Veterans Farm and Home Building Fund of 1943, Department of Veterans Affairs, State of California

Financial Statements for the
Years Ended June 30, 2011 and 2010, and
Independent Auditors' Report

VETERANS FARM AND HOME BUILDING FUND OF 1943,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

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INDEPENDENT AUDITORS' REPORT

California Veterans Board
State of California
Sacramento, California

We have audited the accompanying balance sheets of the Veterans Farm and Home Building Fund of 1943 (the "Fund"), which is administered by the Department of Veterans Affairs, State of California (the "Department") as of June 30, 2011 and 2010, and the related statements of revenues, expenses, and changes in fund equity and cash flows for the years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Fund as of June 30, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the Fund and are not intended to present the financial position of the Department or the results of its operations and its cash flows of its proprietary funds.

Management's Discussion and Analysis on pages 2 through 12 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Department's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and we do not express an opinion on it.

Deloitte & Touche LLP

October 14, 2011

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

Introduction – The Department of Veterans Affairs

The Department of Veterans Affairs (the "Department") began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the California Legislature of the Veterans Farm and Home Purchase Act of 1921 (the "Cal-Vet Farm and Home Program" or the "Program"). In 1943, the Legislature enacted the Veterans Farm and Home Purchase Act of 1943 which modified the Program to meet new needs of California's veterans. The 1943 Act established in the State Treasury the Veterans Farm and Home Building Fund of 1943 (the "Fund"), which is the principal fund utilized for the Cal-Vet Farm and Home Loan Program. Financing is provided as installment loans, which are referred to as Contracts of Purchase.

The sales of the Fund's Home Purchase Revenue Bonds and Veterans General Obligations Bonds combined with monies received from prepayments of Contracts of Purchase and other revenues under the Program not needed at any given time to meet the then current bond retirement schedules and operating costs have financed the purchase of farms and homes since the Program's inception. Expenditures are primarily for debt service and administration of the Program.

Fiscal Year 2011 Compared to Fiscal Year 2010

Condensed Balance Sheets

The following table presents condensed balance sheets for the Fund as of June 30, 2011 and June 30, 2010 (dollars in thousands) and the percentage change.

	2011	2010	Change	% Change
ASSETS				
Cash, cash equivalents and investments	$ 104,605	$ 284,355	$ (179,750)	(63.2)%
Receivables under contracts of purchase — net	1,325,499	1,499,938	(174,439)	(11.6)%
Other receivables and assets	77,204	67,765	9,439	13.9 %
TOTAL ASSETS	$ 1,507,308	$ 1,852,058	$ (344,750)	(18.6)%
LIABILITIES AND FUND EQUITY				
LIABILITIES:				
Bonds payable	$ 1,336,384	$ 1,667,254	$ (330,870)	(19.8)%
Other payables and liabilities	14,276	23,085	(8,809)	(38.2)%
Total liabilities	1,350,660	1,690,339	(339,679)	(20.1)%
Fund Equity	156,648	161,719	(5,071)	(3.1)%
TOTAL LIABILITIES AND FUND EQUITY	$ 1,507,308	$ 1,852,058	$ (344,750)	(18.6)%

Assets — Total assets decreased by $345 million from $1.852 billion at June 30, 2010 to $1.507 billion at June 30, 2011. This decrease consisted primarily of the following items:

- Total cash, cash equivalents and investments decreased by $179 million from $284 million at June 30, 2010 to $105 million at June 30, 2011. The decrease is a principally due to bond calls and significantly lower interest earned on investments.

- Net receivables under contracts of purchase decreased by $175 million from $1.500 billion at June 30, 2010 to $1.325 billion at June 30, 2011. The change was due to payments received and a decrease in the number of new contracts of purchase added to the portfolio.

- All other receivables and assets increased by $9 million from $68 million at June 30, 2010 to $77 million at June 30, 2011.

Liabilities and Fund Equity — Total liabilities decreased by $339 million from $1.690 billion at June 30, 2010 to $1.351 billion at June 30, 2011, principally due to bond calls.

Fund equity decreased by $5 million from $161.7 million at June 30, 2010 to $156.7 million at June 30, 2011, as a result of unfavorable holding costs of cash assets and less revenue due to fewer loans processed.

The total assets to liability ratio increased to 1.12 as of June 30, 2011, from 1.10 as of June 30, 2010.

Condensed Statements of Revenues and Expenses

The following table presents condensed statements of revenues and expenses for the Fund for the fiscal years ended June 30, 2011 and June 30, 2010 (dollars in thousands) and the percentage change.

	2011	2010	Change	% Change
PROGRAM OPERATIONS				
Interest revenues:				
Contracts of purchase	$ 80,412	$ 91,222	$ (10,810)	(11.9)%
Investments and other	5,191	4,960	231	4.7 %
Total program operating revenues	85,603	96,182	(10,579)	(11.0)%
Expenses:				
Interest expense	72,278	89,519	(17,241)	(19.3)%
Provision for program losses	9,592	19,575	(9,983)	(51.0)%
Total program operating expenses	81,870	109,094	(27,224)	(25.0)%
Program operations revenues over (under) program operations expenses	3,733	(12,912)	16,645	(128.9)%
PROGRAM ADMINISTRATION				
Total program administration revenues	4,576	3,825	751	19.6 %
Total program administration expenses	12,992	15,901	(2,909)	(18.3)%
Excess of program administration expenses over program administration revenues	(8,416)	(12,076)	3,660	(30.3)%
Operations deficiency of revenues under expenses	(4,683)	(24,988)	20,305	(81.3)%
Loss on sale of repossessed property	(13,773)	(12,900)	(873)	6.8 %
Contributions from Indemnity Disaster Fund Revenue	13,385		13,385	
Deficiency of revenues under expenses	$ (5,071)	$ (37,888)	$ 19,432	(86.6)%

Program Operations — The program operations revenues over program operations expenses increased $16.6 million from a deficiency of $12.9 million for the fiscal year ended June 30, 2010 to $3.7 million for the fiscal year ended June 30, 2011, respectively, due to the following:

- Interest revenue from contracts of purchase decreased by $10.8 million from $91.2 million for the year ended June 30, 2010 to $80.4 million for the year ended June 30, 2011, due to a decrease in the number of new contracts of purchase to the portfolio.

- Interest revenues on investments and other revenues increased by $0.2 million from $5.0 million for the year ended June 30, 2010 to $5.2 million for the year ended June 30, 2011. This increase is primarily due to advanced interest payments on GIC investment accounts transferred from the Veterans Debenture Revenue Fund and recognition of the reserves transferred from the Veterans Indemnity Fund.

