

In the opinion of Bond Counsel to the Department, under existing statutes and court decisions, and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Offered Revenue Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Federal Tax Code") and (ii) interest on the Offered Revenue Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. (See "TAX MATTERS" herein.)



\$220,435,000
Department of Veterans Affairs of the State of California
Home Purchase Revenue Bonds
2012 Series A
(Non-AMT)

Date: Date of Delivery

Due: See inside front cover

The 2012 Series A Bonds referred to above (the "Offered Revenue Bonds") will be issued by the Department of Veterans Affairs of the State of California (the "Department") as fully-registered bonds which may be purchased in denominations of \$5,000 or any integral multiples thereof in book-entry form. The Offered Revenue Bonds will mature in the years and bear interest at the rates set forth on the inside front cover.

Interest on the Offered Revenue Bonds is payable on June 1 and December 1 of each year, commencing June 1, 2012. The California State Treasurer's Office ("State Treasurer") will serve as agent for sale and trustee.

The Offered Revenue Bonds are subject to redemption prior to maturity, as described herein. See "THE OFFERED REVENUE BONDS – Redemption."

The Offered Revenue Bonds are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds (as defined herein) by a pledge of, (i) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund") (other than proceeds of Veterans G.O. Bonds (as defined herein) and amounts in any Rebate Account (as defined herein)), (ii) the Bond Reserve Account (as defined herein) and (iii) the Loan Loss Account (as defined herein). The undivided interest in the assets of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State of California (the "State") and of the holders of general obligation bonds under any general obligation veterans bond act. **The Department has no taxing power. Neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Offered Revenue Bonds.**

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, PRICES AND CUSIPS

(See inside front cover)

The Offered Revenue Bonds are offered when, as and if issued and delivered to the Underwriters, subject to the approval of validity by the Honorable Kamala D. Harris, Attorney General of the State, and by Hawkins Delafield & Wood LLP, Bond Counsel to the Department. Polsinelli Shughart LLP is serving as Disclosure Counsel to the Department. Certain legal matters will be passed on for the Underwriters by their counsel, Kutak Rock LLP. In connection with the issuance of the Offered Revenue Bonds, Lamont Financial Services Corporation is serving as Pricing Advisor to the State Treasurer. It is expected that the Offered Revenue Bonds will be available for delivery through the facilities of The Depository Trust Company on or about February 14, 2012.

Honorable Bill Lockyer
Treasurer of the State of California

J.P. Morgan

Academy Securities, Inc.
Drexel Hamilton, LLC
Morgan Stanley
Roberts & Ryan Investments Inc.
Southwest Securities, Inc.

Barclays Capital, Inc.
Fidelity Capital Markets
Raymond James & Associates, Inc.
SL Hare Capital
Stone & Youngberg, a Division of Stifel Nicolaus

2012 SERIES A BONDS (Non-AMT)

MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, PRICES AND CUSIPS†

\$172,970,000 Serial Bonds

<u>Maturity Date</u> <u>(December 1)</u>	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>	<u>CUSIP</u> [†]
2018	\$6,335,000	2.150%	130658LX3
2019	6,640,000	2.500	130658LY1
2020	7,065,000	2.750	130658LZ8
2021	15,375,000	3.000	130658MA2
2022	23,785,000	3.150	130658MB0
2023	36,130,000	3.300	130658MC8
2024	31,150,000	3.400	130658MD6
2025	46,490,000	3.500	130658ME4

\$47,465,000, 3.875% 2012 Series A Term Bond due December 1, 2028, CUSIP[†] 130658MF1

Price of all Offered Revenue Bonds: 100%

[†] CUSIP® is a registered trademark of the American Bankers Association. CUSIP data herein is provided by CUSIP Global Services, managed by Standard & Poor's Financial Services LLC on behalf of the American Bankers Association. This information is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services Bureau. CUSIP numbers have been assigned by an independent company not affiliated with the Department, the State Treasurer or the Underwriters and are included solely for the convenience of the registered owners of the applicable Offered Revenue Bonds. None of the Department, the State Treasurer or the Underwriters is responsible for the selection or uses of these CUSIP numbers, and no representation is made as to their correctness on the applicable Offered Revenue Bonds or as included herein. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Offered Revenue Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Offered Revenue Bonds.

