Report of Independent Auditors
and Financial Statements

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

June 30, 2013 and 2012

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

California Veterans Board
State of California

Report on Financial Statements

We have audited the accompanying financial statements of the Veterans Farm and Home Building Fund of 1943 (the "Fund" or the"1943 Fund"), a fund of the Department of Veterans Affairs, State of California (the "Department"), which comprise the statement of net position as of June 30, 2013, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Farm and Home Building Fund of 1943 as of June 30, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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.

Other Matters

Prior Year Audited Financial Statements
The financial statements of the Fund as of and for the year ended June 30, 2012 were audited by other auditors whose report dated October 18, 2012, expressed an unmodified opinion on those statements.

Required Supplementary Information
Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Moss Adams LLP

Sacramento, California
October 14, 2013

INTRODUCTION

The 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 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 Program. Financing is provided as installment loans, which are referred to as Contracts of Purchase.

Financing for Contracts of Purchase are derived from: the sales of Home Purchase Revenue Bonds, Veterans General Obligations Bonds, principal prepayments of Contracts of Purchase, and other Program revenues not needed to meet Fund operating costs and debt service requirements of the bond portfolio. Expenditures are primarily for debt service and administration of the Program.

The revenue bond resolution giving the Department authority to issue Revenue Bonds requires a reserve fund in an amount equal to no less than 3% of the aggregate outstanding principal of all revenue bonds with interest rates fixed to maturity. The Veterans Debenture Revenue Fund ("VDRF") was established to segregate the bond reserve requirements. At June 30, 2013 and 2012, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. Complete financial statements of the VDRF can be obtained by contacting the Department.

The Department operates a Pooled Self-Insurance Fund ("PIF"), which provides segregation of insurance risk from the Program. In accordance with California state law, the Department is required to pay all insurance claims from the PIF. California state law further provides that each of the Department's insurance reserves be self- sufficient and adequately maintained. The 1943 Fund recognizes an asset for the cash advance of seed capital transferred to the PIF in prior years.

The PIF has combined reserves of $27.2 million, which is divided into the following sub accounts:

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
d. The CalVet Primary Mortgage Insurance Fund

FINANCIAL ANALYSIS

Condensed statements of net position – The following table presents the condensed statements of net position for the Fund as of June 30, 2013, 2012, and 2011 (in thousands).

	2013	2012	2011
ASSETS			
Cash, cash equivalents, and investments	$ 171,358	$ 167,395	$ 104,605
Receivables under contracts of purchase – net	921,296	1,145,938	1,325,499
Other receivables and assets	65,681	74,791	77,204
TOTAL ASSETS	$ 1,158,335	$ 1,388,124	$ 1,507,308
LIABILITIES AND NET POSITION			
LIABILITIES:			
Bonds payable	$ 1,001,941	$ 1,217,674	$ 1,336,384
Other payables and liabilities	13,527	15,511	14,276
Total liabilities	1,015,468	1,233,185	1,350,660
NET POSITION – RESTRICTED	142,867	154,939	156,648
TOTAL LIABILITIES AND NET POSITION	$ 1,158,335	$ 1,388,124	$ 1,507,308

Assets – Total assets decreased by approximately $230 million from $1.388 billion at June 30, 2012 to $1.158 billion at June 30, 2013. This decrease consisted primarily of the following items:

> Total cash, cash equivalents, and investments increased by approximately $4 million from $167.4 million at June 30, 2012 to $171.4 million at June 30, 2013. The increase is due from principal repayments of contracts of purchase in the amount of $228.8 million, which was offset by maturities and special redemptions of bonds of $223.8 million, and approximately $2.2 million from other costs related to operating the Fund.
>
> Net receivables under contracts of purchase decreased $224.6 million, from $1.146 billion at June 30, 2012, to $921.3 million at June 30, 2013. The decrease was a function of repayments of contracts of purchase outpacing the origination of new contracts of purchase due to limited demand stemming from the interest rate environment during the fiscal year ended June 30, 2013.
>
> All other receivables and assets decreased by $9.1 million from $74.8 million at June 30, 2012 to $65.7 million at June 30, 2013. The decrease in other receivables and assets was primarily driven by a decrease in interest receivable related to a lower level of outstanding contracts of purchase and investment balances.

FINANCIAL ANALYSIS (CONTINUED)

Additionally, other real estate owned balances have declined due to increased sales of repossessed properties and less contracts of purchase being foreclosed and transferred to other real estate owned.

