Report of Independent Auditors and Financial Statements

# Veterans' Farm and Home Purchase Program of the Department of Veterans Affairs, State of California (Veterans Farm and Home Building Fund of 1943, Veterans Debenture Revenue Fund and Pooled Self-Insurance Fund)

June 30, 2014 and 2013

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 business-type activities of the Veterans' Farm and Home Purchase Program of the Department of Veterans Affairs, State of California (the "Program"), which comprise the statements of net position as of June 30, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements. We have also audited the financial statements of the Veterans Farm and Home Building Fund of 1943 (the "1943 Fund"), Veterans Debenture Revenue Fund (the "VDRF Fund"), and Pooled Self-Insurance Fund (the "PIF Fund") presented as supplementary information, as defined by the Government Accounting Standards Board, in the accompanying combining fund financial statements as of and for the year ended June 30, 2014 and June 30, 2013 as listed in the table of contents.

### *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 opinions 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 opinions.

***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Veterans' Farm and Home Purchase Program of the Department of Veterans Affairs, State of California, as of June 30, 2014 and 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the 1943 Fund, VDRF Fund, and PIF Fund as of June 30, 2014 and 2013, and the respective changes in financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

The financial statements represent only the business activities of the Veterans' Farm and Home Purchase Program of the Department of Veterans Affairs, State of California, and are not intended to present the financial position of the Department of Veterans Affairs, State of California and the results of its operations and its cash flows. The financial statements referred to above 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***

*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 12 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
August 29, 2014

## 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. 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 "1943 Fund"), which is the principal fund utilized for the CalVet Farm and Home Purchase 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.

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 PIF has combined reserves of $25.6 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 Program as of June 30, 2014, 2013, and 2012 (in thousands).

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash, cash equivalents, and investments | $ 126,883 | $ 214,450 | 210,688 |
| Receivables under contracts of purchase – net | 829,508 | 921,296 | 1,145,938 |
| Other receivables and assets | 10,958 | 22,778 | 29,249 |
| TOTAL ASSETS | $ 967,349 | $ 1,158,524 | $ 1,385,875 |
| **LIABILITIES AND NET POSITION** | | | |
| LIABILITIES | | | |
| Bonds payable | $ 803,107 | $ 1,001,941 | 1,217,674 |
| Other payables and liabilities | 13,360 | 14,284 | 13,964 |
| Total liabilities | 816,467 | 1,016,225 | 1,231,638 |
| NET POSITION – RESTRICTED | 150,882 | 142,299 | 154,237 |
| TOTAL LIABILITIES AND NET POSITION | $ 967,349 | $ 1,158,524 | $ 1,385,875 |

**Assets –** Total assets decreased by approximately $191 million from $1.158 billion at June 30, 2013 to $967 million at June 30, 2014. This decrease consisted primarily of the following items:

Total cash, cash equivalents, and investments decreased by approximately $87.5 million from $214.4 million at June 30, 2013 to $126.9 million at June 30, 2014. The decrease is due to maturities and special redemptions of bonds of $199.3 million and payments made for new contracts of purchase of $73.5 million, which was offset by principal repayments of contracts of purchase of $178.7 million, and approximately $6.6 million from other costs related to operating the Fund.

Net receivables under contracts of purchase decreased $91.8 million, from $921.3 million at June 30, 2013, to $829.5 million at June 30, 2014. The decrease was a function of repayments of contracts of purchase outpacing the origination of new contracts due to limited demand stemming from the interest rate environment during the fiscal year June 30, 2014.

**FINANCIAL ANALYSIS (CONTINUED)**

**Assets (continued) –** All other receivables and assets decreased by $11.8 million from $22.8 million at June 30, 2013 to $11 million at June 30, 2014. The decrease in other receivables and assets was primarily driven by a decrease in interest receivable related to fewer outstanding contracts of purchase and investment balances.

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 $227 million from $1.385 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 $3.7 million from $210.7 million at June 30, 2012 to $214.4 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 $224.7 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 $6.4 million from $29.2 million at June 30, 2012 to $22.8 million at June 30, 2013. The decrease in other receivables and assets was primarily driven by a decrease in interest receivable related to fewer outstanding contracts of purchase and investment balances.

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.

**Liabilities and net position –** Total liabilities decreased by approximately $199.5 million from $1.016 billion at June 30, 2013, to $816.5 million at June 30, 2014, principally due to bond calls. The net position increased by approximately $8.6 million from $142.3 million at June 30, 2013, to $150.9 million at June 30, 2014. The increase in net position was due to net operating income of $8.6 million for the year ended June 30, 2014. The total assets to liabilities ratio increased to 1.18 as of June 30, 2014, from 1.14 as of June 30, 2013.

## FINANCIAL ANALYSIS (CONTINUED)

**Liabilities and net position (continued) –** Total liabilities decreased by approximately $216 million from $1.232 billion at June 30, 2012, to $1.016 billion at June 30, 2013, principally due to bond calls. The net position decreased by approximately $11.9 million from $154.2 million at June 30, 2012, to $142.3 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 to the financial statements). The total assets to liabilities ratio increased to 1.14 as of June 30, 2013, from 1.13 as of June 30, 2012.

**Condensed statements of revenues and expenses –** The following table presents condensed statements of revenues and expenses for the Program for fiscal years ended June 30, 2014, 2013, and 2012 (in thousands).

| | 2014 | 2013 | 2012 |
|---|---|---|---|
| **PROGRAM OPERATIONS** | | | |
| Revenues: | | | |
| Contracts of purchase of properties | $ 47,461 | $ 58,970 | $ 70,857 |
| Investments and other | 1,150 | 2,753 | 5,647 |
| Insurance revenue and claim reimbursements | 10,245 | 6,140 | 7,532 |
| Total program operating revenues | 58,856 | 67,863 | 84,036 |
| Expenses: | | | |
| Interest expense | 37,639 | 47,879 | 62,863 |
| (Reversal of) provision for program losses | (3,586) | 3,936 | 6,654 |
| Insurance premiums and claims paid | 4,032 | 4,204 | 6,721 |
| | 38,085 | 56,019 | 76,238 |
| Excess of program operations revenues over program operations expenses | 20,771 | 11,844 | 6,987 |
| **PROGRAM ADMINISTRATION** | | | |
| Total program administration revenues | 2,805 | 2,122 | 1,516 |
| Total program administration expenses | 14,992 | 13,832 | 10,169 |
| Excess of program administration expenses over program administration revenues | (12,187) | (11,710) | (8,653) |
| Operations excess (deficiency) of revenue over expenses | 8,584 | 134 | (1,666) |
| Loss on sale of repossessed property | (1) | (4,305) | (6,665) |
| Excess (deficiency) of revenues over expenses | $ 8,583 | $ (4,171) | $ (8,331) |