- Net program operation expenses decreased $27.2 million from $109.1 the year ended June 30, 2010 to $81.9 million for the year ended June 30, 2011. This is due to a decrease of $17.2 million in interest expense related to a decrease in bonds outstanding, and a decrease of $10.0 million in the provision for program losses.

- The sale of repossessed properties resulted in a loss of $13.8 million for the year ended June 30, 2011 compared to a loss of $12.9 million for the year ended June 30, 2010 due to a reduction in property values from loans made primarily in the calendar years 2005, 2006 and 2007. The Funds' holdings of repossessed properties, net of allowances for losses decreased from $23.3 million as of June 30, 2010 to $18.7 million as of June 30, 2011.

Program Administration — Total program administration revenues include loan origination fees paid to the Department, loan guarantee fees collected by the Department to be applied, in part, to provide mortgage insurance and premiums collected by the department for the fire and hazard insurance program. Total program administration revenues increased by $0.8 million from $3.8 million for the year ended June 30, 2010 to $4.6 million for the year ended June 30, 2011.

Total program administration expenses decreased by $2.9 million from $15.9 million for the year ended June 30, 2010 to $13.0 million for the year ended June 30, 2011. This is due to a decrease of payroll and other support expenditures.

Overview of Loan Portfolio

Single Family Home Loans/Condominiums/Farm Loans — The Department makes loans to veterans for the purchase of individual residences. Approximately 92% of the dollar volume of the Department's loans are for home loans as of June 30, 2011. Currently the maximum loan amount is $521,250 which represents 125% of the maximum loan limit for a single-family home set by the Federal National Mortgage Association ("Fannie Mae").

Loans are made after an underwriting process that includes, but is not limited to: a review of credit history, verifiable income and the amount and source of down payment. In general, credit scores of approved applicants are above the average. Loans with an initial loan to value (LTV) of greater than 80% are required to be insured, either through private mortgage insurance or through the guarantee program of the United States Department of Veterans Affairs (USDVA). Loans with a LTV of 97% or greater are required to be insured through the USDVA guaranty program. Under the USDAVA guarantee program, the Department is insured for the first 25% of loss in the event that they are required to foreclose on a property and need to sell that property for less than the outstanding loan balance.

Interest rates for loans are determined when the loan is originated. As of June 30, 2011, interest rates on loans outstanding ranged from 4.25% to 9.75%. While the Department has the limited ability to adjust the interest rates, post-1999 loans can be adjusted by 0.5% if needed and pre-1999 loans can be adjusted with no rate cap, the policy of the Department has been to leave the interest rate fixed at the rate in effect when the loan was originated.

Mobile Homes — The Department makes loans to veterans for the purchase of mobile homes. Approximately 7% of the dollar volume of the Department's loans are for home loans as of June 30, 2011. Currently the maximum loan amount is $175,000. The terms of the loans for mobile homes are substantially the same as loans made to finance the purchase of single-family homes. In certain circumstances, the interest rate of a mobile home loan may be 1% higher than an equivalent loan on a single family home.

Home Improvement Loans — The Department makes a limited amount of home improvement loans. These loans typically have a LTV of lower than 90%. The Department did not have a significant amount of home improvement loans outstanding at June 30, 2011.

Allowances for Uncollectible Loans and Losses on Other Real Estate Owned

The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectability and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation. Management updates its estimates periodically to take into account changes in the economic environment. The allowance for uncollectible contracts was $16,972,000 and $16,543,000 as of June 30, 2011 and 2010, respectively.

Other Real Estate Owned — Real estate acquired by the Fund by repossession is recorded at the lower of estimated fair value less estimated selling costs (fair value) or the carrying value of the related loan at the date of foreclosure. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses. Operating costs on foreclosed real estate are expensed as incurred. Costs incurred for physical improvements to foreclosed real estate are capitalized if the value is recoverable through future sale.

Higher-Risk Loans (Excluding Home Equity Loans) — The Department's higher risk loans, designated by having a loan-to-value ratio of 97% or greater, are evenly dispersed throughout the state. The loan to value ratio was determined by dividing the current loan balance by the initial purchase price of the property. Out of our 9,027 loan portfolio only 4.2% of those loans were determined to have a high loan-to-value ratio. The highest concentration of those loans is in San Diego County with these loans representing less than 0.4% of the Department's total portfolio. Reducing the risk of many of the loans in the portfolio is the fact that 98.9% of the high loan-to-value loans in the Department's portfolio are currently insured with USDVA. Currently only 0.04% of the total portfolio is uninsured and has a high loan-to-value ratio.

Mitigating Market Factors — The following features of the Program are designed to mitigate and protect the Program from the negative effects of market downturns:

- The Department does not provide variable rate loans.
- The Department requires that, at the time of financing, Program participants reside in the home purchased under the Contracts of Purchase.
- The Department's underwriting requirements, according to an internal unaudited survey by the Department, have resulted in an average borrower FICO credit score in excess of 700 for transactions originated during the last five years.
- Certain of the Department's Contracts of Purchase are guaranteed through the USDVA guaranty program.
- Since 2009, all new Contracts of Purchase require a minimum 1.25% funding fee.

The Department cannot predict whether disruptions in the housing and financial markets generally or difficulties in the national or California economies will continue and, if so, whether the Department's finances will be adversely impacted.

Segregated Insurance Reserves

In 2011, the Department established the Pooled Self-Insurance Fund that provides a segregation of insurance risk from the Home Loan program. Any and all insurance claims can only be paid from this fund with no recourse to Home Loan program. This ensures that each of the department's insurance reserve funds are self-sufficient and adequately maintained for the benefit of the contract purchasers. For reasons of prudent financial management, the department will pool the reserves for the purpose of providing reliable, consistent, and affordable home protection, and to encourage the strengthening of bond ratings, thereby increasing the efficacy of the Veterans' Farm and Home Purchase Act of 1974.

The Department has combined four insurance reserve funds into one Pooled Self-Insurance Fund with segregated sub-accounts, and authorized the insurance reserve funds to subsidize each other, as needed. The fund has combined reserves of $ 26,766,000.

The four sub-accounts are:

a. The Disaster Indemnity Fund, covering earthquake and flood risks;
b. The Fire and Hazard Insurance Fund;
c. The CalVet Legacy Self-Insurance and Disability Fund; and
d. The CalVet Primary Mortgage Insurance Fund

Economic Factors Facing Veterans Farm & Home Building Fund of 1943

At June 30, 2011, the Program's loan portfolio balance was at approximately $1.326 billion, a decrease of $174 million, or 11.6%, from $1.500 billion at June 30, 2010. During the fiscal year, cash and investments balance decreased $179 million, or 63.0%, from a balance of $284 million to $105 million. Bonds payable decreased $331 million, or 19.9%, from $1.667 billion at June 30, 2010 to $1.336 billion at June 30, 2011. Bond ratings for the Department's GO bonds are AA, Aa2 and AA- by rating agencies Standard & Poor's, Moody's and Fitch, respectively. Bond ratings for the Department's Revenue bonds are AA, Aa3 and AA- by Standard & Poor's, Moody's and Fitch, respectively.