Total assets decreased by approximately $119.2 million from $1.507 billion at June 30, 2011 to $1.388 billion at June 30, 2012. This decrease consisted primarily of the following items:

Total cash, cash equivalents and investments increased by approximately $62.8 million from $104.6 million at June 30, 2011 to $167.4 million at June 30, 2012. The increase was due to principal repayments of contracts of purchase in the amount of $179.7 million and the issuance of bonds of $321.6 million, which was offset by maturities and special redemptions of bonds of $438.3 million.

Net receivables under contracts of purchase decreased $179.6 million, from $1.325 billion at June 30, 2011, to $1.146 billion at June 30, 2012. The decrease was a function of repayments of contracts of purchase outpacing the origination of new contracts of purchase due to limited demand stemming from the interest rate environment during the fiscal year ended June 30, 2012.

All other receivables and assets decreased by approximately $2.4 million from $77.2 million at June 30, 2011 to $74.8 million at June 30, 2012. The decrease in other receivables and assets was primarily driven by a decrease in interest receivable related to a lower level of outstanding contracts of purchase. Additionally, other real estate owned balances declined due to increased sales of repossessed properties and less contracts of purchase being foreclosed and transferred to other real estate owned.

Liabilities and net position – Total liabilities decreased by approximately $217.7 million from $1.233 billion at June 30, 2012, to $1.015 billion at June 30, 2013, principally due to bond calls. The net position decreased by approximately $12.1 million from $155 million at June 30, 2012, to $142.9 million at June 30, 2013. The decrease in net position was due to losses on sales of repossessed properties and the restatement of beginning net position as of June 30, 2012 for the cumulative effect of the early adoption of Governmental Accounting Standards Board Statement No. 65 (see Note 1). The total assets to liabilities ratio increased to 1.14 as of June 30, 2013, from 1.13 as of June 30, 2012.

Total liabilities decreased by approximately $117.5 million from $1.351 billion at June 30, 2011, to $1.233 billion at June 30, 2012, principally due to bond calls which exceeded new bond issuances. The net position decreased by approximately $1.7 million from $156.7 million at June 30, 2011, to $155 million at June 30, 2012. The decrease in net position was due to $1.7 million in losses generated from operations and $6.7 million in losses resulting from write downs and sales of repossessed property. This was offset by $1.1 million in income from the Pooled Insurance Fund and $5.5 million in transfers received from other funds. The total assets to liabilities ratio increased to 1.13 as of June 30, 2012, from 1.12 as of June 30, 2011.

FINANCIAL ANALYSIS (CONTINUED)

Condensed statements of revenues and expenses – The following table presents condensed statements of revenues and expenses for the Fund for fiscal years ended June 30, 2013, 2012, and 2011 (in thousands).

	2013	2012	2011
PROGRAM OPERATIONS			
Interest revenues:			
Contracts of purchase	$ 58,970	$ 70,857	$ 80,412
Investments and other	2,674	5,647	5,191
Total program operating revenues	61,644	76,504	85,603
Expenses:			
Interest expense	47,879	62,863	72,278
Provision for program losses	3,936	6,654	9,592
	51,815	69,517	81,870
Program operations revenues over program operations expenses	9,829	6,987	3,733
PROGRAM ADMINISTRATION			
Total program administration revenues	1,980	1,516	4,576
Total program administration expenses	12,055	10,169	12,992
Excess of program administration expenses over program administration revenues	(10,075)	(8,653)	(8,416)
Operations deficiency of revenue over expenses	(246)	(1,666)	(4,683)
Loss on sale of repossessed property	(4,305)	(6,665)	(13,773)
Transfer from other funds	245	6,621	13,385
Deficiency of revenues under expenses	$ (4,306)	$ (1,710)	$ (5,071)

FINANCIAL ANALYSIS (CONTINUED)

Program operations – The program operations revenues over program operations expenses increased by approximately $2.8 million from $7 million for the fiscal year ended June 30, 2012 to $9.8 million for the fiscal year ended June 30, 2013, due to the following:

Interest revenues from contracts of purchase decreased by approximately $11.9 million from $70.9 million for the year ended June 30, 2012 to $59 million for the year ended June 30, 2013, primarily due to a decrease in the average balance of contracts of purchase outstanding during the year.

Interest revenues on investments decreased by approximately $3 million from $5.7 million for the year ended June 30, 2012 to $2.7 million for the year ended June 30, 2013. The decrease in interest revenues is due to the decrease in the average balance of investments outstanding during the year.

Interest expense decreased by approximately $15 million from $62.9 million for the year ended June 30, 2012 to $47.9 million for the year ended June 30, 2013. The decrease in interest expense was a function of a decrease in the average balance of bonds outstanding during the year. Additionally, interest expense for 2013 does not include the amortization of bond issuance costs due to the adoption of GASB 65. Bond issuance cost amortization was approximately $3.6 million during 2012.