## FINANCIAL ANALYSIS (CONTINUED)

**Program operations –** The program operations revenues over program operations expenses increased by approximately $9.0 million from $11.8 million for the fiscal year ended June 30, 2013 to $20.8 million for the fiscal year ended June 30, 2014, due to the following:

Interest revenues from contracts of purchase decreased by approximately $11.5 million from $59 million for the year ended June 30, 2013 to $47.5 million for the year ended June 30, 2014, primarily due to a decrease in the average balance of contracts of purchase outstanding during the year.

Interest revenues on investments decreased by approximately $1.6 million from $2.7 million for the year ended June 30, 2013 to $1.1 million for the year ended June 30, 2014. The decrease in interest revenues is due to the decrease in the average balance of investments outstanding during the year.

Insurance revenue and claim reimbursements increased by approximately $4.1 million from $6.1 million for the year ended June 30, 2013 to $10.2 million for the year ended June 30, 2014. The increase in insurance revenue is due to reimbursements of $5.0 million for insured losses on high loan to value contracts of purchase. The Program met their deductible during 2014 and is now receiving proceeds for reimbursable losses related to this insurance program.

Interest expense decreased by approximately $10.3 million from $47.9 million for the year ended June 30, 2013 to $37.6 million for the year ended June 30, 2014. The decrease in interest expense was a function of a decrease in the average balance of bonds outstanding during the year.

The (reversal of) provision for program losses decreased by approximately $7.5 million from an expense of $3.9 million for the year ended June 30, 2013 to a reversal of provision (revenue) of $3.6 million for the year ended June 30, 2014. The decrease was a function of improved credit quality associated with the contracts of purchase portfolio.

Insurance premiums and claims paid decreased by approximately $0.2 million from a $4.2 million for the year ended June 30, 2013 to $4 million for the year ended June 30, 2014. The decrease was due to fewer outstanding contracts of purchase.

## FINANCIAL ANALYSIS (CONTINUED)

**Program operations (continued) –** The program operations revenues over program operations expenses increased by approximately $4.8 million from $7 million for the fiscal year ended June 30, 2012 to $11.8 million for the fiscal year ended June 30, 2013, due to the following:

Interest revenues from contracts of purchase decreased by approximately $11.8 million from $70.8 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 $2.9 million from $5.6 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.

Insurance revenue and claim reimbursements decreased by approximately $1.4 million from $7.5 million for the year ended June 30, 2012 to $6.1 million for the year ended June 30, 2013. The decrease in interest revenues is due to fewer outstanding contracts of purchase.

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 (reversal of) provision for program losses decreased by approximately $2.7 million from $6.6 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.

Insurance premiums and claims paid decreased by approximately $2.5 million from $6.7 million for the year ended June 30, 2012 to $4.2 million for the year ended June 30, 2013. The decrease in insurance premiums and claims is due to fewer outstanding contracts of purchase.

**Program administration** – Total program administration revenues include loan origination fees paid to the Program, fees for late payments on contracts of purchase, and rent received on a property owned by the Program. Total program administration revenues increased by approximately $0.7 million from $2.1 million for the year ended June 30, 2013, to $2.8 million for the year ended June 30, 2014. Total program administration revenues increased by $0.6 million from $1.5 million for the year ended June 30, 2012, to $2.1 million for the year ended June 30, 2013.

Total program administration expenses increased by $1.2 million from $13.8 million for the year ended June 30, 2013, to $15 million for the year ended June 30, 2014. This is due to an increase of payroll and other support expenditures. Total program administration expenses increased by $3.6 million from $10.2 million for the year ended June 30, 2012, to $13.8 million for the year ended June 30, 2013. This is due to an increase of payroll and other support expenditures.

## FINANCIAL ANALYSIS (CONTINUED)

### Program administration (continued)

**Total excess (deficiency) of revenues under expenses** – Total excess (deficiency) of revenues over expenses increased $12.8 million from a net deficiency of $4.2 million for the year ended June 30, 2013, to a net excess of $8.6 million for the year ended June 30, 2014. The total excess (deficiency) of revenues over expenses increased due to the reasons noted above, in addition to the following:

> Gains (losses) from the sale or write down of repossessed properties resulted in a loss of $1 thousand for the year ended June 30, 2014, compared to a loss of $4.3 million for the year ended June 30, 2013. 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 Program operates in. The Program's holdings of repossessed properties, net of allowances for losses, decreased from $13 million as of June 30, 2013 to $3.1 million as of June 30, 2014.

Total deficiency of revenues under expenses increased $4.1 million from a net deficiency of $8.3 million for the year ended June 30, 2012, to a net deficiency of $4.2 million for the year ended June 30, 2013. The total deficiency of revenues under expenses increased due to the reasons noted above. During the year ended 2012, the Program 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 Program realized a reduction of approximately $0.9 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 Program operates in. The Program's 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.

## 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, 2014. 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").

### OVERVIEW OF LOAN PORTFOLIO (CONTINUED)

**Single family home loans/condominiums/farm loans (continued) –** 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 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 Program 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, 2014, interest rates on loans outstanding ranged from 3.875% to 9.75%. While the Program has the limited ability to adjust the interest rates, post-1999 through December 2010 loans can be adjusted by 0.5% if needed and pre-1999 loans can be adjusted with no rate cap, the policy of the Program has been to leave the interest rate fixed at the rate in effect when the loan was originated. Beginning on January 1, 2011 all contracts of purchase are issued with fixed interest rates.

