S&P Global
Ratings

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California Housing Finance Agency; General Obligation

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Credit Profile		
California Hsg Fin Agy ICR		
Long Term Rating	AA/Stable	Upgraded

Credit Highlights

- S&P Global Ratings raised its issuer credit rating (ICR) to 'AA' from 'AA-' on the California Housing Finance Agency (CalHFA, or the agency).
- The outlook is stable.
- The rating action reflects our view of CalHFA's significant improvement in financial ratios over the past two fiscal years, to levels above those of peers, as well as its significant reduction in leverage and risk.

Security

An ICR reflects our view of the obligor's general creditworthiness, focusing on its capacity and willingness to meet financial commitments as they come due. It does not apply to any specific financial obligation because it does not consider the obligation's nature and provision, standing in bankruptcy or liquidation, statutory preferences, or legality and enforceability.

Credit overview

The rating reflects our view of CalHFA's:

- Financial strength as measured by nearly $2.9 billion in equity, with a five-year equity-to-assets ratio 51.3%, which we view as above average relative to that of peers;
- Above-average profitability compared with that of peers with a return on average assets (ROA) of 16.3% in fiscal 2021, with a five-year average of 7.05% as well as a five-year average net interest margin of 2.5%;
- Higher-than-average asset quality as measured by five-year average nonperforming assets (NPAs) to total assets of 1.4%;
- Stronger-than-average liquidity as measured by five-year average short-term investments to total assets of 28.7% and five-year average total loans (including program mortgage-backed securities) to total assets of 62.1%;
- Extremely strong management team and board members with strong organizational, administrative, financial management, and strategic planning capabilities as well as senior management's experience and track record of successfully managing programs even during difficult times; and
- Strong economic environment, with California's high income levels (per capita income was 119% of the U.S. average in 2021) and good economic diversity.

Partly offsetting the above strengths, in our view, is the reduction in CalHFA's balance sheet since the Great Recession.

While the decline in liabilities has outpaced the decline in assets, contributing to the improvement in financial metrics, the reduction in loans and long-term assets has contributed to a reduction in ongoing revenue-generating programs and loan production. However, the agency's strategic plans include increasing debt to finance on-balance-sheet single-family and multifamily loans. We view this as a proactive step in line with its mission, so we expect ratios to somewhat decline to levels more in line with our 'AA' category benchmarks.

Environmental, social, and governance

We analyzed CalHFA's environmental, social, and governance risks relative to its financial strength, management and legislative mandate, and the local economy. In our opinion, the ICR exhibits social opportunities related to social capital. The agency's mission to invest in diverse communities with financing programs that help more Californians have a place to call home aims to address socioeconomic inequities affecting demographic and income trends considered in our rating. Our rating also incorporates the elevated environmental risks for California given its exposure to various climate-related events such as wildfires and drought, and natural disasters such as earthquakes can affect the state's economy and disrupt population migration should these areas become undesirable. However, we believe the agency's financial strength, especially relative to its minimal debt profile, mitigates these risks. We view social and governance risks as neutral in our credit rating analysis.

Outlook

The stable outlook reflects our expectation that CalHFA's financial ratios, which are above our 'AA' category benchmarks, will decline to some degree, compared with the current very high levels given the agency's leverage and on-balance-sheet lending plans. While we expect capital adequacy and profitability to remain somewhat elevated compared with those of peers during the outlook period, these ratios may stabilize in the longer term as CalHFA's new programs begin and balance sheet assets grow.

Downside scenario

Although such a scenario is unlikely during the outlook period given CalHFA's above-average financial ratios, we could take a negative rating action if the agency's financial performance significantly declined to the point where they were no longer in line with our 'AA' category benchmarks.

Upside scenario

Should CalHFA's financial ratios remain well above our 'AA' category benchmarks, we could take positive rating action. Given the agency's strategic plans, we expect an increase in leverage and on-balance-sheet lending during the outlook period that will result in a decline in key financial ratios. If ratios continue to exceed our benchmarks even after this anticipated decline, with no changes in other criteria factors, they could support a higher rating.