The information set forth or incorporated by reference herein has been obtained from the Department and other sources which are believed to be reliable but it is not guaranteed as to accuracy or completeness. The presentation of such information is intended to show historical information and is not intended to indicate future or continuing trends. No representation is made that past experience, as shown by such financial and other information, will necessarily continue or be repeated in the future. However, this Official Statement contains statements relating to future results that are "forward-looking statements." When used in this Official Statement, the words "estimate," "forecast," "intend," "expect," "plan," "budget" and similar expressions identify forward-looking statements. Such statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those contemplated in such forward-looking statements. Prospective investors should not place undue reliance on forward-looking statements.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE OFFERED REVENUE BONDS AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE OFFERED REVENUE BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT YIELDS HIGHER THAN THOSE STATED ON THE INSIDE FRONT COVER HEREOF, AND SAID PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

This Official Statement contains, in part, estimates, projections and matters of opinion, whether or not expressly stated to be such, which are not intended as statements or representation of fact or certainty, and no representation is made as to the correctness of such estimates, projections and opinions, or that they will be realized. The information and expressions of opinion herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Department since the date hereof.

A wide variety of other information, including financial information, concerning the Department and the Program (as defined herein) is available from the Department, Department publications and the Department's website. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as may be expressly noted.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Offered Revenue Bonds by a person in any jurisdiction in which it is unlawful for such person to make such an offer, solicitation or sale. No dealer, broker, salesperson or other person has been authorized to give any information or to make any representations other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized.

Copies of this Official Statement may be obtained from:

HONORABLE BILL LOCKYER

Treasurer of the State of California

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Sacramento, California 94209-0001

(800) 900-3873

STATE OF CALIFORNIA
Edmund G. Brown Jr., Governor
DEPARTMENT OF VETERANS AFFAIRS

Peter James Gravett
Secretary

Lawrence Gonzales
Undersecretary, Operations

Mark Lennon
Deputy Secretary,
Administration

Jim Lowrey
Deputy Secretary,
Farm and Home Purchases

Eric Tiche
Assistant Deputy Secretary,
Bond Finance and Investments

Marian "Denise" Lewis
Acting Chief Counsel, Legal
Affairs

**VETERANS' DEBENTURE FINANCE COMMITTEE
AND VETERANS FINANCE COMMITTEE OF 1943**

Edmund G. Brown Jr., Governor

Bill Lockyer
State Treasurer

John Chiang
State Controller

Ana J. Matosantos
Director of Finance

Peter James Gravett
Secretary of Veterans Affairs

CALIFORNIA VETERANS BOARD

Thomas J. Moran, Chair
Thomas Richards, Vice Chair
Vernon Chong, M.D.
Alexander Tsao
Donna L. Dacier
John Farrell
(One Vacancy)