**Mobile homes –** The Program makes loans to veterans for the purchase of mobile homes. Approximately 3.5% of the dollar volume of the Program's loans is for home loans as of June 30, 2014. 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 Program makes a limited amount of home improvement loans. Approximately 0.5% of the dollar volume of the Program's loans is for home loans as of June 30, 2014. 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 $6.1 million and $10.5 million as of June 30, 2014 and 2013, respectively.

**OVERVIEW OF LOAN PORTFOLIO (CONTINUED)**

**Other real estate owned –** Real estate acquired by the Program 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 or gains on sales of foreclosures are charged against non-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 Program'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, 2014, the Program had 6,180 active loans in its portfolio, of which 2.54% were determined to have a high LTV. As of June 30, 2014, 2.51% of the total portfolio has a high LTV and is insured with USDVA, and 0.03% of the total portfolio has a high LTV and is uninsured. The Program 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 Program does not provide variable rate loans.

The Program requires that Program participants reside in the home purchased under the Contracts of Purchase for the term of the loan.

The Program'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 Program'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 Program 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 Program's finances will be adversely impacted.

## ECONOMIC FACTORS FACING FARM AND HOME PURCHASE PROGRAM

At June 30, 2014, the Program's gross receivables under contracts of purchase were $829.5 million, a decrease of $91.8 million, or 10.3%, from $921.3 million at June 30, 2013. During the fiscal year, cash and investments balance decreased $87.6 million, or 40.8%, from a balance of $214.4 million to $126.9 million. Bonds payable decreased $198.7 million, or 19.8%, from $1.002 billion at June 30, 2013, to $803 million at June 30, 2014. Bond ratings for the Department's G.O. 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 maintain an excess of revenues over expenses in future periods and the financial performance of the Program 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 Program has recognized losses on the disposition of repossessed property. For the fiscal years ended June 30, 2012, 2013, and 2014 the Program recognized losses on repossessions of $6.7 million, $4.3 million, and $1 thousand, respectively. The Program 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, 2014 and 2013 have been $178.7 million and $228.7 million, respectively, while special and optional redemption over the same period were $199.2 million and $195.6 million, respectively. 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.

# FINANCIAL STATEMENTS

# VETERANS' FARM AND HOME PURCHASE PROGRAM
## DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
## STATEMENTS OF NET POSITION
## (In Thousands)

**ASSETS**

| | JUNE 30, 2014 | JUNE 30, 2013 |
|---|---|---|
| CURRENT ASSETS | | |
| Cash in the state treasury | $ 12,288 | $ 16,502 |
| State of California Surplus Money Investment Fund | 89,393 | 175,247 |
| Total cash and cash equivalents | 101,681 | 191,749 |
| Current portion of receivables under contracts of purchase – net of allowance for uncollectible contracts | 27,663 | 36,133 |
| Interest receivables: | | |
| Contracts of purchase | 4,383 | 6,239 |
| State of California Surplus Money Investment Fund | 63 | 127 |
| Other investments | 50 | 36 |
| Total interest receivables | 4,496 | 6,402 |
| Total current assets | 133,840 | 234,284 |
| NONCURRENT ASSETS | | |
| Investments: | | |
| Guaranteed investment contracts | 10,327 | 7,850 |
| Taxable municipal securities and other investments | 14,875 | 14,851 |
| Total investments | 25,202 | 22,701 |
| Receivables under contracts of purchase – net of allowance for uncollectible contracts | 801,845 | 885,163 |
| Other real estate owned – net of valuation allowances of $190 and $5,812 at June 30, 2014 and 2013, respectively | 3,153 | 12,980 |
| Capital assets – net | 876 | 863 |
| Other noncurrent assets | 2,433 | 2,533 |
| Total noncurrent assets | 833,509 | 924,240 |
| TOTAL ASSETS | $ 967,349 | $ 1,158,524 |

**(In Thousands)**

**LIABILITIES AND NET POSITION**

| | JUNE 30, 2014 | JUNE 30, 2013 |
|---|---|---|
| CURRENT LIABILITIES | | |
| Bonds payable – current portion | $ - | $ 100 |
| Accrued interest and other liabilities | 10,975 | 12,228 |
| Due to other funds | 198 | 171 |
| Total current liabilities | 11,173 | 12,499 |
| NONCURRENT LIABILITIES | | |
| Bonds payable – noncurrent portion | 803,107 | 1,001,841 |
| Insurance claims reserves | 623 | 569 |
| Other postemployment benefits | 1,564 | 1,316 |
| Total noncurrent liabilities | 805,294 | 1,003,726 |
| Total liabilities | 816,467 | 1,016,225 |
| NET POSITION – RESTRICTED | 150,882 | 142,299 |
| TOTAL LIABILITIES AND NET POSITION | $ 967,349 | $ 1,158,524 |

See accompanying notes

# VETERANS' FARM AND HOME PURCHASE PROGRAM
## DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
## (In Thousands)

| | JUNE 30, 2014 | JUNE 30, 2013 |
|---|---|---|
| PROGRAM OPERATIONS | | |
| Revenues: | | |
| Contracts of purchase of properties | $ 47,461 | $ 58,970 |
| Investments and other | 1,150 | 2,753 |
| Insurance revenue and claim reimbursements | 10,245 | 6,140 |
| Total program operating revenues | 58,856 | 67,863 |
| Expenses: | | |
| Interest expense | 37,639 | 47,879 |
| (Reversal of) provision for program loan losses | (3,586) | 3,936 |
| Insurance premiums and claims paid | 4,032 | 4,204 |
| | 38,085 | 56,019 |
| Excess of program operations revenues over program operations expenses | 20,771 | 11,844 |
| PROGRAM ADMINISTRATION | | |
| Revenues: | | |
| Fees | 1,220 | 554 |
| Other revenue | 1,585 | 1,568 |
| Total program administration revenues | 2,805 | 2,122 |
| Expenses: | | |
| Payroll and related costs | 8,457 | 7,685 |
| General and administrative expenses | 6,535 | 6,147 |
| Total program administration expenses | 14,992 | 13,832 |
| Deficiency of program administration revenues over program administration expenses | (12,187) | (11,710) |
| NET OPERATING INCOME | 8,584 | 134 |
| NONOPERATING REVENUE (EXPENSE) | | |
| Loss on sale and write down of repossessed property | (1) | (4,305) |
| Excess (deficiency) of revenues over expenses | 8,583 | (4,171) |
| NET POSITION | | |
| Beginning of year | 142,299 | 154,236 |
| GASB 65 adjustment | - | (7,766) |
| Excess (deficiency) of revenues over expenses | 8,583 | (4,171) |
| End of year | $ 150,882 | $ 142,299 |