Credit Opinion

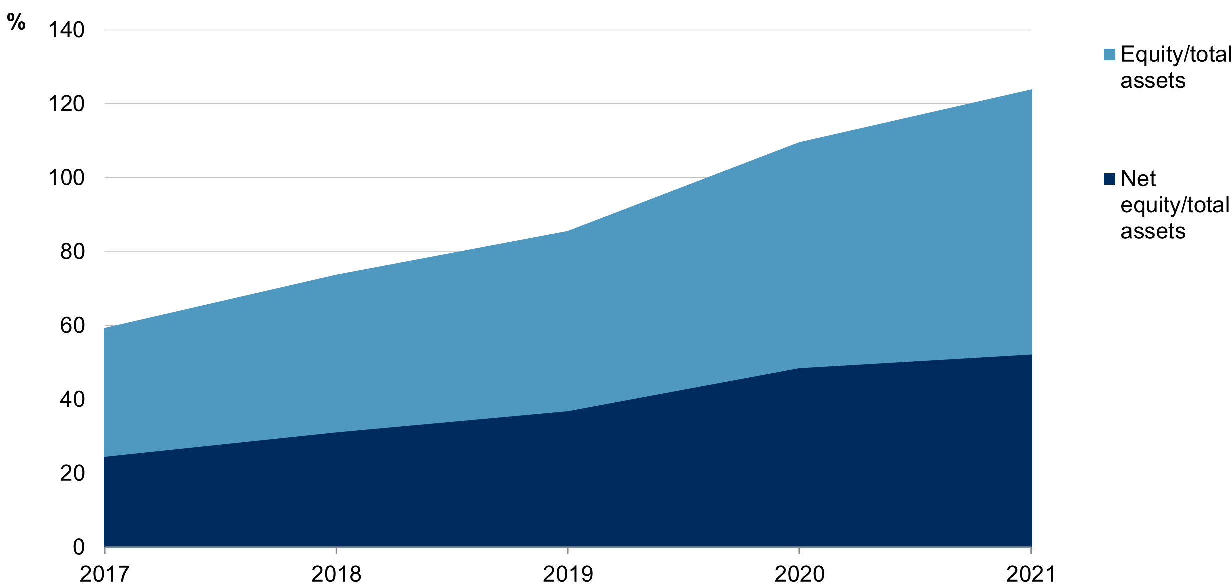
Financial Strength

Capital adequacy

CalHFA's equity to total assets and net equity to total assets grew significantly in the past five years to 71.3% and 52.4% from 34.4% and 24.7%, respectively. These levels far exceed our 15.0% benchmark for the 'AA' category as well as the five-year HFA averages of 30.7% and 25.3%.