TABLE OF CONTENTS

<u>Page</u>	<u>Page</u>
INTRODUCTION	1
Home Purchase Revenue Bonds	2
PLAN OF FINANCE	2
THE DEPARTMENT	3
General	3
Governance of the Department	3
Administration of the Department	3
SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS	6
General	6
The 1943 Fund	6
Bond Reserve Account	7
Loan Loss Account	8
Cash Flow Statements and Program Operating Procedures	8
Cash Flow Statements to be Delivered in Connection with the Offered Revenue Bonds	10
Maintenance of Fund Parity	11
Additional Revenue Bonds	12
SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION	13
Selected Financial Data of the 1943 Fund	13
Department's Discussion of Financial Data	17
Department Outlook	21
Investments in the Surplus Money Investment Fund	22
THE OFFERED REVENUE BONDS	22
General	22
Interest	22
Redemption	23
Redemption Notice	25
ESTIMATED SOURCES AND USES OF THE OFFERED REVENUE BONDS	25
THE PROGRAM	26
History	26
General	26
Program Financing	26
Certain Statutory Requirements	27
Allocation of Lendable Monies	30
Administration of the Program	30
Contracts of Purchase	31
Mobile Home Contracts of Purchase	42
Home Improvement Contracts of Purchase	43
Construction Contracts of Purchase	44
Pooled Self-Insurance Fund	44
USDVA Guaranty Program; Loan Insurance	45
Property Insurance	48
Life and Disability Insurance	50
Legislative Protection of Veterans	51
External Reviews of the Program	52
TAX MATTERS	52
Federal Tax Matters	52
State Tax Matters	55
Miscellaneous	55
LITIGATION	55
UNDERWRITING	55
CERTAIN LEGAL MATTERS	56
INDEPENDENT AUDITORS	56
LEGALITY FOR INVESTMENT	56
FORWARD-LOOKING STATEMENTS	57
RATINGS	57
CONTINUING DISCLOSURE	57
MISCELLANEOUS	58
APPENDIX A	FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2011 AND 2010 AND INDEPENDENT AUDITORS' REPORT
APPENDIX B	FINANCIAL STATEMENTS OF THE VETERANS DEBENTURE REVENUE FUND FOR FISCAL YEARS 2011 AND 2010 AND INDEPENDENT AUDITORS' REPORT
APPENDIX C	CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA
APPENDIX D	DTC AND BOOK-ENTRY ONLY SYSTEM
APPENDIX E	THE AMENDED AND RESTATED MASTER CONTINUING DISCLOSURE UNDERTAKING
APPENDIX F	PROPOSED FORM OF OPINION OF BOND COUNSEL TO THE DEPARTMENT TO BE DELIVERED IN CONNECTION WITH THE ISSUANCE OF THE OFFERED REVENUE BONDS
APPENDIX G	PROPOSED FORM OF OPINION OF THE ATTORNEY GENERAL TO BE DELIVERED IN CONNECTION WITH THE ISSUANCE OF THE OFFERED REVENUE BONDS
APPENDIX H	CERTAIN FEDERAL TAX CODE REQUIREMENTS
APPENDIX I	SUMMARY OF CERTAIN PROVISIONS OF RESOLUTION RB-1
APPENDIX J	LETTERS FROM CERTAIN UNDERWRITERS

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OFFICIAL STATEMENT

\$220,435,000
DEPARTMENT OF VETERANS AFFAIRS
OF THE STATE OF CALIFORNIA
HOME PURCHASE REVENUE BONDS
2012 Series A
(Non-AMT)

INTRODUCTION

This Introduction contains only a brief summary of certain of the terms of the Offered Revenue Bonds (as defined below) and a brief description of this Official Statement. A full review should be made of the entire Official Statement, including the cover page and the Appendices. All statements contained in this Introduction are qualified in the entirety by reference to the entire Official Statement. All capitalized terms used in this Official Statement and not defined herein shall have the meanings set forth in Resolution RB-1. See APPENDIX I – “SUMMARY OF CERTAIN PROVISIONS OF RESOLUTION RB-1 – Definitions (Section 103).”

This Official Statement is being furnished to provide information in connection with the sale of \$220,435,000 principal amount of Department of Veterans Affairs of the State of California (the “Department”) Home Purchase Revenue Bonds, 2012 Series A (Non-AMT) (the “Offered Revenue Bonds”) which will mature in the years and will bear interest at the rates set forth on the inside front cover page hereof.

The Offered Revenue Bonds are being issued pursuant to (1) the Veterans’ Revenue Debenture Act of 1970, as amended (the “Act”), constituting Chapter 7 of Division 4 of the Military and Veterans Code (the “Veterans Code”) of the State of California (the “State”); (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the “Original Resolution”); (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997, as amended (the “Eighth Supplemental Resolution”); (4) the Tenth Supplemental Resolution Providing for Amendments and Supplements to Resolution No. RB-1, adopted February 24, 1999 (the “Tenth Supplemental Resolution”); (5) the provisions of Section 2714 of the Eighteenth Supplemental Resolution Providing for the Issuance of An Amount Not to Exceed \$167,920,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted November 21, 2007 (the “Eighteenth Supplemental Resolution”); and (6) the Twentieth Supplemental Resolution Providing for Amendments and Supplements to Resolution No. RB-9, adopted June 16, 2010 (the “Twentieth Supplemental Resolution”). The Original Resolution, as amended and supplemented by the Eighth Supplemental Resolution, the Tenth Supplemental Resolution, the Eighteenth Supplemental Resolution and the Twentieth Supplemental Resolution, are referred to as “Resolution RB-1.” The Nineteenth Supplemental Resolution providing for the issuance of certain Revenue Bonds adopted March 18, 2009 is referred to as the “Offered Bonds Series Resolution.” Resolution RB-1 and the Offered Bonds Series Resolution are collectively referred to herein as the “Resolution.” The Treasurer of the State of California (the “State Treasurer”) is trustee (the “Trustee”) for Revenue Bonds (as defined below) pursuant to Resolution RB-1.