Department Outlook — The ability of the Department to return to an excess of revenues over expenses in future periods and the financial performance of the 1943 Fund depends upon a variety of factors including, among others: (a) the level of interest rates available on short-term investments (including the rate paid on the SMIF and investment contracts as such contracts may be acquired) relative to the level of interest rates on outstanding Veterans G.O Bonds and Revenue Bonds; (b) the rate of origination and the rate of prepayment of Contracts of Purchase, which will directly affect the amount of bond proceeds, recycling funds and revenues held in such investments; (c) the interest rates established from time to time by the Department for newly originated Contracts of Purchase relative to the interest cost on bonds issued to finance such Contracts of Purchase; (d) the interest rates on outstanding Contracts of Purchase relative to the interest cost on outstanding bonds; (e) the Department's ability to use special and optional redemption provisions to minimize the overall cost of outstanding debt; (f) the market prices that can be achieved upon the sale of repossessed properties relative to the then-outstanding Contract of Purchase balances; (g) the level of administrative expenses relative to the rate of origination and outstanding balances of the Contracts of Purchase;
(h) counter-party performance under the Department's investment agreements; (i) uncertainties, disruption or volatility in the financial markets, generally, and in the mortgage and residential real estate markets, specifically; (j) the accuracy of certain projections and assumptions upon which the Department's financial

planning may be based, including, among other things, the rate of repayment of Contracts of Purchase, levels of defaults and delinquencies and losses on Contracts of Purchase; (k) the issuance and structuring of any additional Veterans G.O. Bonds or Revenue Bonds; (l) the implementation of any new programs of the Department; and (m) changes in law, including changes which may affect the timing and the amount the Department may recover from Contracts of Purchase. The Department expects that there will be significant variations in results in future periods, including additional periods in which there may be a deficit of revenues under expenses.

Fiscal Year 2010 Compared to Fiscal Year 2009

Condensed Balance Sheets

The following table presents condensed balance sheets for the Fund as of June 30, 2010 and June 30, 2009 (dollars in thousands) and the percentage change.

	2010	2009	Change	% Change
ASSETS				
Cash, cash equivalents and investments	$ 284,355	$ 322,507	$ (38,152)	(11.8)%
Receivables under contracts of purchase — net	1,499,938	1,688,016	(188,078)	(11.1)%
Other receivables and assets	67,765	70,501	(2,736)	(3.9)%
TOTAL ASSETS	$ 1,852,058	$ 2,081,024	$ (228,966)	(11.0)%
LIABILITIES AND FUND EQUITY				
LIABILITIES:				
Bonds payable	$ 1,667,254	$ 1,852,512	$ (185,258)	(10.0)%
Other payables and liabilities	23,085	28,905	(5,820)	(20.1)%
Total liabilities	1,690,339	1,881,417	(191,078)	(10.2)%
Fund Equity	161,719	199,607	(37,888)	(19.0)%
TOTAL LIABILITIES AND FUND EQUITY	$ 1,852,058	$ 2,081,024	$ (228,966)	(11.0)%

Assets — Total assets decreased by $229 million from $2.081 billion at June 30, 2009 to $1.852 billion at June 30, 2010. This decrease consisted primarily of the following items:

- Total cash, cash equivalents and investments decreased by $38 million from $322 million at June 30, 2009 to $284 million at June 30, 2010. The decrease is a principally due to bond calls and significantly lower interest earned on investments.

- Net receivables under contracts of purchase decreased by $188 million from $1.688 billion at June 30, 2009 to $1.500 billion at June 30, 2010. The change was due to payments received and a decrease in the number of new contracts of purchase added to the portfolio.

All other receivables and assets decreased by $3 million from $71 million at June 30, 2009 to $68 million at June 30, 2010.

Liabilities and Fund Equity — Total liabilities decreased by $191 million from $1.881 billion at June 30, 2009 to $1.690 billion at June 30, 2010, principally due to bond calls.

Fund equity decreased by $37.9 million from $199.6 million at June 30, 2009 to $161.7 million at June 30, 2010, as a result of unfavorable holding costs of cash assets, less revenue due to fewer loans processed and increased reserves for uncollectible contracts of purchase and REO losses.

The total assets to liability ratio decreased to 1.10 as of June 30, 2010, from 1.11 as of June 30, 2009.

Condensed Statements of Revenues and Expenses

The following table presents condensed statements of revenues and expenses for the Fund for the fiscal years ended June 30, 2009 and June 30, 2008 (dollars in thousands) and the percentage change.

	2010	2009	Change	% Change
PROGRAM OPERATIONS				
Interest revenues:				
Contracts of purchase	$ 91,222	$ 99,058	$ (7,836)	(7.9)%
Investments and other	4,960	12,261	(7,301)	(59.5)%
Total program operating revenues	96,182	111,319	(15,137)	(13.6)%
Expenses:				
Interest expense	89,519	103,043	(13,524)	(13.1)%
Change in allowance for uncollectible contracts	19,575	11,293	8,282	73.3 %
Total program operating expenses	109,094	114,336	(5,242)	(4.6)%
Excess of program operations revenues over program operations expenses	(12,912)	(3,017)	(9,895)	328.0 %
PROGRAM ADMINISTRATION				
Total program administration revenues	3,825	2,475	1,350	54.5 %
Total program administration expenses	15,901	18,246	(2,345)	(12.9)%
Excess of program administration expenses over program administration revenues	(12,076)	(15,771)	3,695	(23.4)%
Operations excess (deficiency) of revenues over (under) expenses	(24,988)	(18,788)	(6,200)	33.0 %
(Loss) gain on sale of repossessed property	(12,900)	(3,468)	(9,432)	272.0 %
(Deficiency) excess of revenues (under) over expenses	$ (37,888)	$ (22,256)	$ (15,632)	70.2 %

Program Operations — The deficiency in program operations revenues over program operations expenses increased $9.8 million from a deficiency of $3.0 million compared to a deficiency of $12.8 million for the fiscal year ended June 30, 2009 and 2010, respectively, due to the following:

- Interest revenue from contracts of purchase decreased by $7.9 million from $99.1 million for the year ended June 30, 2009 to $91.2 million for the year ended June 30, 2010, due to a decrease in the number of new contracts of purchase to the portfolio.