Chart 1

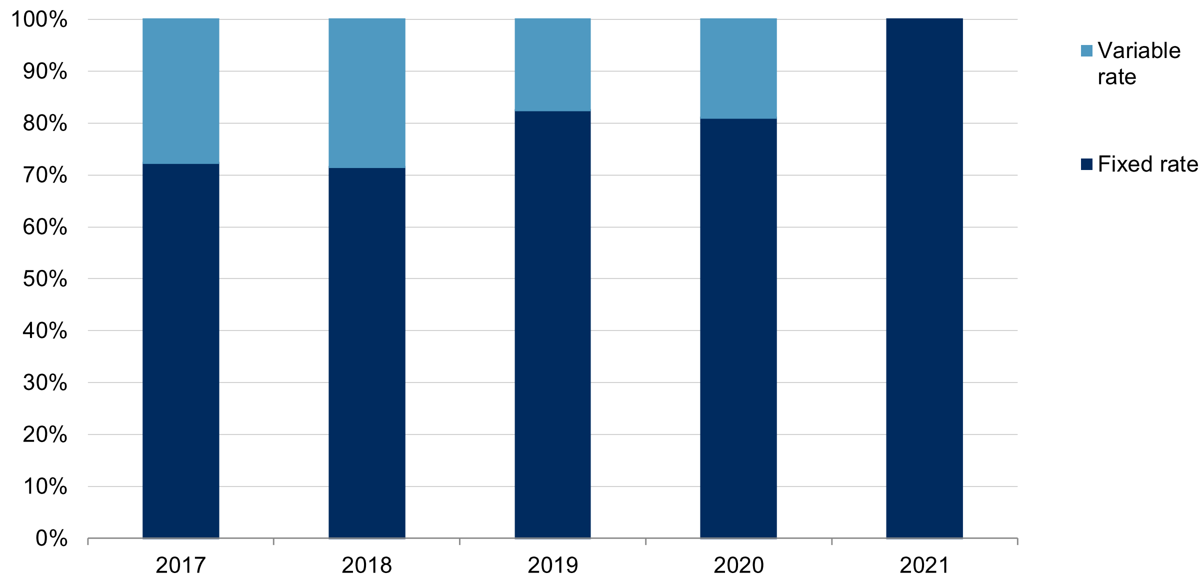
Capital Adequacy Ratios



The main factor in the improvement in these ratios is the agency's purposeful reduction in liabilities, which exceeds its reduction in assets over the five-year period. In fiscal 2021 alone, the agency reduced its debt by 42%, having reduced debt by 31% the year prior. This decline continued the agency's decade-long strategy to reduce risk and de-leverage after experiencing hardship during The Great Recession. Along with the reduction, the agency targeted risk reduction in its debt profile, proactively paying down variable-rate debt to minimize exposure. CalHFA's fixed- to variable-rate debt ratio was 74% in 2017, compared with 97% fixed-rate debt at the end of fiscal 2021. In May 2021, all the agency's variable-rate debt was paid off.