The provision for program losses decreased by approximately $2.7 million from $6.7 million for the year ended June 30, 2012 to $3.9 million for the year ended June 30, 2013. The decrease was a function of improved credit quality associated with the contracts of purchase portfolio.

The program operations revenues over program operations expenses increased by approximately $3.3 million from $3.7 million for the fiscal year ended June 30, 2011 to $7 million for the fiscal year ended June 30, 2012, due to the following:

Interest revenues from contracts of purchase decreased by approximately $9.6 million from $80.4 million for the year ended June 30, 2011 to $70.9 million for the year ended June 30, 2012, due primarily to a decrease in the average balance of contracts of purchase outstanding during the year.

Interest revenues on investments increased by approximately $.5 million from $5.2 million for the year ended June 30, 2011 to $5.7 million for the year ended June 30, 2012. The increase in interest revenues was due to the increase in the average balance of investments outstanding during the year.

Interest expense decreased by approximately $9.4 million from $72.3 million for the year ended June 30, 2011 to $62.9 million for the year ended June 30, 2012. The decrease in interest expense was a function of a decrease in the average balance of bonds outstanding during the year.

The provision for program losses decreased by approximately $2.9 million from $9.6 million for the year ended June 30, 2011 to $6.7 million for the year ended June 30, 2012. The decrease was a function of improved credit quality associated with the contracts of purchase portfolio.

FINANCIAL ANALYSIS (CONTINUED)

Program administration – Total program administration revenues include loan origination fees paid to the Department, fees for late payments on contracts of purchase, and rent received on a property owned by the Fund. Total program administration revenues increased by $0.5 million from $1.5 million for the year ended June 30, 2012, to $2 million for the year ended June 30, 2013. Total program administration revenues decreased by $3.1 million from $4.6 million for the year ended June 30, 2011, to $1.5 million for the year ended June 30, 2012.

Total program administration expenses increased by $1.9 million from $10.2 million for the year ended June 30, 2012, to $12.1 million for the year ended June 30, 2013. This is due to an increase of payroll and other support expenditures. Total program administration expenses decreased by $2.8 million from $13 million for the year ended June 30, 2011, to $10.2 million for the year ended June 30, 2012. This was due to a reduction in payroll and other support expenditures.

Total deficiency of revenues over expenses – Total deficiency of revenues over expenses increased $2.6 million from a net deficiency of $1.7 million for the year ended June 30, 2012, to a net deficiency of $4.3 million for the year ended June 30, 2013. The total deficiency of revenues over expenses increased due to the reasons noted above, in addition to the following:

> During the year ended 2012, the Department received a transfer from the California National Guard and Home Building Fund of 1978 of $5.5 million. A similar transfer was not received during 2013. Additionally, the Department realized a reduction of approximately $.9 million in PIF income.
>
> Losses from the sale or write down of repossessed properties resulted in a loss of $4.3 million for the year ended June 30, 2013, compared to a loss of $6.7 million for the year ended June 30, 2012. The reduction in losses and write downs were a function of the improved credit quality associated with the contracts of purchase portfolio and increases in real estate values in the markets the Department operates in. The Funds' holdings of repossessed properties, net of allowances for losses decreased from $16.2 million as of June 30, 2012 to $13 million as of June 30, 2013.

Total deficiency of revenues over expenses decreased $3.4 million from a net deficiency of $5.1 million for the year ended June 30, 2011, to a net deficiency of $1.7 million for the year ended June 30, 2012. The total deficiency of revenues over expenses decreased primarily due to the reasons noted above. During the year ended 2012, the Department received a transfer from the California National Guard and Home Building Fund of 1978 of $5.5 million. This transfer declined as compared to the $13.4 million transfer received during 2011. Losses from the sale or write down of repossessed properties resulted in a loss of $6.7 million for the year ended June 30, 2012, compared to a loss of $13.8 million for the year ended June 30, 2011.

The reduction in losses and write downs were a function of the improved credit quality associated with the contracts of purchase portfolio and increases in real estate values in the markets the Department operates in. The Funds' holdings of repossessed properties, net of allowances for losses decreased from $18.7 million as of June 30, 2011 to $16.2 million as of June 30, 2012.

OVERVIEW OF LOAN PORTFOLIO

Single family home loans/condominiums/farm loans – The Department makes loans to veterans for the purchase of individual residences. Approximately 96% of the dollar volume of the Department's loans is for home loans as of June 30, 2013. Currently, the maximum loan amount is $521,250 ($625,250 for farms), 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, upfront mortgage insurance funding fee 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 guarantee program. Under the USDVA 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, 2013, interest rates on loans outstanding ranged from 3.90% 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 3.5% of the dollar volume of the Department's loans is for home loans as of June 30, 2013. 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. Approximately 0.50% of the dollar volume of the Department's loans is for home loans as of June 30, 2013. These loans typically have a LTV of lower than 90%.