- Interest revenues on investments decreased by $7.3 million from $12.3 million for the year ended June 30, 2009 to $5.0 million for the year ended June 30, 2010. This decrease is due to the SMIF quarterly interest rate decreasing over the fiscal year from 1.51% at June 30, 2009 to 0.56% at June 30, 2010 combined with a decrease in the cash, cash equivalents and investments during that time.

- Net program operation expenses decreased $5.2 million from $114.3 the year ended June 30, 2009 to $109.1 million for the year ended June 30, 2010. This is due to a decrease of $13.5 million in interest expense related to a decrease in bonds outstanding, offset by an increase of $8.2 million in the provision for program losses.

- The sale of repossessed properties resulted in a loss of $12.9 million for the year ended June 30, 2010 compared to a loss of $3.5 million for the year ended June 30, 2009 due to a reduction in property values from loans made in the calendar years 2005, 2006 and 2007. The Funds' holdings of repossessed properties, net of allowances for losses increased from $23 million as of June 30, 2009 to $23.3 million as of June 30, 2010.

Program Administration — Total program administration revenues include loan origination fees paid to the Department, loan guarantee fees collected by the Department to be applied, in part, to the purchase of private mortgage insurance and premiums collected by the department for the fire and hazard insurance program. Total program administration revenues decreased by $13.7 million from $2.5 million for the year ended June 30, 2009 to a deficiency of $11.2 million for the year ended June 30, 2010, due to the following:

- The fire and hazard insurance program experienced a decrease in net revenues of $0.3 million due to claimed losses during the fiscal year.

- Other income decreased by $12.6 million, including a decrease of $0.8 million related to loan origination fees.

Total program administration expenses decreased by $2.3 million from $18.2 million for the year ended June 30, 2009 to $15.9 million for the year ended June 30, 2010. This is due to a decrease of payroll and other support expenditures.

Overview of Loan Portfolio

Single Family Home Loans — The Department makes loans to veterans for the purchase of individual residences. Approximately 89% of the dollar volume of the Department's loans are for home loans as of June 30, 2010. Currently the maximum loan amount is $521,250 which represents 125% of the maximum loan limit for a single-family home set by the Federal National Mortgage Association ("Fannie Mae").

Loans are made after an underwriting process that includes, but is not limited to: a review of credit history, verifiable income and the amount and source of down payment. In general, credit scores of approved applicants are above the average. Loans with an initial loan to value (LTV) of greater than 80% are required to be insured, either through private mortgage insurance or through the guarantee program of the United States Department of Veterans Affairs (USDVA). Loans with a LTV of 97% or greater are required to be insured through the USDVA guaranty program. Under the USDAVA guarantee program, the Department is insured for the first 25% of loss in the event that they are required to foreclose on a property and need to sell that property for less than the outstanding loan balance.

Interest rates for loans are determined when the loan is originated. As of June 30, 2010, interest rates on loans outstanding ranged from 4.25% to 9.75%. While the Department has the limited ability to adjust the interest rates, post-1999 loans can be adjusted by 0.5% if needed and pre-1999 loans can be adjusted with no rate cap, the policy of the Department has been to leave the interest rate fixed at the rate in effect when the loan was originated.

Mobile Homes — The Department makes loans to veterans for the purchase of mobile homes. Approximately 7% of the dollar volume of the Department's loans are for home loans as of June 30, 2010. Currently the maximum loan amount is $175,000. The terms of the loans for mobile homes are substantially the same as loans made to finance the purchase of single-family homes. In certain circumstances, the interest rate of a mobile home loan may be 1% higher than an equivalent loan on a single-family home.

Construction or Home Improvement Loans — The Department makes a limited amount of construction or home improvement loans. These loans typically have a LTV of lower than 90%. The Department did not have a significant amount of construction or home improvement loans outstanding at June 30, 2010.

Allowances for Uncollectible Loans and Losses on Other Real Estate Owned

The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectability and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation. Management updates its estimates periodically to take into account changes in the economic environment. The allowance for uncollectible contracts was $16,543,000 and $13,927,000 as of June 30, 2010 and 2009, respectively.

Other Real Estate Owned — Real estate acquired by the Fund by repossession is recorded at the lower of estimated fair value less estimated selling costs (fair value) or the carrying value of the related loan at the date of foreclosure. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses. Operating costs on foreclosed real estate are expensed as incurred. Costs incurred for physical improvements to foreclosed real estate are capitalized if the value is recoverable through future sale.

Higher-Risk Loans — The Department's higher risk loans, designated by having a loan-to-value ratio of 97% or greater, are evenly dispersed throughout the state. The loan to value ratio was determined by dividing the current loan balance by the initial purchase price of the property. Out of our 10,801 loan portfolio (not including home improvement loans) only 6.4% of those loans were determined to have a high loan-to-value ratio. The highest concentration of those loans was in San Diego County with these loans representing less than 1% of the Department's total portfolio. Reducing the risk of many of the loans in the portfolio is the fact that 99.8% of the high loan-to-value loans in the Department's portfolio are currently insured with USDVA leaving only 0.2% of the total portfolio being uninsured and having a high loan-to-value ratio.

Mitigating Market Factors — The following features of the Program are designed to mitigate and protect the Program from the negative effects of market downturns:

- The Department does not provide variable rate loans.
- The Department requires that, at the time of financing, Program participants reside in the home purchased under Contracts of Purchase.
- The Department's underwriting requirements, according to an internal unaudited survey by the Department, have resulted in an average borrower FICO credit score in excess of 700 for transactions originated during the last five years.

- Certain of the Department's Contracts of Purchase are guaranteed through the USDVA guaranty program. See "THE PROGRAM – USDVA Guaranty Program; Loan Insurance.

- Since 2009, all new Contracts of Purchase require a minimum 1.25% funding fee.

The Department cannot predict whether disruptions in the housing and financial markets generally or difficulties in the national or California economies will continue and, if so, whether the Department's finances will be adversely impacted.

Economic Factors Facing Veterans Farm & Home Building Fund of 1943

At June 30, 2010, the Program's loan portfolio balance was at approximately $1.500 billion, a decrease of $188 million, or 11.1%, from $1.688 billion at June 30, 2009. During the fiscal year, cash and investments balance decreased $38 million, or 11.8%, from a balance of $322 million to $284 million. Bonds payable decreased $185 million, or 10.0%, from $1.852 billion at June 30, 2009 to $1.667 billion at June 30, 2010. Bond ratings for the Department's GO bonds are AA, A1 and AA- by rating agencies Standard & Poor's, Moody's and Fitch, respectively. Bond ratings for the Department's Revenue bonds are AA-, Aa2 and AA- by Standard & Poor's, Moody's and Fitch, respectively.

