

California Housing Finance Agency

Most Indicators Point to Continued Solvency Despite Its Financial Difficulties Created, in Part, by Its Past Decisions

REPORT NUMBER 2010-123, ISSUED FEBRUARY 2011

This report concludes that, although the California Housing Finance Agency (CalHFA) will continue to face significant risks, its major housing programs and the fund it uses to pay its operating expenses should remain solvent under most foreseeable circumstances. The report also concludes that past decisions by CalHFA, such as its decisions to significantly increase its use of variable-rate bonds and interest-rate swap agreements, and to launch new mortgage products that were easier for borrowers to qualify for, but that eventually proved to have high delinquency rates, contributed to its current difficulties. These decisions revealed the need for changes in how its board of directors (board) governs the agency. In particular, CalHFA's board should approve any new debt-issuance strategy or mortgage product prior to its implementation, which is something it had not always done in the past, and should include language in its annual resolutions delegating authority to CalHFA staff restricting staff's actions to the debt strategies and mortgage products specified in the annual delegations themselves, approved business plans, or subsequent board resolutions.

In the report, the California State Auditor (state auditor) made the following recommendations to CalHFA. The state auditor's determination regarding the current status of recommendations is based on CalHFA's response to the state auditor as of August 2011.

Recommendation 2.1—See page 50 of the audit report for information on the related finding.

To ensure that CalHFA's business plans and strategies are thoroughly vetted by an experienced and knowledgeable board, the Legislature should consider amending the statute that specifies the composition of CalHFA's board to include appointees with specific knowledge of housing finance agencies, single-family mortgage lending, bonds and related financial instruments, interest-rate swaps, and risk management.

Legislative Action: Partially implemented.

Chapter 408, Statutes of 2011 (Assembly Bill 1222), allows individuals affiliated with the housing, banking, insurance, and other specified industries to serve on the CalHFA board, even though they may have a conflict of interest, provided they publicly disclose the interest and do not attempt to influence or participate in the decision in which they have an interest.

Recommendation 2.2—See pages 49, 50, 58, and 59 of the audit report for information on the related finding.

To provide better oversight of CalHFA, its board should issue a policy stating that it must approve any new debt-issuance strategy or mortgage product prior to its implementation, either directly or by inclusion in CalHFA's annual business plan. The board should, where appropriate, prescribe limits on how much of the debt portfolio can be fixed- or variable-rate bonds, and what proportion of the loans it purchases can consist of mortgage products it identifies as riskier than other mortgage products.

CalHFA's Action: Fully implemented.

A board resolution approved May 2011 requires staff to present new financing strategies and new loan products for full discussion and approval by majority vote of the board prior to implementation by CalHFA. This resolution also specifies that proposed annual business plans submitted to the board by CalHFA staff shall address limitations on the use of variable rate debt and identification of loan products that CalHFA identifies as involving higher levels of risk than traditional CalHFA loan products.

Recommendation 2.3—See pages 49, 50, 58, and 59 of the audit report for information on the related finding.

Within its annual resolutions delegating authority to CalHFA staff, the CalHFA board should include language restricting staff's actions regarding debt strategies and mortgage products to those specified in the annual delegations themselves, the approved business plans, or subsequent board resolutions.

CalHFA's Action: Fully implemented.

Board resolutions approved in January 2011 and amended in March 2011 include restrictions on actions CalHFA staff may take regarding debt strategies and mortgage products. When taken together with the May 2011 board resolution (mentioned above), these actions restrict CalHFA staff to implementing only financing strategies and loan products approved by the board.