Allowances for uncollectible contracts – The allowance for uncollectible contracts are 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 $10.5 million and $14.1 million as of June 30, 2013 and 2012, respectively.

OVERVIEW OF LOAN PORTFOLIO (continued)

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 or the carrying value of the related loan at the date of foreclosure. After repossession, the value of the underlying contract is written down through the allowance for uncollectible contracts 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 LTV was determined by dividing the current loan balance by the initial purchase price of the property. As of June 30, 2013, the Department had 7,158 active loans in its portfolio, of which 1.6% were determined to have a high LTV. As of June 30, 2013, 85% of high LTV loans were insured with USDVA, and 0.25% of the total portfolio has a high LTV and is uninsured. The Department believes these factors adequately mitigate the risks inherent with loans which are considered to have a high LTV.

Mitigating 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 Program participants reside in the home purchased under the Contracts of Purchase for the term of the loan.

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 guarantee 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 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, 2013, the Program's gross receivables under contracts of purchase were $931.8 million, a decrease of $228.3 million, or 19.6%, from $1.16 billion at June 30, 2012. During the fiscal year, cash and investments balance increased $4 million, or 2.4%, from a balance of $167.4 million to $171.4 million. Bonds payable decreased $215.7 million, or 17.7%, from $1.218 billion at June 30, 2012, to $1.002 billion at June 30, 2013. 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:

> **Loan portfolio performance –** Significant factors include uncertainties, disruption, or volatility in the financial markets, generally, and the market prices that can be achieved upon the sale of repossessed properties relative to the then-outstanding Contract of Purchase balances. The Fund has recognized significant losses on the disposition of repossessed property. For the fiscal years ended June 30, 2011, 2012, and 2013 the Department recognized losses on repossessions of $13.8 million, $6.7 million, and $4.3 million, respectively. The Department believes that this downward trend of losses is indicative of an improving housing market.
>
> **Cost of bond portfolio –** The Department has strategically used principal proceeds from contracts of purchase to fund special and optional redemption to minimize the overall cost of outstanding debt. Principal repayments of contracts of purchase for the years ended June 30 2013, and 2012 have been $228.7 million and $179.7 million, respectively, while special and optional redemption over the same period were $195.6 million and $391.3 million, respectively. Special and optional redemption in 2012 specifically related to an opportunity for the department to refinance $321.6 million of the outstanding bond portfolio at significantly reduced rates. The Department will continue to look for strategic opportunities to issue additional Veterans G.O. Bonds or Revenue Bonds.
>
> **Overall program administration –** Specifically management of the level of administrative expenses the department incurs relative to the rate of origination and outstanding balances of the Contracts of Purchase. As well as the management of the level of interest rates available on short-term investments (including the rate paid on the State of California's Surplus Money Investment Fund ("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.
>
> 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 over expenses.

FINANCIAL STATEMENTS

VETERANS FARM AND HOME BUILDING FUND OF 1943
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
STATEMENTS OF NET POSITION
(In Thousands)

ASSETS

	JUNE 30, 2013	JUNE 30, 2012
CURRENT ASSETS		
Cash in the state treasury	$ 16,499	$ 15,316
State of California Surplus Money Investment Fund	132,158	128,552
Total cash and cash equivalents	148,657	143,868
Current portion of receivables under contracts of purchase – net of allowance for uncollectible contracts	36,133	36,294
Interest receivables:		
Contracts of purchase	6,239	7,624
State of California Surplus Money Investment Fund	100	115
Other investments	46	81
Due from other funds	-	2,593
Total interest receivables	6,385	10,413
Total current assets	191,175	190,575
NONCURRENT ASSETS		
Investments:		
Guaranteed investment contracts	7,850	9,490
Taxable municipal securities and other investments	14,851	14,037
Total investments	22,701	23,527
Receivables under contracts of purchase – net of allowance for uncollectible contracts	885,163	1,109,644
Due from Veterans Debenture Revenue Fund – restricted	15,742	15,742
Due from Pooled Insurance Fund	27,190	27,243
Other real estate owned – net of valuation allowances of $5,812 and $8,050 at June 30, 2013 and 2012, respectively	12,980	16,216
Capital assets – net	863	595
Other noncurrent assets	2,521	4,582
Total noncurrent assets	967,160	1,197,549
TOTAL	$ 1,158,335	$ 1,388,124

(In Thousands)