Chart 2

Debt Composition

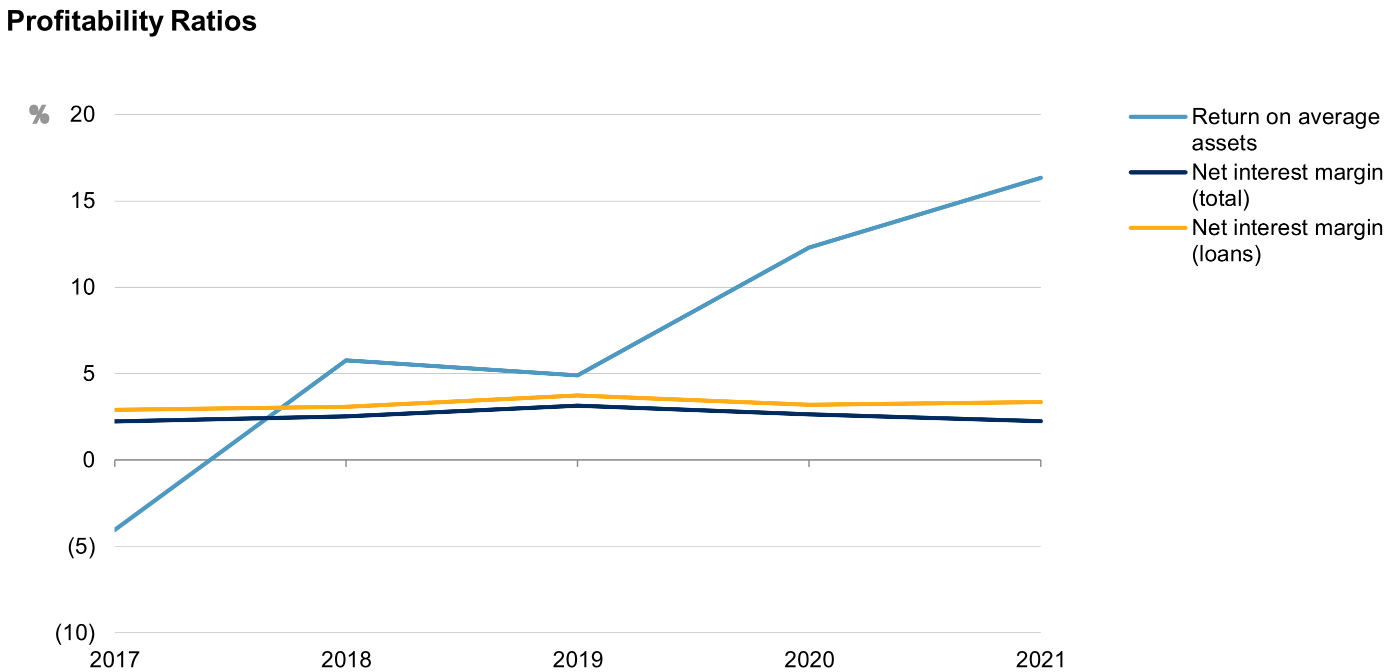


Profitability

CalHFA's profitability metrics also exceed those of peers with a five-year average ROA of 7.1% and a net interest margin on loans of 3.2%. Largely contributing to the agency's extremely strong ROA is its shift to securitizing and selling loans on the secondary to-be-announced (TBA) market. Participation in the TBA market does not provide annuity income streams as on-balance-sheet lending does, but can be an effective tool to boost earnings while fulfilling the agency's mission. Therefore, while CalHFA's ROA is among the highest of similarly rated peers, it is in line with the ROA ratios of HFAs with more active TBA programs compared with on-balance-sheet lending. Also contributing to the agency's improved profitability position is the reduction in debt, leading to significantly lower interest expense during the past five years. The reduction in assets contributes as well.

Given the agency's strategic plans to increase on-balance-sheet lending, we expect profitability metrics to decline in the coming years. However, our five-year benchmark for ROA in the 'AA' category is 0.5%, which we believe the agency will continue to exceed. In our view, an increase in on-balance-sheet lending would help stabilize revenue over time, with the addition of annuity interest income.

Chart 3

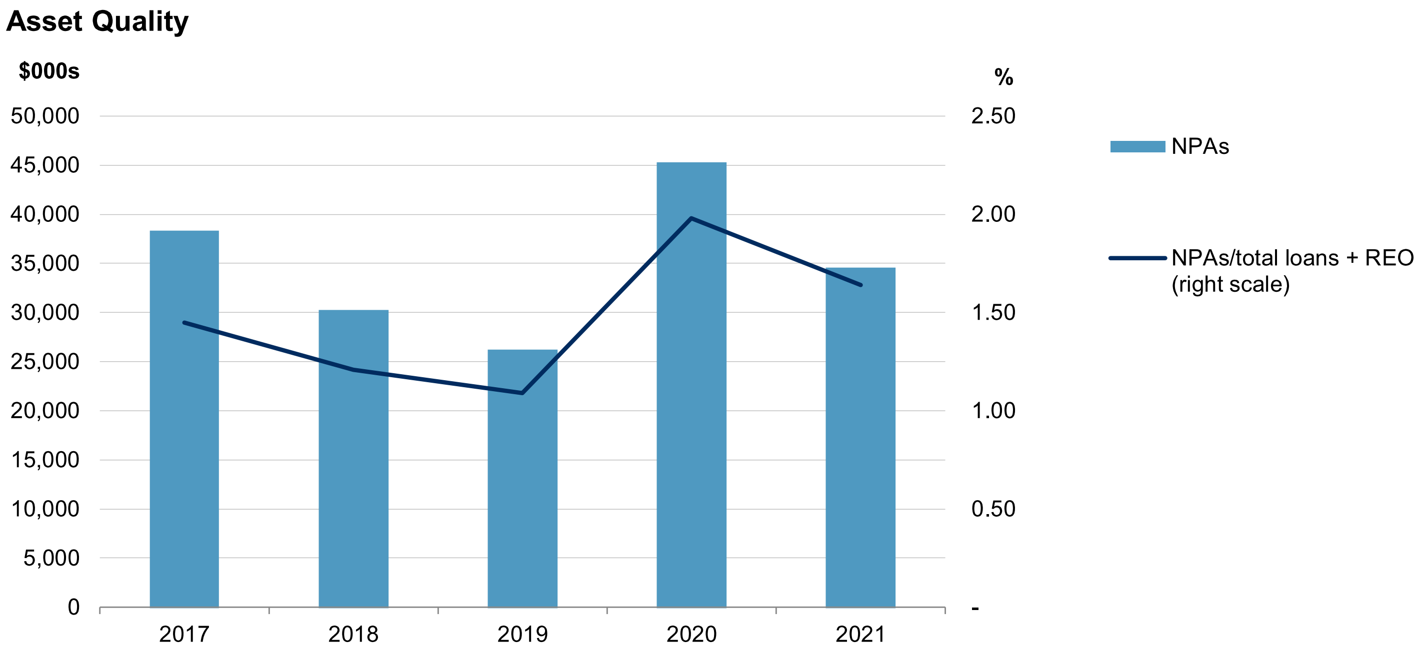


Asset quality

After CalHFA's asset base decreased from 2017 to 2019, total assets increased by a slight 0.1% in 2020 and by 8.8% in fiscal 2021. The agency remains one of the largest rated HFAs with total assets of $4 billion, and we believe the agency's overall asset quality to be above average.

