities:
  - The ability to borrow improves the Agency's liquidity profile and allows for the use of its cash to redeem variable-rate bonds.
Flow of funds on swap related transactions

- **CallHFA General Obligation**: 1/25: Swap Collateral, $129Mn posted
- **Swap Counterparties**: 2/1: Net Payment (HMRB), $39Mn
  - 2/8: Returned Collateral, $26Mn
- **HMRB Special Obligation**: 2/6: Reimbursement, $39Mn.
Swap collateral postings and remaining Agency cash

- Total Collateral Posted
- Remaining Cash

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Terms of the interaccount borrowing

- Parties:
  - Lender: Earned Surplus Account
  - Borrower: CalHFA's Operating Account

- Summary of terms:
  - Minimum balance for the Earned Surplus Account: $10Mn
  - Interest rate: most recent quarterly SMIF rate plus 50 bps
  - 3-month maturity:
    - Lender can demand repayment with a notice (7 days)
    - Borrower can repay with a notice (7 days)
Interaccount borrowing under Housing Finance Fund

Housing Finance Fund

- Bond indentures
- Operating Account
- Housing Assistance Trust (HAT): Earned Surplus, FAF Savings, Unencumbered Assets
- Emergency Reserve
- Contract Administration

Operating Account (borrower) $ Operating borrows 3-month maturity

Earned Surplus (lender) $ Operating repays Upon maturity or 7-day notice
Rationale for the interaccount borrowing

- Why authorize the interaccount borrowing?
  - It enhances the Agency's financial flexibility.

- Can this borrowing interfere with the statutory use of the Funds?
  - No. The borrowing is short-term and cannot interfere with the statutory use of the Funds.

- Is the need for this borrowing long-term?
  - No. As the Agency's swap obligations amortize over time, the liquidity demands (and the need to borrow) will decline.

- Will this help the Agency's ratings?
  - Yes. The Agency believes that the rating agencies will conclude that this is a credit positive for the Agency's G-O.
  - It improves the Agency's liquidity profile and allows the Agency to use its cash to redeem variable rate bonds.
What are the cons of the borrowing?

- Will anyone object to this interaccount borrowing?
  - Project owners and affordable housing advocates could argue that this borrowing jeopardizes a source of subsidy for affordable housing.

- Can the Agency fail to repay the loan in a timely manner?
  - If the Agency’s G-O is downgraded out of the single-A range (currently A-/A3) by either rating agency, the Agency’s borrowing horizon may change from short-term to longer-term.
    - **Cause:** the collateral posting requirements would roughly double.
    - **Mitigating factors:** 1) the Agency can monetize its unencumbered assets to payoff the loan; 2) the amortization of the Agency’s swap portfolio over the next few years, which translates into lower swap valuations and lower liquidity demands (and the need to borrow).
Declining swap notionals and valuations

Swap Notional/Valuation Date

- Maximum Notional
- Minimum Notional
- Mark To Market
Agenda Item 7a –
Multifamily portfolio preservation program using a renewed HUD 50/50 risk-share agreement
Existing authorization for FHA risk-share loans

- Financing authorization
  - In the annual multifamily bond financing resolution 12-02 (adopted on 1/19/12):
    - Under Article II, Section 8.(6), the Board approved the issuance of new money bonds under “Article XIII of the Residential Mortgage Revenue Bonds General Indenture…”
    - And under the “Article XIII” of the indenture, the definition of “Permitted Mortgage Loans” includes “loans insured by FHA, including loans under the FHA risk-sharing program…”

- Lending authorization with the FHA risk-share insurance
  - On 7/4/94, the Board adopted Resolution 94-11 amending CalHFA’s business plan to include a "pilot' Risk Share Program.
  - On 5/11/95, the Board adopted Resolution 95-19 amending CalHFA's business plan to include the Risk Share Program.
Treasury has approved the use of risk-share

- On March 9, U.S. Treasury approved the use of risk-share under NIBP
  - Of the estimated $400Mn of remaining SF allocation transferred to MF, $150Mn can be used for risk-share

- The approval process considered many factors
  - The impact on TCLP
    - Preservation transactions result in prepayments of existing loans and redemptions of TCLP-backed VRDOs
  - The impact on CalHFA’s G-O ratings
    - Estimated capital charge for $150Mn of new risk-share loans: $13.3Mn
    - Estimate can be reduced by the insurance status of the existing loan