LIABILITIES AND NET POSITION

	JUNE 30, 2013	JUNE 30, 2012
CURRENT LIABILITIES		
Bonds payable – current portion	$ 100	$ 28,145
Accrued interest and other liabilities	12,040	14,405
Due to other funds	171	17
Total current liabilities	12,311	42,567
NONCURRENT LIABILITIES		
Bonds payable – noncurrent portion	1,001,841	1,189,529
Other postemployment benefits	1,316	1,089
Total noncurrent liabilities	1,003,157	1,190,618
Total liabilities	1,015,468	1,233,185
NET POSITION – RESTRICTED	142,867	154,939
TOTAL	$ 1,158,335	$ 1,388,124

VETERANS FARM AND HOME BUILDING FUND OF 1943
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
(In Thousands)

	JUNE 30, 2013	JUNE 30, 2012
PROGRAM OPERATIONS		
Interest revenues:		
Contracts of purchase of properties	$ 58,970	$ 70,857
Investments and other	2,499	4,908
Transfers of revenues from Veterans Debentures Revenue Fund	175	739
Total program operating revenues	61,644	76,504
Expenses:		
Interest expense	47,879	62,863
Provision for program loan losses	3,936	6,654
	51,815	69,517
Excess of program operations revenue over program operations expenses	9,829	6,987
PROGRAM ADMINISTRATION		
Revenues:		
Loan fees	345	387
Other revenue	1,635	1,129
Total program administration revenues	1,980	1,516
Expenses:		
Payroll and related costs	7,685	7,624
General and administrative expenses	4,370	2,545
Total program administration expenses	12,055	10,169
Deficiency of program administration revenues over program administration expenses	(10,075)	(8,653)
NET OPERATING LOSS	(246)	(1,666)
NONOPERATING REVENUE (EXPENSE)		
Loss on sale and write down of repossessed property	(4,305)	(6,665)
Income from Pooled Insurance Fund	245	1,129
Transfer from California National Guard Farm and Home Building Fund of 1978	-	5,492
Deficiency of revenues over expenses	(4,306)	(1,710)
NET POSITION - RESTRICTED		
Beginning of year	154,939	156,649
GASB 65 adjustment	(7,766)	-
Deficiency of revenues over expenses	(4,306)	(1,710)
End of year	$ 142,867	$ 154,939

See accompanying notes

STATEMENTS OF CASH FLOWS
(In Thousands)

	YEARS ENDING JUNE 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from contract holders	$ 228,760	$ 179,709
Interest received	65,672	76,186
Interest payments	(47,879)	(58,772)
Payments to suppliers and employees	(13,736)	(11,749)
Payments made for new contracts of purchase	(9,123)	(10,549)
Other receipts (payments)	4,041	(2,210)
Net cash provided by operating activities	227,735	172,615
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from issuance of bonds	-	321,585
Maturities of bonds payable	(28,145)	(47,020)
Early redemption of bonds payable	(195,609)	(391,260)
Increase to deferred finance costs	-	(6,105)
Amounts received from Veterans Debenture Fund	-	4,000
Transfer from California National Guard Farm and Home Building Fund of 1978	-	5,492
Net cash used in noncapital financing activities	(223,754)	(113,308)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of land, improvements, and equipment	(316)	(40)
Net cash used in capital and related financing activities	(316)	(40)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net decrease (increase) in investments	826	(6,831)
Receipt from Pooled Insurance Fund	298	3,523
Net cash provided by (used in) investing activities	1,124	(3,308)
INCREASE IN CASH AND CASH EQUIVALENTS	4,789	55,959
CASH AND CASH EQUIVALENTS		
Beginning of year	143,868	87,909
End of year	$ 148,657	$ 143,868

See accompanying notes

VETERANS FARM AND HOME BUILDING FUND OF 1943
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
STATEMENTS OF CASH FLOWS
(In Thousands)

	YEARS ENDING JUNE 30,	
	2013	2012
RECONCILIATION OF OPERATIONS EXCESS OF REVENUES OVER EXPENSES TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net operating loss	$ (246)	$ (1,666)
Adjustments to reconcile to net cash in operating activities:		
Bond amortization	255	4,091
Provision for program losses related to uncollectible contracts	3,936	6,654
Depreciation	48	56
Effect of changes in assets and liabilities:		
Decrease (increase) in interest receivable – State of California Surplus Money Investment Fund	15	(4)
Decrease in interest receivable – other investments	35	35
Decrease in interest receivable – contracts of purchase	1,385	1,115
Decrease in interest receivable – due from other funds	2,593	-
Decrease in receivable under contracts of purchase	219,637	168,773
Decrease (increase) in other assets	2,061	(2,210)
Decrease in accrued interest and other liabilities	(2,365)	(912)
Decrease (increase) in due from other funds	154	(935)
Increase in other postretirements benefits	227	211
Decrease in fire and hazard insurance claims payable	-	(2,593)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 227,735	$ 172,615

NOTE 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 "1943 Fund" or 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 Fund is administered by the Department and 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 Department established The Veterans Debenture Revenue Fund and the Pooled Self-Insurance Fund to provide ancillary support for the 1943 Fund. The net position of each fund is recognized as a non-current asset in the financial statements. Notes 5 and 8 provide disclosures related to these funds.