NPAs declined steadily from 2017 to 2019, following the trend since the Great Recession as loans paid down, but not surprisingly NPAs increased in 2020 during the COVID-19 pandemic as a result of federal forbearance programs. Still, the agency's NPA to total assets and real estate owned was 1.9% in 2020 and 1.6% in 2021, lower than the HFA average at 3.2% in 2020 and 2.6% in 2021.

Chart 4



NPAs--Nonperforming assets. REO--Real estate owned.

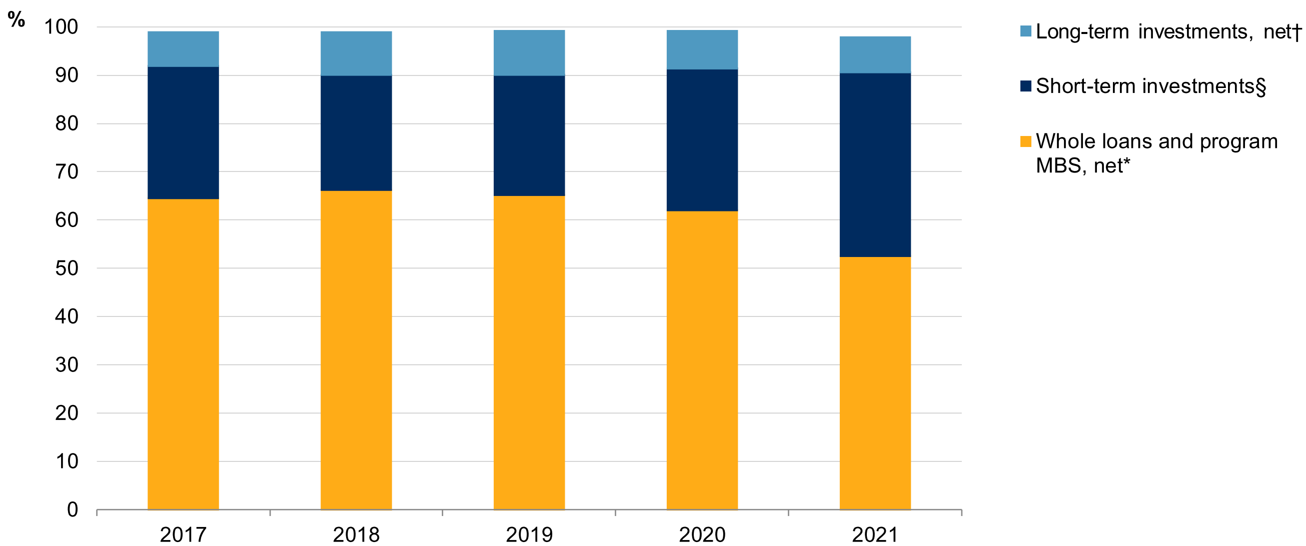
CalHFA's investment portfolio is high quality and relatively low-risk, in our view. Cash and investments totaled $1.8 billion as of fiscal 2021, up 32% from $1.4 billion the prior year. Investments are governed by the agency's investment policy and are generally restricted to certain high-quality securities such as direct obligations of the U.S. government and its agencies, the state treasurer's Pooled Money Investment Account, long-term investment agreements that are issued by high-investment-grade institutions, and other approved financial instruments.

Liquidity

CalHFA's reserve and investment policies are relatively conservative. The agency's investment and debt management policy prioritize the safety of principal, liquidity, and yield optimization. Approximately 53% of the agency's assets are whole loans and mortgage-backed securities, a lower ratio than that of peers, but short-term investments make up approximately 38% of the agency's assets, making for what we consider highly liquid. The agency's investment portfolio consists mostly of Ginnie Mae securities and other federal agency securities.

Chart 5

Liquidity And Investments (As % Of Total Assets)



*Reported net of loan loss allowance, if applicable. §Includes accrued interest receivable on investments and loans. †Reported net of fair value adjustment. MBS--Mortgage-backed securities.