See accompanying notes

## STATEMENTS OF CASH FLOWS

# VETERANS' FARM AND HOME PURCHASE PROGRAM
## DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
## STATEMENTS OF CASH FLOWS
## (In Thousands)

| | YEARS ENDING JUNE 30, 2014 | 2013 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Receipts from contract holders | $ 178,708 | $ 228,760 |
| Interest received | 50,517 | 63,166 |
| Interest payments | (37,639) | (47,879) |
| Payments to suppliers and employees | (15,300) | (15,802) |
| Payments made for new contracts of purchase | (73,508) | (9,123) |
| Disaster insurance revenue | 10,245 | 6,140 |
| Disaster insurance premiums and claims paid | (4,032) | (4,204) |
| Other receipts | 2,905 | 6,774 |
| Net cash provided by operating activities | 111,896 | 227,832 |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES | | |
| Maturities of bonds payable | (100) | (28,145) |
| Early redemption of bonds payable | (199,235) | (195,609) |
| Net cash used in noncapital financing activities | (199,335) | (223,754) |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | |
| Purchase of land, buildings, and equipment | (128) | (316) |
| Net cash used in capital and related financing activities | (128) | (316) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Net (increase) decrease in investments | (2,501) | 6,560 |
| Net cash (used in) provided by investing activities | (2,501) | 6,560 |
| (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (90,068) | 10,322 |
| CASH AND CASH EQUIVALENTS | | |
| Beginning of year | 191,749 | 181,427 |
| End of year | $ 101,681 | $ 191,749 |

## (In Thousands)

| | YEARS ENDING JUNE 30, 2014 | 2013 |
|---|---|---|
| RECONCILIATION OF OPERATIONS EXCESS OF REVENUES OVER EXPENSES TO NET CASH PROVIDED BY OPERATING ACTIVITIES | | |
| Net operating income | $ 8,584 | $ 134 |
| Adjustments to reconcile to net cash in operating activities: | | |
| Bond amortization | 501 | 255 |
| (Reversal of) provision for program losses related to uncollectible contracts | (3,586) | 3,936 |
| Depreciation | 115 | 48 |
| Effect of changes in assets and liabilities: | | |
| Decrease in interest receivable – State of California Surplus Money Investment Fund | 64 | 23 |
| (Increase) decrease in interest receivable – other investment | (14) | 35 |
| Decrease in interest receivable – contracts of purchase | 1,856 | 1,385 |
| Decrease in receivable under contracts of purchase | 105,200 | 219,637 |
| Decrease in other assets | 98 | 4,652 |
| Decrease in accrued interest payable and other liabilities | (1,253) | (2,521) |
| Change in insurance claims reserves | 54 | (134) |
| Increase in due from other funds | 27 | 155 |
| Increase in other postretirements benefits | 250 | 227 |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | $ 111,896 | $ 227,832 |

## 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 Purchase Program (the "Program"), oversees the Veterans Farm and Home Building Fund of 1943 (the "1943 Fund"). The 1943 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 1943 Fund is administered by the Program 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 1943 Fund is tax exempt.

The Department established The Veterans Debenture Revenue Fund ("VDRF") and the Pooled Self-Insurance Fund ("PIF") to provide ancillary support for the 1943 Fund. These funds are also managed by the Farm and Home Purchase Program of the California Department of Veterans Affairs. Notes 5 and 8 provide disclosures related to these funds.

The financial statements represent only the business-type activities of the Farm and Home Purchase Program of the California Department of Veterans Affairs, which include the 1943 Fund, VDRF, and PIF (collectively, the "Program"), 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 Program 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 Program has been classified as a proprietary fund for accounting purposes, and the 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 Program follows the standards of governmental accounting and financial reporting, as promulgated by the Governmental Accounting Standards Board ("GASB").

For the year ended June 30, 2013, the Program 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 Program, 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)

**Accounting standards (continued) -** The State of California early adopted GASB Statement No. 65, ("GASB 65"), "*Items Previously Reported as Assets and Liabilities"* as of June 30, 2013. Accordingly, the Program assessed the impact of GASB 65 and identified $7,766,482 of bond issuance costs from prior fiscal years. A retroactive restatement of the prior years was not considered to be necessary as the effects were not material to the Program. The cumulative effect of adopting the statement was reported as a restatement of beginning net position for the period ending June 30, 2013.

For the year ended June 30, 2014, the Program adopted Governmental Accounting Standards Board Statement No. 66 ("GASB 66"), "*Technical Corrections – 2012 – Amendment of GASB Statements No. 10 and No. 62*". GASB 66 was issued to resolve conflicting Guidant that was previously issued relating to operating lease payments, purchase of a loan or group of loans, and service fees related to mortgage loans. The requirements of the statement are effective for financial statement periods beginning after December 15, 2012. For the Program, adopting GASB 66 had no impact on these financial statements.

Additionally, for the year ended June 30, 2014, the Program adopted Governmental Accounting Standards Board Statement No. 70 ("GASB 70"), "*Accounting and Financial Reporting for Nonexchange Financial Guarantees*". Some governments extend financial guarantees for the obligations of another government, a not-for-profit organization, a private entity, or individual without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity or individual that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. The requirements of the statement are effective for financial statement periods beginning after June 15, 2013. The general obligation bonds of the Program are guaranteed by the State of California. See Note 5.

**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.

### NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Cash and cash equivalents –** The Program 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, 2014 and 2013, cash equivalents consisted of the State of California Surplus Money Investment Fund ("SMIF"), carried at cost, which approximates fair value.