The Department has previously issued under Resolution RB-1 and separate Series Resolutions eighteen series of its Revenue Bonds (collectively, the “Prior Revenue Bonds”) of which ten series remain Outstanding. The outstanding Prior Revenue Bonds, the Offered Revenue Bonds, and the bonds of any additional series issued under Resolution RB-1 (“Additional Revenue Bonds”) are secured on a parity basis (except for bonds which are subordinate obligations as expressly provided in Resolution RB-1 or in a Series Resolution) and are collectively referred to herein as “Revenue Bonds.”

Home Purchase Revenue Bonds

Revenue Bonds (which include all Bonds issued and Outstanding pursuant to Resolution RB-1), including the Offered Revenue Bonds, are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of, (i) an undivided interest in the assets of the Veterans’ Farm and Home Building Fund of 1943 (the “1943 Fund”) other than (x) proceeds of Veterans G.O. Bonds (as defined below) and (y) any amounts in any Rebate Account, (ii) the Bond Reserve Account and (iii) the Loan Loss Account. The undivided interest in the assets of the 1943 Fund is secondary and subordinate to any interest or right in the 1943 Fund of the people of the State and of the holders of general obligation bonds issued by the Department under any and all present and future veterans general obligation bond acts (including commercial paper notes) (collectively, the “Veterans G.O. Bonds”). **The Department has no taxing power. Neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Offered Revenue Bonds.** See “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS.”

Under the Department’s Farm and Home Purchase Program (the “Program”), the Department acquires residential property to be sold to eligible veterans under contracts of purchase between the Department and such veterans (“Contracts of Purchase”). Such acquisitions are financed principally with the proceeds of bonds, including Veterans G.O. Bonds and Revenue Bonds.

See “PLAN OF FINANCE” for a discussion of the uses of the proceeds of the Offered Revenue Bonds.

PLAN OF FINANCE

The Offered Revenue Bonds are being issued (i) for the purpose of refunding certain Outstanding Revenue Bonds (the “Refunded Bonds”) which will result in a reduction of the Department’s cost of borrowing and a better matching of the Department’s debt service obligations to anticipated revenues and (ii) for the purpose of making deposits into funds, accounts or subaccounts as provided in the Resolution.

See “THE PROGRAM – Contracts of Purchase – Interest Rates.” See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds – Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds” for information about the Refunded Bonds, Revenue Bonds and Veterans G.O. Bonds. Also see “ESTIMATED SOURCES AND USES OF THE OFFERED REVENUE BONDS.” See “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – General,” “—The 1943 Fund” and “—Cash Flow Statements and Program Operating Procedures.”

THE DEPARTMENT

General

In 1921, the California Legislature (the “Legislature”) created the Veterans’ Welfare Board and the Program. The Department became the successor to the Veterans’ Welfare Board under the Veterans’ Farm and Home Purchase Act of 1943 (the “1943 Act”). The Department is a subdivision of the State and constitutes a public corporation. One of the Department’s basic objectives is to provide eligible veterans the opportunity to acquire homes with long-term low-interest financing provided under the Program. See “THE PROGRAM.”

Governance of the Department

The California Veterans Board (the “Board”) advises the Department on policies for all operational matters. The Board is composed of seven members appointed by the Governor and subject to Senate confirmation. Each member of the Board must be a veteran. In addition, one member must be retired from the active or reserve forces of the United States military service. One member must have substantial training or professional expertise in mortgage lending and real estate finance. One member must have substantial training or professional expertise in geriatrics, gerontology or long-term care. One member must have an accounting or auditing background and preferably be a certified public accountant. One member of the board shall have a degree in health care administration or shall have experience in the financial management of health care facilities. Six of the members, including each of the foregoing five members, serve four-year terms. Finally, one member must be a resident of one of the State veterans homes run by the Department which were established for qualified aged and disabled veterans and their spouses. This member serves only a two-year term. There is presently one vacancy on the Board.