The financial statements represent only the activities of the 1943 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 other 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, and its financial statements are prepared on the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded when liabilities are incurred, regardless of the timing of related cash flows.

Accounting standards – The Fund follows the standards of governmental accounting and financial reporting, as promulgated by the Governmental Accounting Standards Board ("GASB").

For the fiscal year ending June 30, 2013 the state of California has opted to early adopt GASB Statement No. 65, ("GASB 65"), "*Items Previously Reported as Assets and Liabilities"*. Accordingly, the Department has assessed the impact of GASB 65 on the Fund, and identified $7,766,482 of bond issuance costs from prior fiscal years which are now required to be expensed when incurred. A retroactive restatement of the prior years was not considered to be necessary as the effects are not material to the Fund. The cumulative effect of adopting the statement has been reported as a restatement of beginning net position for the period ending June 30, 2013.

For the year ended June 30, 2013, the Department implemented Governmental Accounting Standards Board Statement No. 63 ("GASB 63"), *"Financial reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position."* The requirements of this statement are effective for financial statement periods beginning after December 15, 2011. For the Fund, the impact of GASB 63 was to report the former Statement of Net Assets as the Statement of Net Position.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Restrictions on net position – The proceeds of the General Obligation and Revenue bonds are restricted by the state of California Military and Veterans Code for the purpose of providing farm and home aid for veterans in accordance with the Veterans' Farm and Home Purchase Act of 1974 and of all acts amendatory thereof and supplemental thereto.

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, 2013 and 2012, cash equivalents consisted of the State of California 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 statements of net position 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.

Classification of operating revenues and expenses – Revenues and expenses are classified as operating as they relate to the administration of the 1943 Fund. Operating revenues include interest income, loan fees other fees received related to the origination and collection of contracts of purchase, and transfers from the Veterans Debenture Revenue Fund. Operating expenses include provisions for program loan losses, interest expense associated with the issuance of bonds payable, and general and administrative expenses, including payroll, associated with the administration of the 1943 Fund's objectives. Nonoperating revenues and expenses include transfers between other funds and expenses incurred in the disposition of repossessed property.

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 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. The allowance for uncollectible contracts was approximately $10.5 million and $14.1 million as of June 30, 2013 and 2012, respectively.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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"). The contract guarantee is forwarded to the Pooled Insurance Fund (PIF), where it is recognized as revenue when received. 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. Estimates of these losses are included in the allowance for uncollectible contracts.

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 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.

Capital assets – Capital assets are stated at cost less accumulated depreciation and reflect assets with an estimated useful life in excess of one year. Depreciation is provided for in amounts sufficient to relate the cost of capital assets over their estimated service lives using the straight-line method. Building improvements and equipment have an estimated useful life of five years.

Amortization of bond premiums and discounts – Premiums and discounts arising from the issuance of bonds are capitalized and amortized using the monthly amortization method, which approximates the interest method.

Reclassifications – Certain prior year amounts have been reclassified to conform to the current year presentation. There was no effect on operations or net position as a result of reclassifications.

NOTE 2– CASH, CASH EQUIVALENTS, AND INVESTMENTS

The Fund's cash, cash equivalents, and investments held at cost as of June 30, 2013 and 2012 were as follows (in thousands):

	JUNE 30,	
	2013	2012
Cash in the state treasury	$ 16,499	$ 15,316
State of California Surplus Money Investment Fund	132,158	128,552
Cash and cash equivalents	148,657	143,868
Guaranteed investment contracts (at cost)	7,850	9,490
Amounts held in trust fund with insurance administrators (at cost)	14,851	14,037
Investments	22,701	23,527
Total cash, cash equivalents, and investments	$ 171,358	$ 167,395

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.

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, 2013 and 2012, 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.

NOTE 2– CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

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 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 investments held in trust fund with insurance administrators include taxable municipal securities, government bonds and money market funds designated as short-term investments.

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, 2013, the investments held in trust fund with insurance are all considered investment grade and are rated equal to or greater than Aa2 by Moody's.

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, 2013, the Fund did not have any investments exposed to custodial credit. All investments are held by the state of California.