**Investments –** The Program 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 Program. Operating revenues include interest income, insurance fees, loan fees, and other fees received related to the origination and collection of contracts of purchase. Operating expenses include provisions for program loan losses, interest expense associated with the issuance of bonds payable, insurance premiums and claims paid, and general and administrative expenses, including payroll, associated with the administration the Program's objectives. Nonoperating revenues and expenses include gains or losses 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 $6.1 million and $10.5 million as of June 30, 2014 and 2013, respectively.

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Contract guarantees and primary mortgage insurance –** The Program 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 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 Program 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 Program 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 or gains on sales of foreclosed properties are charged against non-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, 2014 and 2013 were as follows (in thousands):

| | JUNE 30, 2014 | JUNE 30, 2013 |
|---|---|---|
| Cash in the state treasury | $ 12,288 | $ 16,502 |
| State of California Surplus Money Investment Fund (SMIF) | 89,393 | 175,247 |
| Cash and cash equivalents | 101,681 | 191,749 |
| Guaranteed investment contracts (at cost) | 10,327 | 7,850 |
| Amounts held with insurance administrators (at cost) | 14,875 | 14,851 |
| Investments | 25,202 | 22,701 |
| Total cash, cash equivalents, and investments | $ 126,883 | $ 214,450 |

**Cash in state treasury –** Cash in the state treasury represents amounts held in the Program'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. For a complete description of the risks related to cash in state treasury, refer to the State of California Comprehensive Annual Financial Report ("CAFR").

**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, 2014 and 2013, 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 CAFR that includes information about the state's pooled investment program.

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

**Investments –** Investments from proceeds of bond issuances are 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 Program monitors the creditworthiness of all companies that hold investments of the Program.

The Program's investments include amounts held in trust by insurance administrators and also amounts held by the State of California which are invested in guaranteed investment contracts ("GICs") with an insurance company. The investments held by the insurance administrator include taxable municipal securities, government bonds, and money market funds designated as short-term investments. The GICs are collateralized by investments held by the State of California on behalf of the Program. Additionally, the Program 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 Program's exposure to credit risk.

**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 Program to invest substantially all of its funds within SMIF and the remainder in investment contracts or with insurance administrators to limit the Program'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, 2014, the investments held 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, 2014, the Fund did not have any investments exposed to custodial credit risk. The GIC is held by the State of California in a separate account on behalf of the Program. The investments held by the insurance administrator are held in trust for the benefit of the Department.

## 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 Program to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. At June 30, 2014, the Program 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. There is only one remaining GIC as of June 30, 2014, with an interest rate fixed at 5.37%. The GIC expires in 2029. 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 weighted average interest rate for the municipal securities at June 30, 2014 is 2.62% and the weighted average maturity date is 5.8 years. The interest rate on the underlying government bond held in trust with insurance administrators was 4.55% and matures in November 2014.

## NOTE 3 – RECEIVABLES UNDER CONTRACTS OF PURCHASE

The Program retains title to all real property subject to contracts of purchase until the contract is satisfied. The veterans' contracts have original terms of 25 to 30 years and bear interest at rates of 3.875% to 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, 2014 and 2013, were as follows (in thousands):

| | JUNE 30, 2014 | JUNE 30, 2013 |
|---|---|---|
| Receivables under contracts of purchase | $ 835,611 | $ 931,791 |
| Less allowance for uncollectible contracts of purchase | (6,103) | (10,495) |
| Total, net | 829,508 | 921,296 |
| Less current portion, net | (27,663) | (36,133) |
| Noncurrent receivables under contracts of purchase, net | $ 801,845 | $ 885,163 |

## NOTE 4 – LAND, BUILDINGS, AND EQUIPMENT

The changes in capital assets during the year ended June 30, 2014 were as follows (in thousands):

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| NON-DEPRECIABLE | | | | |
| Land | $ 443 | $ - | $ - | $ 443 |
| Total non-depreciable | 443 | - | - | 443 |
| DEPRECIABLE | | | | |
| Buildings | 12,876 | - | - | 12,876 |
| Equipment | 3,256 | 128 | - | 3,384 |
| Total depreciable | 16,132 | 128 | - | 16,260 |
| ACCUMULATED DEPRECIATION | | | | |
| Buildings | (12,515) | (93) | - | (12,608) |
| Equipment | (3,197) | (21) | - | (3,218) |
| Total accumulated depreciation | (15,712) | (115) | - | (15,827) |
| Total capital assets being depreciated | 420 | 13 | - | 433 |
| Total capital assets, net of depreciation | $ 863 | $ 13 | $ - | $ 876 |

The changes in capital assets during the year ended June 30, 2013 were as follows (in thousands):

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| NON-DEPRECIABLE | | | | |
| Land | $ 443 | $ - | $ - | $ 443 |
| Total non-depreciable | 443 | - | - | 443 |
| DEPRECIABLE | | | | |
| Buildings | 12,586 | 290 | - | 12,876 |
| Equipment | 3,229 | 27 | - | 3,256 |
| Total depreciable | 15,815 | 317 | - | 16,132 |
| ACCUMULATED DEPRECIATION | | | | |
| Buildings | (12,480) | (35) | - | (12,515) |
| Equipment | (3,184) | (13) | - | (3,197) |
| Total accumulated depreciation | (15,664) | (48) | - | (15,712) |
| Total capital assets being depreciated | 151 | 269 | - | 420 |
| Total capital assets, net of depreciation | $ 594 | $ 269 | $ - | $ 863 |

**NOTE 5 – BONDS PAYABLE**

The Veterans General Obligation bonds are general obligations of the State of California to which the full faith and credit of the State is pledged. Because the debt service requirements on the Veterans General Obligation bonds are payable first from the 1943 Fund of the Farm and Home Purchase Program, the bonds are included as obligations of the Program when the proceeds from the bond sales are received by the Program. To the extent that the 1943 Fund is not able to service the debt, the secondary repayment source would come from the General Fund of the State Treasury. The Program has been able to service all debt requirements and there have been no amounts paid by the State through the General Fund.