Department Outlook — The ability of the Department to return to an excess of revenues over expenses in future periods and the financial performance of the 1943 Fund depends upon a variety of factors including, among others: (a) the level of interest rates available on short-term investments (including the rate paid on the SMIF and investment contracts as such contracts may be acquired) relative to the level of interest rates on outstanding Veterans G.O Bonds and Revenue Bonds; (b) the rate of origination and the rate of prepayment of Contracts of Purchase, which will directly affect the amount of bond proceeds, recycling funds and revenues held in such investments; (c) the interest rates established from time to time by the Department for newly originated Contracts of Purchase relative to the interest cost on bonds issued to finance such Contracts of Purchase; (d) the interest rates on outstanding Contracts of Purchase relative to the interest cost on outstanding bonds; (e) the Department's ability to use special and optional redemption provisions to minimize the overall cost of outstanding debt; (f) the market prices that can be achieved upon the sale of repossessed properties relative to the then-outstanding Contract of Purchase balances; (g) the level of administrative expenses relative to the rate of origination and outstanding balances of the Contracts of Purchase; (h) counter-party performance under the Department's investment agreements; (i) uncertainties, disruption or volatility in the financial markets, generally, and in the mortgage and residential real estate markets, specifically; (j) the accuracy of certain projections and assumptions upon which the Department's financial planning may be based, including, among other things, the rate of repayment of Contracts of Purchase, levels of defaults and delinquencies and losses on Contracts of Purchase; (k) the issuance and structuring of any additional Veterans G.O. Bonds or Revenue Bonds; (l) the implementation of any new programs of the Department; and (m) changes in law, including changes which may affect the timing and the amount the Department may recover from Contracts of Purchase. The Department expects that there will be significant variations in results in future periods, including additional periods in which there may be a deficit of revenues under expenses

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

BALANCE SHEETS
JUNE 30, 2011 AND 2010
(In thousands)

	2011	2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents:		
Cash in state treasury	$ 22,909	$ 16,586
State of California's Surplus Money Investment Fund	65,000	224,418
Total cash and cash equivalents	87,909	241,004
Current portion of receivables under contracts of purchase — net of allowance for uncollectible contracts	39,769	43,154
Interest receivables:		
Contracts of purchase	8,739	10,637
State of California's Surplus Money Investment Fund	111	272
Other investments	116	304
Total interest receivables	8,966	11,213
Total current assets	136,644	295,371
NONCURRENT ASSETS:		
Investments:		
Guaranteed Investment Contracts	10,046	36,701
Insurance administrators	6,650	6,650
Total investments	16,696	43,351
Receivables under contracts of purchase — net of allowance for uncollectible contracts	1,285,730	1,456,784
Due from Veterans Debenture Revenue Fund	19,742	28,753
Advances to Pooled Insurance Fund (Note 9)	26,766	
Other real estate owned — net of allowance for losses of $10,108 and $10,993 in 2011 and 2010, respectively	18,747	23,272
Land, improvements, and equipment — net of accumulated depreciation of $15,716 and $15,798 in 2011 and 2010, respectively	611	505
Other noncurrent assets	2,372	4,022
Total noncurrent assets	1,370,664	1,556,687
TOTAL	$ 1,507,308	$ 1,852,058
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES:		
Bonds payable — current portion	$ 47,020	$ 33,940
Accrued interest and other liabilities	15,317	19,830
Due to other funds	(1,919)	(6)
Fire and hazard insurance claims payable		875
Total current liabilities	60,418	54,639
NONCURRENT LIABILITIES:		
Bonds payable — noncurrent portion	1,289,364	1,633,314
Other postemployment benefits	878	675
Self-insured life and disability insurance loss reserve		1,711
Total noncurrent liabilities	1,290,242	1,635,700
Total liabilities	1,350,660	1,690,339
COMMITMENTS AND CONTINGENCIES (Note 7)		
FUND EQUITY — Unrestricted	156,648	161,719
TOTAL	$ 1,507,308	$ 1,852,058

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND EQUITY
YEARS ENDED JUNE 30, 2011 AND 2010
(In thousands)

	2011	2010
PROGRAM OPERATIONS:		
Interest revenues:		
Contracts of purchase of properties	$ 80,412	$ 91,222
Investments and other	3,049	3,595
Transfers of revenues from Veterans Debenture Revenue Fund	2,142	1,365
Total revenues	85,603	96,182
Expenses:		
Interest expense	72,278	89,519
Provision for program loan losses	9,592	19,575
Total expenses	81,870	109,094
Excess (deficiency) of program operations revenue over (under) program operations expenses	3,733	(12,912)
PROGRAM ADMINISTRATION:		
Revenues:		
Loan fees	513	785
Other revenue	4,063	1,145
Net revenue — fire and hazard insurance program		1,303
Net revenue — self-insured life and disability insurance program		592
Total revenues	4,576	3,825
Expenses:		
Payroll and related costs	8,952	8,343
General and administrative expenses	4,040	7,558
Total expenses	12,992	15,901
Deficiency of program administration revenues under program administration expenses	(8,416)	(12,076)
OPERATIONS DEFICIENCY OF REVENUES UNDER EXPENSES	(4,683)	(24,988)
NONOPERATING REVENUE (EXPENSE):		
Loss on sale of repossessed property	(13,773)	(12,900)
Transfer from Veterans Indemnity Fund (Note 9)	13,385	
Deficiency of revenues under expenses	(5,071)	(37,888)
FUND EQUITY:		
Beginning of year	161,719	199,607
End of year	$156,648	$161,719

See notes to financial statements.