CalHFA's swap profile presents a low liquidity risk to the agency, in our view, given the significantly reduced notional amount of swaps, diversified counterparty risk, minimal basis risk, good management oversight, and reduced risk that CalHFA may have to post additional collateral based on the swaps' rating triggers for collateralization. CalHFA's continued efforts to reduce its swap exposure contributed to the improvement in net operating income in the past five years. As of June 30, 2021, the agency had $512.9 million in notional amount outstanding and had posted $22.1 million in securities as collateral. While we view these swaps as contingent liabilities, we see little liquidity risk given a lack of associated debt outstanding and given the decline in the amount of collateral posting required along with the notional amount outstanding. Moreover, in the past several months, the agency has renegotiated and/or terminated approximately half of its swaps outstanding, leaving only $48.4 million in notional amount outstanding. The agency anticipates having no swaps outstanding by the end of February 2023--a big accomplishment, in our view, given that 10 years ago it held approximately $2 billion in notional amount outstanding.

Management

We view CalHFA's management team as extremely strong, comprising experienced, dedicated senior staff and guided by detailed strategic plans, initiatives, and policies.

CalHFA was established in 1975 by the state governor's office for the purpose of working with the private sector to provide more affordable housing for Californians. CalHFA is governed by a board of directors (consisting of 14 board members as of October 2022) and is a discretely presented component unit of the State of California. The board oversees the executive director, who is an appointee of the governor and directs the staff of the agency.

Earlier this year, CalHFA executed its strategic business plan and updated its mission statement: investing in diverse communities with financing programs that help more Californians have a place to call home. CalHFA's strategic business plan is thorough and permeates the agency's departments. In addition, we view the agency's disclosure and reporting to be transparent, frequent, and thorough. The agency has won a Government Finance Officers Assn. certificate of achievement for excellence in financial reporting from 2020 to 2022. We believe management has very strong planning and internal control processes, including strong cyber risk policies. Despite turnover at the executive and directorate levels in recent years, we believe the agency's team is highly experienced and demonstrates sophistication in its business approach.

Economy

As we noted in our report published March 1, 2022, on RatingsDirect, California's economy is strong and diverse, with employment composition reflective of that of the U.S. California's population makes up 12% of the nation's. The state's economy has been one of the top performers for the past several years. California's unemployment rate, which had been below the national level before the pandemic, averaged 10.1% in 2020 compared with 8.1% for the U.S., and 7.3% in 2021 compared with 5.3% for the nation. However, the state's preliminary unemployment rate of 4.1% as of August 2022 was lower than its pre-pandemic rate. S&P Global Market Intelligence estimates California has recovered 98% of its pre-pandemic jobs lost in March and April of 2020. Many of the jobs lost disproportionately affected lower-income workers, and California's per capita income actually improved to 120% of that of the nation in 2021, up from 118% in 2020 and 115% in 2019. S&P Global Market Intelligence forecasts 2.3% real gross state product growth in calendar 2022 and 0.5% in 2023, compared with GDP growth of 1.7% and 0.9%, respectively, for the nation.

High home prices remain a housing affordability problem in the state with the median state home price at $796,570 as of December 2021. The governor has made housing and homelessness issues an important part of his budget priorities, and the state has sold bond issues to tackle homelessness for those with mental health issues, backed by Proposition 85's extra 1% income tax on those making more than $1 million per year. The prioritization of housing by the state bodes well for CalHFA's programs and financial performance, in our opinion, as the agency builds up its on-balance-sheet lending programs over the next several years.

Table 1

Financial Ratios (2017-2021)

%	2017	2018	2019	2020	2021	Five-year average
Capital adequacy						
Equity/total assets	34.36	42.20	48.24	60.49	71.25	51.31
Net equity/total assets	24.73	31.32	37.03	48.79	52.37	38.85
Net equity/total loans	36.88	45.88	54.62	75.30	94.85	61.50
Net equity/total loans + MBS (loans)	36.88	45.88	54.62	75.30	94.85	61.50
Equity/total debt	66.22	101.43	130.85	237.98	528.29	212.95
Net equity/total debt	47.65	75.29	100.43	191.96	388.30	160.73
Net equity/GO debt	343.27	459.40	608.43	1,097.21	2,095.48	920.76
Available liquid assets/ total loans	33.92	36.84	28.63	52.05	42.88	38.87
GO debt/total debt	13.38	15.32	16.12	17.42	18.91	16.23