The Program has outstanding general obligation bonds payable with fixed annual interest rates ranging from 2.2% to 5.7% due in varying installments through 2042 and subject to varying redemption provisions. The authorized and unissued bonds under the Veterans Bond Act of 2000 were $538.6 million and $238.6 million at June 30, 2014 and 2013, respectively. In November 2008, California voters approved the Veterans Bond Act of 2008 ("2008 Bond Act") totaling $900 million. In October 2013, Assembly Bill 639, Veterans Housing and Homeless Prevention Act of 2014, reduced the voter authorized amount from $900 million to $300 million. As of June 30, 2014 and 2013, 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 Program. 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 Program is secondary and subordinate to any interest or right in the Program 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 Program. 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, 2014 and 2013, authorized and unissued revenue bonds were $372.7 million.

In December 1997, the Program amended the revenue bond resolution provision regarding the Bond Reserve Account in the VDRF. The revenue bond resolution requires the establishment and maintenance of a Bond Reserve Account in an amount not less than 3% of the aggregate outstanding principal amount of all Revenue Bonds with interest rates fixed to maturity. 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 Account Payments on Revenue Bonds. Amounts on deposit in the Bond Reserve Account in excess of the bond reserve requirement may be transferred out of the VDRF to the 1943 Fund at the request of the Program. Investment earnings of the VDRF are transferred to the 1943 Fund. The total amounts in the Bond Reserve Account were $13.7 million and $15.7 million at June 30, 2014 and 2013 and were held in the State of California Surplus Money Investment Fund.

During the years ended June 30, 2014 and 2013, the Program did not issue general obligation bonds or home purchase revenue bonds. Currently, the Program has no outstanding commercial paper.

**NOTE 5 – BONDS PAYABLE (CONTINUED)**

The activity for bonds payable for the year ended June 30, 2014, is as follows (in thousands):

| | Outstanding July 1, 2013 | Issued | Matured / Redeemed During Year | Outstanding June 30, 2014 | Due Within One Year |
|---|---|---|---|---|---|
| General Obligation Bonds | $ 585,360 | $ - | $ 151,715 | $ 433,645 | - |
| Home Purchase Revenue Bonds | 420,325 | - | 47,620 | 372,705 | - |
| Total | 1,005,685 | - | 199,335 | 806,350 | - |
| Less | | | | | |
| Discounts | (1,550) | - | 258 | (1,292) | - |
| Premium | 177 | - | (15) | 162 | - |
| Unamortized bond redemption premiums | (2,371) | - | 258 | (2,113) | - |
| Total | $ 1,001,941 | $ - | $ 199,836 | $ 803,107 | - |

The activity for bonds payable for the year ended June 30, 2013, is as follows (in thousands):

| | Outstanding July 1, 2012 | Issued | Matured / Redeemed During Year | Outstanding June 30, 2013 | Due Within One Year |
|---|---|---|---|---|---|
| General Obligation Bonds | $ 757,560 | $ - | $ 172,199 | $ 585,361 | 100 |
| Home Purchase Revenue Bonds | 471,880 | - | 51,555 | 420,325 | - |
| Total | 1,229,440 | - | 223,754 | 1,005,686 | 100 |
| Less | | | | | |
| Discounts | (1,650) | - | 99 | (1,551) | - |
| Premium | 223 | - | (46) | 177 | - |
| Cost of bond issuance | (7,766) | - | 7,766 | - | - |
| Unamortized bond redemption premiums | (2,573) | - | 202 | (2,371) | - |
| Total | $ 1,217,674 | $ - | $ 231,775 | $ 1,001,941 | 100 |

## NOTE 5 – BONDS PAYABLE (CONTINUED)

A summary of debt service requirements for the next five years and to maturity as of June 30, 2014 is as follows (in thousands):

| FISCAL YEARS ENDING JUNE 30 | PRINCIPAL | INTEREST |
|---|---|---|
| 2015 | $ - | $ 33,135 |
| 2016 | 31,385 | 32,656 |
| 2017 | 21,590 | 31,823 |
| 2018 | 12,155 | 31,249 |
| 2019 | 13,560 | 30,856 |
| 2020-2024 | 169,315 | 140,237 |
| 2025-2029 | 216,690 | 102,965 |
| 2030-2034 | 171,695 | 57,690 |
| 2035-2039 | 113,710 | 26,151 |
| 2040-2044 | 56,250 | 3,852 |
| Total | $ 806,350 | $ 490,614 |

## NOTE 6 – COMMITMENTS AND CONTINGENCIES

**Commitments –** As of June 30, 2014 and 2013, the Program had loan commitments to veterans for the purchase of properties under contracts of sale of approximately $18.4 million and $5.2 million, respectively.

The Program leases a building that was formerly used to administer the affairs of the Program. The building is not currently being utilized. However, the Program is still subject to minimum lease requirements through the expiration of the lease agreement. Rent expense for the years ended June 30, 2014 and 2013, was $73,000 and $80,000, respectively. Minimum annual rent under the operating lease as of June 30, 2014 is as follows (in thousands):

| FISCAL YEARS ENDING JUNE 30 | |
|---|---|
| 2015 | $ 31 |
| 2016 | 31 |
| 2017 | 31 |
| 2018 | 31 |
| 2019 | 31 |
| Total | $ 155 |

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

**NOTE 7 – EMPLOYEE BENEFIT PLANS**

**Public Employees' Retirement Fund (PERF)**

*Plan description* – The Program 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 PERF are funded by both the Program 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 Program to the PERF for the years ended June 30, 2014 and 2013 were approximately $1,085,000 and $941,000, or approximately 19% of participants' salaries during each year ended.

*Annual pension cost* – For fiscal years June 30, 2014 and 2013, the Program's annual pension cost was equal to the Program'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 Program 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, 2013, CalPERS CAFR.

## NOTE 7 – EMPLOYEE BENEFIT PLANS (CONTINUED)

### State of California Other Postemployment Benefit Plan (SCOPEB)

*Plan description* – The Program 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 Program's estimated other postemployment benefit cost was $1.6 million and $1.3 million for the years ended June 30, 2014 and 2013, respectively. The Program recognized $250,000 and $227,000 in expense related to other postemployment benefits for the years ended June 30, 2014 and 2013, respectively.

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

## NOTE 8 – POOLED SELF-INSURANCE FUND

Effective July 1, 2010, pursuant to legislation enacted by the California State Legislature, the Department established a Pooled Self-Insurance Fund (the "PIF"). The PIF 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 Program manages the PIF, and allocates the PIF related payroll expenses which the 1943 Fund incurs on its behalf.