VETERANS FARM AND HOME BUILDING FUND OF 1943, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010
(In thousands)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from contract holders	$ 513	$ 5,095
Interest received	87,850	95,414
Interest payments	(69,515)	(89,519)
Payments to suppliers and employees	(19,145)	(18,189)
Other payments	96	(1,370)
Net cash used in operating activities	(201)	(8,569)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from sales of bonds payable		118,710
Maturities of bonds payable	(33,940)	(63,405)
Early redemption of bonds payable	(299,580)	(242,785)
Increase to deferred finance costs	(113)	(1,032)
Changes in due from Veterans Debenture Fund	9,011	3,336
Transfer From Veterans Indemnity Fund	13,385	
Net cash used in noncapital financing activities	(311,237)	(185,176)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net decrease in receivables under contracts of purchase	155,599	155,603
Decrease (increase) in guaranteed investment contracts	26,655	(6,985)
Advance to Pooled Insurance Fund (Note 9)	(23,735)	
Purchase of land, improvements, and equipment	(176)	(10)
Net cash provided by investing activities	158,343	148,608
DECREASE IN CASH AND CASH EQUIVALENTS	(153,095)	(45,137)
CASH AND CASH EQUIVALENTS:		
Beginning of year	241,004	286,141
End of year	$ 87,909	$ 241,004
RECONCILIATION OF (DEFICIENCY) EXCESS OF REVENUES (UNDER) OVER EXPENSES TO NET CASH USED IN OPERATING ACTIVITIES:		
Deficiency of revenues under expenses	(5,071)	(37,888)
Adjustments to reconcile deficiency of revenues under expenses to net cash used in operating activities:		
Bond amortization	2,763	3,254
Allowance for uncollectible contracts	9,592	19,575
Depreciation	70	37
Loss on sale of repossessed property	13,773	12,900
Increase of net assets of Pooled Insurance Fund	(3,031)	
Transfer from Veterans Indemnity Fund	(13,385)	
Effect of changes in assets and liabilities:		
Decrease in interest receivable — State of California's Surplus Money Investment Fund	161	850
Decrease (increase) in interest receivable — other investments	188	(173)
Decrease (increase) in interest receivable — contracts of purchase	1,898	(80)
Decrease (increase) in other assets	1,650	(1,224)
Decrease in accrued interest and other liabilities	(4,513)	(2,824)
(Decrease) increase in due to other funds	(1,913)	142
Increase in other postretirement benefits	203	194
(Decrease) increase in fire and hazard insurance claims payable	(875)	447
Decrease in self-insured life and disability insurance loss reserve	(1,711)	(3,779)
NET CASH USED IN OPERATING ACTIVITIES	$ (201)	$ (8,569)

See notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Description — The California Department of Veterans Affairs (the "Department") is a separate legal entity and a cabinet-level agency of the state of California. A seven-member California Veterans Board (the "Board") has policy oversight of the operations of the Department, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Veterans Farm and Home Building Fund of 1943 (the "Fund") was established under the authority of the California Constitution to provide low-interest, long-term farm and home mortgage loan contracts to veterans living in California. The contract loan program has been continuous since 1922. Proceeds from the sale of general obligation bonds, periodically authorized by the vote of the people of California, and revenue bonds authorized by the legislature are used for contract loans to veterans. Expenses are primarily for debt service and administration of the program. The Fund is tax exempt.

The financial statements represent only the activities of the Fund and are not intended to present the financial position of the Department and the results of its operations and its cash flows of its proprietary funds. The financial statements of the Fund are included in the financial statements of the state of California as the State represents the primary government and has ultimate oversight responsibility for the Fund.

Basis of Accounting — The Fund has been classified as a proprietary fund for accounting purposes. Revenues are recorded when earned and expenses are recognized as incurred.

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 option under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, which allows the Fund to apply all GASB pronouncements and only Financial Accounting Standards Board (FASB) pronouncements which date prior to November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: FASB statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the committee on accounting procedures.

Use of Estimates in the Preparation of Financial Statements — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 from those estimates.

Cash and Cash Equivalents — The Fund considers all cash and highly liquid investments purchased with original maturities of three months or less to be cash and cash equivalents. At June 30, 2011 and 2010, cash equivalents consisted of the State of California's Surplus Money Investment Fund (SMIF), carried at cost, which approximates fair value.

Investments — The Department reports all investments at fair value except for certain nonparticipating fixed-interest investment contracts, which are valued at cost. The fair value of investments is based on published market prices and quotations from major investment brokers. Uncommitted bond proceeds for loans to veterans are reflected in the balance sheets within the investments balance.

Receivables under Contracts of Purchase — Receivables under contracts of purchase consist of the remaining contract principal balance net of the allowance for uncollectible contracts.

Revenue Recognition — Interest is recognized as revenue when earned according to the terms of the loans. Interest accrual is only discontinued at the point of physical property repossession.

Allowance for Uncollectible Contracts — The allowance for uncollectible contracts is established through a provision charged to operations. The allowance is an amount that management believes will be adequate to absorb losses inherent in existing contracts and commitments to extend credit, based on evaluations of the collectibility and prior loss experience of contracts and commitments to extend credit. The evaluations take into consideration such factors as changes in the nature and volume of the portfolio, overall portfolio quality, specific problem contracts, commitments, and current and anticipated economic conditions that may affect the borrowers' ability to repay the obligation. The allowance for uncollectible contracts was $16,972,000 and $16,543,000 as of June 30, 2011 and 2010, respectively.

Contract Guarantees and Primary Mortgage Insurance — The Department collects a contract guarantee fee on all contracts with down payments less than 20% of purchase price. Such contracts are classified as high loan to value (HLTV) contracts. For eligible borrowers, the fee is used to purchase contract guarantees from the U.S. Department of Veterans Affairs (USDVA) or primary mortgage insurance (PMI). Prior to March 31, 2008, for certain HLTV contracts not eligible for USDVA guarantees, the Fund purchased PMI from Radian Guaranty Inc., formerly, the Commonwealth Mortgage Assurance Company. The PMI provides lifetime coverage on the HLTV contracts, not covered by USDVA guarantees, subject to an aggregate 2% deductible. The Department is responsible for any losses not covered by the USDVA guarantees or the PMI.

Other Real Estate Owned — Real estate acquired by the Fund by repossession is recorded at the lower of estimated fair value, less estimated selling costs (fair value) or the carrying value of the related loan at the date of foreclosure. After repossession, the value of the underlying contract is written down to the estimated fair value of the real estate, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of any related income, are included in other expenses. Operating costs on foreclosed real estate are expensed as incurred. Costs incurred for physical improvements to foreclosed real estate are capitalized if the value is recoverable through future sale.

Fire and Hazard Insurance Plan — This insurance program is provided to eligible contract holders as part of the loan program. The difference between premiums charged to contract holders and claims and expenses incurred is included as a net amount in the statements of revenues, expenses, and changes in fund equity. Fire and hazard insurance claims payable include unpaid claims and incurred but not reported claims. Prior to July 1, 2010, program activity was included in the Fund; during 2011 this activity was transferred to the Pooled Insurance Fund. See footnote 9.

Self-Insured Life and Disability Insurance Plan — Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated on June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these obligations of the protection plan, which include future disability and life benefits were derived from an actuarial evaluation performed in 2006 that is updated internally on an annual basis. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%. Self-insured life and disability insurance loss reserve include unpaid claims, incurred but not reported claims and loss reserve. Prior to July 1, 2010, program activity was included in the Fund; during 2011 this activity was transferred to the Pooled Insurance Fund. See footnote 9.

Amortization of Bond Premiums, Discounts, and Issuance Costs — Premiums and discounts arising from the issuance of bonds and expenses incurred in connection with the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash in State Treasury — Cash in the state treasury represents amounts held in the Fund's general operating accounts with the state treasury. These monies are pooled with the monies of other state agencies and invested by the state treasurer's office. These assets are not individually identifiable. At June 30, 2011 and 2010, the carrying amount of the Fund's deposits in state treasury was $22,909,000 and $16,586,000, respectively.