NOTE 2– CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

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, 2013, 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. The interest rates on the GIC's are fixed and range from 5.37% to 5.50%. The GIC's expire from 2029 to 2032. The interest rates on the underlying taxable municipal securities reflected as investments with insurance administrators range from 1.30% to 3.39% and mature from 2018 to 2024. The interest rate on the underlying government bond held in trust fund with insurance administrators was 4.55% and matures in 2014.

NOTE 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 3.9% – 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, 2013 and 2012, were as follows (in thousands):

	JUNE 30,	
	2013	2012
Receivables under contracts of purchase	$ 931,791	$ 1,160,063
Less allowance for uncollectible contracts of purchase	(10,495)	(14,125)
Total	921,296	1,145,938
Less current portion	(36,133)	(36,294)
Receivables under contracts of purchase, net	$ 885,163	$ 1,109,644

NOTE 4 – LAND, IMPROVEMENTS, AND EQUIPMENT

Land, improvements, and equipment as of June 30, 2013 and 2012 consisted of the following (in thousands):

	JUNE 30,	
	2013	2012
Land	$ 443	$ 443
Building improvements	12,876	12,586
Equipment	3,256	3,230
	16,575	16,259
Less accumulated depreciation	(15,712)	(15,664)
Capital assets – net	$ 863	$ 595

During 2013, the Fund acquired approximately $316,000 of capital assets and incurred depreciation expense of approximately $48,000. There were no disposals of capital assets during 2013.

NOTE 5 – BONDS PAYABLE

Bonds payable as of June 30, 2013 and 2012 included the following (in thousands):

	JUNE 30, 2013	JUNE 30, 2012
General obligation bonds of the state of California, fixed annual interest rates from 2.2% to 5.7% due in varying annual installments through 2042 (subject to varying redemption provisions)	$ 585,360	$ 757,560
Home purchase revenue bonds, fixed annual interest rates from 1.3% to 5.0%, due in varying annual installments through 2042 (subject to varying redemption provisions)	420,325	471,880
Total	1,005,685	1,229,440
Less:		
Discounts	(1,550)	(1,650)
Premium	177	223
Unamortized bond origination costs	-	(7,766)
Unamortized bond redemption premiums	(2,371)	(2,573)
Total	1,001,941	1,217,674
Less current portion	100	28,145
Noncurrent portion	$ 1,001,841	$ 1,189,529

NOTE 5 – BONDS PAYABLE (continued)

The following is a rollforward of bonds payable for the years ended June 30, 2013 and 2012 (in thousands):

	JUNE 30,	
	2013	2012
Beginning balance	$ 1,217,674	$ 1,336,384
Additions:		
Issuance of bonds	-	321,585
Early adoption of GASB 65	7,766	-
Amortization of premiums/discounts	255	4,091
Total additions	8,021	325,676
Reductions:		
Capitalized debt issuance costs	-	(6,106)
Scheduled maturities of bonds payable	(28,145)	(47,020)
Early redemption of bonds payable	(195,609)	(391,260)
	(223,754)	(444,386)
Ending balance	$ 1,001,941	$ 1,217,674
Current portion	$ 100	$ 28,145
Noncurrent portion	$ 1,001,841	$ 1,189,529

NOTE 5 – BONDS PAYABLE (CONTINUED)

A summary of debt service requirements for the next five years and to maturity as of June 30, 2013 is as follows (in thousands):

FISCAL YEARS ENDING JUNE 30	PRINCIPAL	INTEREST
2014	$ 100	$ 42,135
2015	24,775	41,774
2016	31,385	40,935
2017	21,590	40,102
2018	33,210	39,042
2019-2023	202,230	173,338
2024-2028	261,620	127,827
2029-2033	234,285	72,351
2034-2038	119,370	31,630
2039-2043	77,120	7,017
Total	$ 1,005,685	$ 616,151

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 $238.6 million at June 30, 2013 and 2012. In November 2008, California voters approved the Veterans Bond Act of 2008 ("2008 Bond Act") totaling $900 million. As of June 30, 2013 and 2012, no bonds have been issued under the 2008 Bond Act.

Home purchase revenue bonds are generally used to fund contracts of purchase and represent special obligations of the Department payable solely from, and by a pledge of, an undivided interest in the assets and net revenues of the Fund and the Veterans Debenture Revenue Fund, a separate fund of the Department. The amount of the pledge is equal to the remaining principal and interest requirements associated with the outstanding revenue bonds and the term of the pledge coincides with the remaining term of the revenue bonds. 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. The net revenues pledged represent the total net revenues of the Fund. During the year ended June 30, 2013, the Fund recognized pledged gross revenues of approximately $63.6 million and a net loss from operations of $246 thousand. In comparison, principal and interest requirements for the same period totaled approximately $79.2 million. 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, 2013 and 2012, authorized and unissued revenue bonds were $958.6 million.