The 1943 Fund 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 had an excess $24.6 million and a deficit of $0.6 million as of June 30, 2014 and 2013, respectively. During the current year, it was determined that repayment of the net position to the 1943 Fund was not expected within a reasonable time. As a result, the interfund balance was reduced and the amount not expected to be repaid was reported as a transfer from the 1943 Fund to the PIF as of June 30, 2014.

## NOTE 9 – RISK MANAGEMENT

The Program 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 Program established the PIF and carries commercial insurance.

There have been no significant reductions in insurance coverage or settlements in excess of insurance coverage for the years ended June 30, 2014 and 2013.

# VETERANS' FARM AND HOME PURCHASE PROGRAM
## DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
## COMBINING STATEMENT OF NET POSITION
## (In Thousands)

**ASSETS**

| | June 30, 2014 | | | |
|---|---|---|---|---|
| | Veterans Farm and Home Building Fund | Veterans Debenture Revenue Fund | Pooled Self-Insurance Fund | Total |
| CURRENT ASSETS | | | | |
| Cash in the state treasury | $ 11,633 | $ 1 | $ 654 | $ 12,288 |
| State of California Surplus Money Investment Fund | 49,764 | 13,741 | 25,888 | 89,393 |
| Total cash and cash equivalents | 61,397 | 13,742 | 26,542 | 101,681 |
| Current portion of receivables under contracts of purchase – net of allowance for uncollectible contracts | 27,663 | - | - | 27,663 |
| Due from other funds | 951 | (8) | (943) | - |
| Interest receivables: | | | | |
| Contracts of purchase | 4,383 | - | - | 4,383 |
| State of California Surplus Money Investment Fund | 40 | 8 | 15 | 63 |
| Other investments | 50 | - | - | 50 |
| Total interest receivables | 4,473 | 8 | 15 | 4,496 |
| Total current assets | 94,484 | 13,742 | 25,614 | 133,840 |
| NONCURRENT ASSETS | | | | |
| Investments: | | | | |
| Guaranteed investment contracts | 10,327 | - | - | 10,327 |
| Taxable municipal securities and other investments | 14,875 | - | - | 14,875 |
| Total investments | 25,202 | - | - | 25,202 |
| Receivables under contracts of purchase – net of allowance for uncollectible contracts | 801,845 | - | - | 801,845 |
| Other real estate owned – net of valuation allowances of $190 and $5,812 at June 30, 2014 and 2013, respectively | 3,153 | - | - | 3,153 |
| Capital assets – net | 876 | - | - | 876 |
| Other noncurrent assets | 2,424 | - | 9 | 2,433 |
| Total noncurrent assets | 833,500 | - | 9 | 833,509 |
| TOTAL | $ 927,984 | $ 13,742 | $ 25,623 | $ 967,349 |

**(In Thousands)**

**LIABILITIES AND NET POSITION**

| | June 30, 2014 | | | |
|---|---|---|---|---|
| | Veterans Farm and Home Building Fund | Veterans Debenture Revenue Fund | Pooled Self-Insurance Fund | Total |
| CURRENT LIABILITIES | | | | |
| Bonds payable – current portion | $ - | $ - | $ - | $ - |
| Accrued interest and other liabilities | 10,535 | - | 440 | 10,975 |
| Due to other funds | 198 | - | - | 198 |
| Total current liabilities | 10,733 | - | 440 | 11,173 |
| NONCURRENT LIABILITIES | | | | |
| Bonds payable – noncurrent portion | 803,107 | - | - | 803,107 |
| Insurance claims reserves | - | - | 623 | 623 |
| Other postemployment benefits | 1,564 | - | - | 1,564 |
| Total noncurrent liabilities | 804,671 | - | 623 | 805,294 |
| Total liabilities | 815,404 | - | 1,063 | 816,467 |
| NET POSITION – RESTRICTED | 112,580 | 13,742 | 24,560 | 150,882 |
| TOTAL | $ 927,984 | $ 13,742 | $ 25,623 | $ 967,349 |

# VETERANS' FARM AND HOME PURCHASE PROGRAM
## DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA
## COMBINING STATEMENT OF NET POSITION (CONTINUED)
## (In Thousands)

**ASSETS**

| | June 30, 2013 | | | |
|---|---|---|---|---|
| | Veterans Farm and Home Building Fund | Veterans Debenture Revenue Fund | Pooled Self-Insurance Fund | Total |
| CURRENT ASSETS | | | | |
| Cash in the state treasury | $ 16,499 | $ 1 | $ 2 | $ 16,502 |
| State of California Surplus Money Investment Fund | 132,158 | 15,741 | 27,348 | 175,247 |
| Total cash and cash equivalents | 148,657 | 15,742 | 27,350 | 191,749 |
| Current portion of receivables under contracts of purchase – net of allowance for uncollectible contracts | 36,133 | - | - | 36,133 |
| Due from other funds | 42,942 | (15,752) | (27,190) | - |
| Interest receivables: | | | | |
| Contracts of purchase | 6,239 | - | - | 6,239 |
| State of California Surplus Money Investment Fund | 100 | 10 | 17 | 127 |
| Other investments | 36 | - | - | 36 |
| Total interest receivables | 6,375 | 10 | 17 | 6,402 |
| Total current assets | 234,107 | - | 177 | 234,284 |
| NONCURRENT ASSETS | | | | |
| Investments: | | | | |
| Guaranteed investment contracts | 7,850 | - | - | 7,850 |
| Taxable municipal securities and other investments | 14,851 | - | - | 14,851 |
| Total investments | 22,701 | - | - | 22,701 |
| Receivables under contracts of purchase – net of allowance for uncollectible contracts | 885,163 | - | - | 885,163 |
| Other real estate owned – net of valuation allowances of $5,812 at June 30, 2013 | 12,980 | - | - | 12,980 |
| Capital assets – net | 863 | - | - | 863 |
| Other noncurrent assets | 2,523 | - | 10 | 2,533 |
| Total noncurrent assets | 924,230 | - | 10 | 924,240 |
| TOTAL | $ 1,158,337 | $ - | $ 187 | $ 1,158,524 |