SMIF — Cash in the SMIF represents the value of the deposits in the state treasurer's pooled investment program, which is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2011 and 2010, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value. For a complete description of the risks related to this program, refer to the state of California Comprehensive Annual Financial Report (CAFR) that includes information about the state's pooled investment program. At June 30, 2011 and 2010, the carrying amount of the Fund's deposits in SMIF was $65,000,000 and $224,418,000, respectively.

Investments — Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments. These investments include direct obligations of the U.S. government and its agencies and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service. The investments with the insurance administrator, held as a deposit in accordance with a master agreement for the remaining active life and disability insurance program for disabled contract holders, are authorized by California law. The Department monitors the creditworthiness of all companies that hold investments of the Fund.

The Fund's investment in nonparticipating fixed-interest contracts, carried at cost, was $10,046,000 and $36,701,000 as of June 30, 2011 and 2010, respectively. The interest rates on investment agreements are fixed and range from 5.30% to 6.46%. The investment agreements expire from 2011 to 2032.

Investment Risk Factors — Many factors 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 factors such as economic conditions, individual company earnings 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 within SMIF and the remainder in investment contracts or with insurance administrators to limit the Fund's exposure to most types of investment risk.

Credit Risk — Fixed-income securities are subject to credit risk, which is the chance 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 June 30, 2011 and 2010, the Fund does not have significant 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 June 30, 2011 and 2010, 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 June 30, 2011 and 2010, the Fund does not have a significant 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 June 30, 2011 and 2010, the Fund does not have any significant debt investments that are highly sensitive to changes in interest rates.

The Fund's investments include amounts held in trust fund with insurance administrators and various guaranteed investment contracts (GICs) with insurance companies. The GICs are collateralized by investments held by the state of California on behalf of the Fund. Additionally, the Fund only invests in investment agreements issued by highly rated insurance companies, and management regularly monitors the credit rating of the insurance companies issuing such investment agreements as part of monitoring the Fund's exposure to credit risk.

The Fund's investments as of June 30, 2011 and 2010 are as follows (in thousands):

	2011	**2010**
Guaranteed Investment Contracts (at cost)	$ 10,046	$ 36,701
Amounts held in trust fund with insurance administrators	6,651	6,650
Total investment	$ 16,697	$ 43,351

3. RECEIVABLES UNDER CONTRACTS OF PURCHASE

The Fund retains title to all real property subject to contracts of purchase until the contract is satisfied. The veterans' contracts have original terms of 25–30 years and bear interest at rates of 4.25%–9.75%, depending on the age and type of contract and the classification of the contract holder. Receivables under contracts of purchase, net of allowance for uncollectible contracts as of June 30, 2011 and 2010, were as follows (in thousands):

	2011	2010
Receivables under contracts of purchase	$ 1,342,471	$ 1,516,481
Less allowance for uncollectible contracts of purchase	(16,972)	(16,543)
Total	1,325,499	1,499,938
Less current portion	(39,769)	(43,154)
Receivables under contracts of purchase — net	$ 1,285,730	$ 1,456,784

4. LAND, IMPROVEMENTS, AND EQUIPMENT

Land, improvements, and equipment as of June 30, 2011 and 2010, consisted of the following (in thousands):

	2011	2010
Land	$ 443	$ 443
Buildings	12,586	12,410
Equipment	3,298	3,450
Total	16,327	16,303
Less accumulated depreciation	(15,716)	(15,798)
Land, improvements, and equipment — net	$ 611	$ 505

5. BONDS PAYABLE

Bonds payable as of June 30, 2011 and 2010, included the following (in thousands):

	2011	2010
General obligation bonds of the state of California, fixed annual interest rates from 2.2% to 6.2% due in varying annual installments through 2042 (subject to varying redemption provisions)	$ 799,475	$ 1,002,225
Home purchase revenue bonds, fixed annual interest rates from 4.6% to 5.5%, due in varying annual installments through 2042 (subject to varying redemption provisions)	546,660	677,430
Total	1,346,135	1,679,655
Less:		
Discounts	(1,509)	(1,618)
Premium	234	247
Unamortized bond origination costs	(7,904)	(10,331)
Unamortized bond redemption premiums	(572)	(699)
Total	1,336,384	1,667,254
Less — current portion	47,020	33,940
Noncurrent portion	$ 1,289,364	$ 1,633,314

A summary of debt service requirements for the next five years and to maturity as of June 30, 2011, is as follows (in thousands):

June 30	Principal	Interest
2012	$ 47,020	$ 59,860
2013	28,145	58,570
2014	50,840	57,365
2015	24,675	56,235
2016	29,900	55,408
2017-2021	165,585	258,057
2022-2026	313,905	206,943
2027-2031	322,515	124,839
2032-2036	222,285	56,235
2037-2041	126,805	17,254
2042	14,460	809
Total	$ 1,346,135	$ 951,575

General obligation bonds of the state of California are payable in accordance with the various veterans bond acts by the state general fund. The full faith and credit of the state of California is pledged for the payment of both principal and interest. All general obligation bonds have an equal claim against the general fund of the state of California. These bonds are included as obligations of the Fund when the proceeds from bond sales are received. The repayment for the bonds is the responsibility of the Fund.

The authorized and unissued bonds under the Veterans Bond Act of 2000 were $238,610,000 at June 30, 2011 and 2010, respectively. In November 2008, California voters approved the Veterans Bond Act of 2008 ("2008 Bond Act") totaling $900,000,000. As of June 30, 2011 and 2010, no bonds have been issued under the 2008 Bond Act.

Home purchase revenue bonds are special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets of the Fund and the Veterans Debenture Revenue Fund, a separate fund of the Department. The undivided interest in the net revenues of the Fund is secondary and subordinate to any interest or right in the Fund of the people of the state of California and of the holders of general obligation veterans bonds. At any point in time, authorized and unissued revenue bonds equal the $1.5 billion ceiling authorized in 1987, less revenue bonds outstanding at that time. At June 30, 2011 and 2010, authorized and unissued revenue bonds were $953,340,000 and $822,570,000, respectively.