NOTE 5 – BONDS PAYABLE (CONTINUED)

The revenue bond resolution provisions regarding the bond reserve account in the Veterans Debenture Revenue Fund 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. 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, 2013 and 2012, the total assets of the Veterans Debenture Revenue Fund are shown as a receivable of the Fund. The underlying assets of the Veterans Debenture Revenue Fund include cash deposits in the State of California Surplus Money Investment Fund, carried at cost, which approximates fair value, and accrued interest receivable related to those deposits. There are no liabilities recorded by the Veterans Debenture Revenue Fund, other than amounts payable to the Department, which equal the Department's recorded receivable balance. Complete financial statements of the Veterans Debenture Revenue Fund, Department of Veterans Affairs, and state of California can be obtained by contacting the Department.

During the years ended June 30, 2013 and 2012, the Department did not issue general obligation bonds. For the year ended June 30, 2013, the Department did not issue home purchase revenue bonds. For the year ended June 30, 2012, the Department issued home purchase revenue bonds totaling $321.6 million of which $308.3 million was used to refund certain outstanding home purchase revenue bonds and $13.3 million was available to finance new and existing contracts of purchase. Currently, the Department has no outstanding commercial paper.

In fiscal year 2012, the Department redeemed $83 million for home purchase revenue bonds to pay off higher coupon debt prior to maturity. The Department also paid off $41.9 million of general obligation debt and $5.1 million of home purchase revenue debt, due to maturity.

NOTE 6 – COMMITMENTS AND CONTINGENCIES

Commitments – As of June 30, 2013 and 2012, the Fund had loan commitments to veterans for the purchase of properties under contracts of sale of approximately $5.2 million and $2.2 million, respectively.

The Fund leases several buildings used as district offices. Rent expense for the years ended June 30, 2013 and 2012, was $80,000 and $72,000, respectively. Minimum annual rentals under operating leases as of June 30, 2013 are as follows (in thousands):

FISCAL YEARS ENDING JUNE 30		
2014	$	71
2015		31
2016		31
2017		31
2018		31
Total	$	195

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.

NOTE 7 – EMPLOYEE BENEFIT PLANS

Public Employees' Retirement Fund (PERF)

Plan Description – The Fund contributes to the 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, 2013 and 2012 were approximately $941,000 and $881,000, or approximately 19% and 17% of participants' salaries, respectively.

NOTE 7 – EMPLOYEE BENEFIT PLANS (CONTINUED)

Annual pension cost – For fiscal years June 30, 2013 and 2012, 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, 2012, 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, 2012, CalPERS CAFR.

State of California Other Postemployment Benefit Plan (SCOPEB)

Plan description – The Fund contributes to the 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 other postemployment benefit cost was $1.3 million and $1.1 million for the years ended June 30, 2013 and 2012, respectively. The Fund recognized $227,000 and $211,000 in expense for the years ended June 30, 2013 and 2012, respectively.

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

NOTE 8 – POOLED INSURANCE FUND

Effective July 1, 2010, pursuant to legislation enacted by the California State Legislature, the Department established a Pooled Insurance Fund (the "PIF"). The fund was established to help ensure that each of the Department's insurance programs, which include Fire and Reserve Hazard, Primary Mortgage, Disaster, and Life and Disability, is self-sufficient and adequately maintained for the benefit of the contract purchasers. The Department manages the PIF, and allocates the PIF related payroll expenses which the 1943 Fund incurs on its behalf.

The net position of the PIF is 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 PIF, although it is not precluded from doing so if circumstances warrant. The net position for the PIF was $27.2 million as of June 30, 2013 and 2012, respectively, and is reflected as a noncurrent receivable on the accompanying statements of net position of the 1943 Fund. Transfers received from the PIF are reflected as non-operating revenues on the statements of revenues, expenses and changes in net position.

NOTE 9 – CALIFORNIA NATIONAL GUARD FUND

All of the loans and remaining funds of the California National Guard members' Farm and Home Purchase Act of 1978 ("Cal Guard") totaling $5.492 million were transferred to and combined with the Veterans' Farm and Home Purchase Act of 1974 on October 30, 2011. Since the inception of the Cal Guard program, Cal Vet has always administered the program. There are no further bonds outstanding for this program.

NOTE 10 – RISK MANAGEMENT

The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; natural disasters for which the Department established the PIF and carries commercial insurance.

NOTE 11 – SUBSEQUENT EVENTS

On September 1, 2013, the Department voluntarily redeemed $44.405 million of general obligation bonds.