Table 1

Financial Ratios (2017-2021) (cont.)						
%	**2017**	**2018**	**2019**	**2020**	**2021**	**Five-year average**
Profitability						
Return on average assets	(4.05)	5.76	4.91	12.30	16.33	7.05
Net interest margin	2.23	2.50	3.14	2.62	2.25	2.55
Net interest margin (MBS (loans) + loans)	2.90	3.07	3.73	3.20	3.35	3.25
Net interest margin (loans)	2.90	3.07	3.73	3.20	3.35	3.25
Asset quality						
NPAs/total loans + REO	1.39	1.17	1.05	1.90	1.56	1.41
Net charge-offs/average NPAs	52.77	1.26	(2.63)	(0.57)	(0.69)	10.03
Loan loss reserves/total loans	3.83	2.95	3.88	4.28	4.67	3.92
Loan loss reserves/NPAs	275.63	250.99	369.72	225.66	299.23	284.25
Net charge-offs/average loans	0.81	0.02	(0.03)	(0.01)	(0.01)	0.16
Liquidity						
Total loans/total assets	64.48	66.26	65.16	62.03	52.63	62.11
Total loan + MBS (loans)/total assets	64.48	66.26	65.16	62.03	52.63	62.11
Short-term investments/total assets	27.44	23.77	24.97	29.41	37.99	28.71
Total investments/total assets	34.44	32.71	33.99	37.09	45.18	36.68

GO--General obligation. MBS--Mortgage-backed securities. NPA--Nonperforming asset. REO--Real estate owned.

Table 2

Five-Year Trends ($000s)					
	2017	**2018**	**2019**	**2020**	**2021**
Total assets	4,103,282.00	3,766,927.00	3,673,519.00	3,677,033.00	4,002,064.30
% change	(14.02)	(8.20)	(2.48)	0.10	8.84
Total debt	2,129,231.00	1,567,031.00	1,354,275.00	934,628.00	539,751.00
% change	(18.70)	(26.40)	(13.58)	(30.99)	(42.25)
Total equity	1,410,044.00	1,589,478.00	1,772,056.00	2,224,237.00	2,851,425.18
% change	(11.30)	12.73	11.49	25.52	28.20
Total net equity	1,014,684.34	1,179,839.90	1,360,145.52	1,794,121.14	2,095,832.32
% change	21.11	16.28	15.28	31.91	16.82
Revenue	268,088.00	258,090.00	341,421.00	347,922.00	262,446.68
% change	22.18	(3.73)	32.29	1.90	(24.57)
Expenses	157,929.00	128,190.00	166,299.00	120,968.00	102,683.93
% change	8.52	(18.83)	29.73	(27.26)	(15.11)
Net income	(179,574)	226,784.00	182,578.00	452,181.00	627,187.80
% change	(372.47)	(226.29)	(19.49)	147.66	38.70
Total program MBS and loans	2,645,847.00	2,495,995.00	2,393,534.00	2,280,758.00	2,106,451.46
% change	(14.87)	(5.66)	(4.11)	(4.71)	(7.64)
Nonperforming assets	38,237.61	30,187.00	26,137.37	45,204.85	34,485.37
% change	(26.55)	(21.05)	(13.42)	72.95	(23.71)

MBS--Mortgage-backed securities.

Table 3

Peer Comparison (2017-2021)			
	CalHFA	**'AA' category HFAs**	**All HFAs**
Capital adequacy (%)			
Total equity/total assets	51.31	31.21	30.69
Total net equity/total assets	38.85	25.77	25.25
Profitabliity (%)			
Return on average assets	7.05	1.71	1.80
Net interest margin	2.55	4.14	1.60
Asset quality (%)			
NPAs/total loans and real estate owned	1.41	2.64	2.61
Loan loss reserves/total loans	3.92	5.39	2.01
Liquidity (%)			
Short-term investments/total assets	28.71	17.42	15.14
Total loans + MBS/total assets	62.11	65.08	69.12

HFA--Housing finance agency. MBS--Mortgage-backed securities. NPA--Nonperforming asset.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022