## (In Thousands)

**LIABILITIES AND NET POSITION**

| | June 30, 2013 | | | |
|---|---|---|---|---|
| | Veterans Farm and Home Building Fund | Veterans Debenture Revenue Fund | Pooled Self-Insurance Fund | Total |
| CURRENT LIABILITIES | | | | |
| Bonds payable – current portion | $ 100 | $ - | $ - | $ 100 |
| Accrued interest and other liabilities | 12,042 | - | 186 | 12,228 |
| Due to other funds | 171 | - | - | 171 |
| Total current liabilities | 12,313 | - | 186 | 12,499 |
| NONCURRENT LIABILITIES | | | | |
| Bonds payable – noncurrent portion | 1,001,841 | - | - | 1,001,841 |
| Insurance claims reserves | - | - | 569 | 569 |
| Other postemployment benefits | 1,316 | - | - | 1,316 |
| Total noncurrent liabilities | 1,003,157 | - | 569 | 1,003,726 |
| Total liabilities | 1,015,470 | - | 755 | 1,016,225 |
| NET POSITION – RESTRICTED | 142,867 | - | (568) | 142,299 |
| TOTAL | $1,158,337 | $ - | $ 187 | $1,158,524 |

**(In Thousands)**

**STATEMENT OF CHANGE IN REVENUES, EXPENSES AND NET POSITION**

| | June 30, 2014 | | | |
|---|---|---|---|---|
| | Farm and Home Building Fund | Veterans Debenture Revenue Fund | Pooled Self-Insurance Fund | Total |
| PROGRAM OPERATIONS | | | | |
| Revenues: | | | | |
| Contracts of purchase of properties | $ 47,461 | $ - | $ - | $ 47,461 |
| Investments and other | 1,051 | 36 | 63 | 1,150 |
| Insurance revenue and claim reimbursements | 4,982 | - | 5,263 | 10,245 |
| Total program operating revenues | 53,494 | 36 | 5,326 | 58,856 |
| Expenses: | | | | |
| Interest expense | 37,639 | - | - | 37,639 |
| (Reversal of) provision for program loan losses | (3,586) | - | - | (3,586) |
| Insurance premiums and claims paid | - | - | 4,032 | 4,032 |
| | 34,053 | - | 4,032 | 38,085 |
| Excess of program operations revenue over program operations expenses | 19,441 | 36 | 1,294 | 20,771 |
| PROGRAM ADMINISTRATION | | | | |
| Revenues: | | | | |
| Fees | 914 | - | 306 | 1,220 |
| Other revenue | 1,585 | - | - | 1,585 |
| Total program administration revenues | 2,499 | - | 306 | 2,805 |
| Expenses: | | | | |
| Payroll and related costs | 8,457 | - | - | 8,457 |
| General and administrative expenses | 5,691 | - | 844 | 6,535 |
| Total program administration expenses | 14,148 | - | 844 | 14,992 |
| Deficiency of program administration revenues over program administration expenses | (11,649) | - | (538) | (12,187) |
| NET OPERATING INCOME | 7,792 | 36 | 756 | 8,584 |
| NONOPERATING REVENUE (EXPENSE) | | | | |
| Loss on sale and write down of repossessed property | (1) | - | - | (1) |
| Excess of revenues over expenses | 7,791 | 36 | 756 | 8,583 |
| NET POSITION | | | | |
| Beginning of year | 142,867 | - | (568) | 142,299 |
| Excess of revenues over expenses | 7,791 | 36 | 756 | 8,583 |
| Transfers | (38,078) | 13,706 | 24,372 | - |
| End of year | $ 112,580 | $ 13,742 | $ 24,560 | $ 150,882 |

**(In Thousands)**

### STATEMENT OF CHANGE IN REVENUES, EXPENSES AND NET POSITION

| | June 30, 2013 | | | |
|---|---|---|---|---|
| | Farm and Home Building Fund | Veterans Debenture Revenue Fund | Pooled Self-Insurance Fund | Total |
| PROGRAM OPERATIONS | | | | |
| Revenues: | | | | |
| Contracts of purchase of properties | $ 58,970 | $ - | $ - | $ 58,970 |
| Investments and other | 2,498 | 175 | 80 | 2,753 |
| Insurance revenue and claim reimbursements | - | | 6,140 | 6,140 |
| Total program operating revenues | 61,468 | 175 | 6,220 | 67,863 |
| Expenses: | | | | |
| Interest expense | 47,879 | - | - | 47,879 |
| Provision for program loan losses | 3,936 | - | - | 3,936 |
| Insurance premiums and claims paid | - | - | 4,204 | 4,204 |
| | 51,815 | - | 4,204 | 56,019 |
| Excess of program operations revenue over program operations expenses | 9,653 | 175 | 2,016 | 11,844 |
| PROGRAM ADMINISTRATION | | | | |
| Revenues: | | | | |
| Fees | 411 | - | 143 | 554 |
| Other revenue | 1,568 | - | - | 1,568 |
| Total program administration revenues | 1,979 | - | 143 | 2,122 |
| Expenses: | | | | |
| Payroll and related costs | 7,685 | - | - | 7,685 |
| General and administrative expenses | 4,368 | - | 1,779 | 6,147 |
| Total program administration expenses | 12,053 | - | 1,779 | 13,832 |
| Deficiency of program administration revenues over program administration expenses | (10,074) | - | (1,636) | (11,710) |
| NET OPERATING (LOSS) INCOME | (421) | 175 | 380 | 134 |
| NONOPERATING REVENUE (EXPENSE) | | | | |
| Loss on sale and write down of repossessed property | (4,305) | - | - | (4,305) |
| Excess of revenues over expenses | (4,726) | 175 | 380 | (4,171) |
| NET POSITION | | | | |
| Beginning of year | 154,939 | - | (703) | 154,236 |
| GASB 65 Adjustment | (7,766) | | | (7,766) |
| Excess (deficiency) of revenues over expenses | (4,726) | 175 | 380 | (4,171) |
| Transfers | 420 | (175) | (245) | - |
| End of year | $ 142,867 | $ - | $ (568) | $ 142,299 |