During fiscal year 1998, the Department amended the revenue bond resolution provisions regarding the bond reserve account in the Veterans Debenture Revenue Fund (a separate entity). The revenue bond resolution requires the establishment and maintenance of a bond reserve account in an amount equal to at least 3% of the aggregate outstanding principal amount of all revenue bonds with interest rates fixed to maturity. To calculate the reserve requirement, the Ninth Supplemental Resolution established, with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B, and C Bonds, 1998 Series A Bonds, 1999 Series A and B Bonds, 2000 Series A, B, and C Bonds, and 2001 Series A Bonds), a requirement equal to at least 7% of the outstanding principal amount of such revenue bonds, and for Series 2002 an amount equal to 5% of the outstanding principal amount. Amounts in the bond reserve account shall be used solely for the purposes of paying the principal of and the interest on the revenue bonds and for making mandatory sinking fund account payments on revenue bonds. Amounts on deposit in the bond reserve account as of any date, in excess of the bond reserve requirement, may be transferred out of the Veterans Debenture Revenue Fund to the Fund, at the request of the Department. Investment earnings of the Veterans Debenture Revenue Fund are transferred to the Fund. At June 30, 2011 and 2010, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California can be obtained by contacting the Department.

6. BOND REDEMPTION AND REFUNDING

For the year ended June 30, 2011, the Department did not issue general obligation bonds or home purchase revenue bonds. For the year ended June 30, 2010, the Department issued general obligation bonds totaling $118,710,000 of which $93,710,000 was used to refund certain outstanding general obligation bonds and $25,000,000 was available to finance new and existing contracts of purchase.

The Department redeemed $126,935,000 for home purchase revenue bonds and $172,645,000 for general obligation bonds, to pay off higher coupon debt prior to maturity. The Department also paid off $22,820,000 of general obligation noncallable debt and $7,285,000 of callable general obligation debt and $3,835,000 of callable home purchase revenue debt, due to maturity. Currently, the Department has no outstanding commercial paper.

7. COMMITMENTS AND CONTINGENCIES

Commitments — As of June 30, 2011, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately $2,071,000.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 2011 and 2010, was $237,000 and $241,000, respectively. Minimum annual rentals under operating leases as of June 30, 2011, are as follows (in thousands):

Fiscal Years Ending June 30	
2012	$ 52
2013	54
2014	54
2015	55
Total	$ 215

Contingencies — The Fund is subject to a variety of legal actions arising out of the normal course of business. Based upon information available to the Fund, its review of such lawsuits and consultation with legal counsel, the Fund believes the liability relating to these actions, if any, would not have a material adverse effect on the Fund's financial statements.

8. EMPLOYEE BENEFIT PLANS

Public Employees' Retirement Fund

Plan Description — 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 CAFR that includes financial statements and required supplementary information for the PERF. A copy of that report may be obtained from CalPERS, Central Supply, P.O. Box 942715, Sacramento, CA 95229-2715 or via the Internet at www.calpers.ca.gov.

Funding Policy — Contributions to the Plan are funded by both the Department and the employee and are actuarially determined by CalPERS based on covered compensation. State employees, with the exception of employees in the second-tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on 8% of compensation in excess of $513 each month.

Contributions by the Department to the Plan for the years ended June 30, 2011 and 2010, were approximately $977,000 and $851,000, or approximately 16% and 14% of participants' salaries, respectively.

Annual Pension Cost — For fiscal years June 30, 2011 and 2010, the Department's annual pension cost was equal to the Department's required and actual contributions. The required contribution is determined by actuarial valuation using the entry age normal actuarial cost method. The most recent actuarial valuation available is as of June 30, 2007, which actuarial assumptions included (a) 7.75% investment rate of return compounded annually, (b) projected salary increases that vary based on duration of service, and (c) overall payroll growth factor of 3.25% annually. Both (a) and (b) included an inflation component of 3.0% and a 0.25% per annum productivity increase assumption. The actuarial value of CalPERS assets attributable to the Department was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a two- to five-year period.

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, is presented in the June 30, 2008, CalPERS CAFR.

State of California Other Postemployment Benefit Plan

Plan Description — The Fund contributes to the State of California Other Postemployment Benefit Plan (SCOPEB) as part of the state of California, the primary government. The SCOPEB is a cost-sharing multiple-employer defined benefit postemployment health care plan administered by the state of California and CalPERS. CalPERS provides retirement, death, disability, and postretirement health care benefits to members as established by state statute. CalPERS issues a publicly available CAFR that includes financial statements and required supplementary information for the SCOPEB. A copy of that report may be obtained from CalPERS, Central Supply, P.O. Box 942715, Sacramento, CA 95229-2715 or via the Internet at www.calpers.ca.gov.

Funding Policy — The state controller's office sets the employer contribution rate based on the annual required contribution (ARC) of the employers, an amount actuarially determined in accordance with the parameters of GASB Statement No. 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 30 years. The Fund's estimated unfunded other postemployment benefit cost was $878,000 and $675,000 for the years ended June 30, 2011 and 2010, respectively. The Fund recognized $203,000 and $194,000 in expense for the years ended June 30, 2011 and 2010, respectively.

The Department has expensed the above amounts in the appropriate fiscal years and a reserve has been established to transfer to the state's trust account once the account is established. The Department has fully funded its other postemployment benefit costs by setting aside 100% of the established amounts to fund this expense.

9. POOLED INSURANCE FUND

Prior to July 1, 2010, the Farm and Home Fund maintained on its books the reserves for the Department's Fire and Reserve Hazard, Primary Mortgage, and Life and Disability insurance programs. In addition, the Department maintained a separate Disaster Indemnity Fund.

Effective July 1, 2010, pursuant to legislation enacted by the California State Legislature, the Department established a new Pooled Insurance Fund. A primary purpose of this new fund is to help ensure that each of the Department's insurance programs are self-sufficient and adequately maintained for the benefit of the contract purchasers.

In connection with the establishment of the Pooled Insurance Fund, the Disaster Indemnity Fund was terminated and its net assets of $13,385,000 were transferred to the Farm and Home Fund. Subsequently, the Farm and Home Fund transferred cash of $23,735,000 to the Pooled Insurance Fund. This amount, along with the Pooled Insurance Fund's 2011 increase in net assets is included as an advance on the accompanying balance sheet of the Farm and Home Fund at June 30, 2011, as all net assets of the Pooled Insurance Fund are payable to the Farm and Home Fund on demand at the discretion of the Department. The Department is not legally bound to make any further advances to the Pooled Insurance Fund, although it is not precluded from doing so if circumstances warrant.

10. SUBSEQUENT EVENTS

On September 30, 2011, the Governor signed Assembly Bill 1084 (Davis), Veterans' farm and home purchases: shared equity cooperative housing bill was enrolled with an urgency clause (takes effect 30 days after signature, October 30, 2011). This will allow the transfer of $5,448,000 from the California National Guard Members' Farm and Home Building Fund of 1978 to the Veteran's Farm and Home Building Fund of 1943.

On October 1, 2011, the Department voluntarily redeemed $17,525,000 million of home purchase revenue bonds.

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