Certain actions of the Department, for example, certain actions relating to interest rates on Contracts of Purchase, require the approval of the Veterans’ Finance Committee of 1943, which is comprised of the Governor, the State Treasurer, the State Controller, the State Director of Finance and the Secretary of the Department (the “Veterans’ Finance Committee”). See “THE PROGRAM – Contracts of Purchase – Interest Rates.” Certain actions of the Department require the approval of the Veterans’ Debenture Finance Committee comprised of the Governor, the State Treasurer, the State Controller, the State Director of Finance and the Secretary of the Department (the “Secretary”). Members of the Board sit on various committees of the Department including policy and procedures, legislative, communication, administrative, home and veterans services.

Administration of the Department

There are four principal divisions within the Department: the Division of Veterans Services, the Division of Administration, the Veterans’ Home Division and the Division of Farm and Home Purchases. The Program is administered by the Division of Farm and Home Purchases with support from the Division of Administration and other Department support units. See “THE PROGRAM.”

General administration of the Program, including fiscal, legal, personnel and other administrative functions, is performed at the Department’s headquarters in Sacramento California. The Division of Farm and Home Purchases also maintains field offices located in San Diego and Fresno. See “THE PROGRAM.”

The Secretary is appointed by the Governor, serves at the pleasure of the Governor and must be a veteran. The Secretary and other senior staff personnel of the Department principally responsible for the administration of the Program are listed below. As of December 31, 2011, the Department employed approximately 87 people in support of the Program.

Peter James Gravett
Secretary since April 2011

Mr. Gravett is a retired Major General with more than 35 years of commissioned service in the California National Guard in ten countries. Mr. Gravett's experience includes: State chair for the Southern California Employer Support of the Guard and Reserve Committee since 2007; principal business associate at Traiden Global Solutions since 2008; President and Chief Executive Officer of Gravett and Associates from 2002 to 2008; and Commander of the 40th Infantry Division from 1999, when he was promoted to Major General, to 2002, becoming the first African-American division commander in the 225-year history of the United States National Guard.

Lawrence Gonzales
Undersecretary since July 2011

Mr. Gonzales is a retired Colonel with more than 38 years of enlisted and commissioned service in the United States Marine Corps and is a combat veteran of Desert Storm. Mr. Gonzales' experience includes: member of the National Committee of the Employer Support of the Guard and Reserve from 2003 to 2005; director of the Equal Opportunity Branch for the United States Marine Corps from 2002 to 2003; and multiple positions in the Los Angeles Unified School District from 1968 to 2000, including the position of Principal at three elementary schools from 1982 to 2000.

Jim Lowrey
Deputy Secretary for Farm and Home Purchases since March 2009

Mr. Lowrey has over 34 years of financial experience in auditing, accounting and bond finance. Mr. Lowrey's experience includes: Deputy Secretary for Farm and Home Purchases, which division includes bond finance and investment, since March 2009; Chief of Bond Finance at the Department from 2007 to 2009; managing the General Obligation bond program at the State Treasurer's Office from 2002 to 2007; Chief of Internal Audits at the Department for three years; Chief of Financial Management and Audits at the Department for two years; and performing various audit and financial programs at the State Controller's Office prior to joining the Department. Mr. Lowrey holds a bachelor's degree in accounting from California State Polytechnic University at Pomona, is a Certified Public Accountant and a Certified Governmental Financial Manager.

Eric Tiche
Assistant Deputy Secretary for Bond Finance and Investments since January 2010

Mr. Tiche is responsible for the management and oversight of the Department's debt portfolio, investments and cash management section and has been with the Department for more than 13 years. Mr. Tiche's experience includes: Acting Assistant Deputy Secretary, Bond Finance and Investments for two years and Manager of the Bond Finance Unit for over two years. Mr. Tiche graduated from California State University, Sacramento in 1995 with a Bachelor of Science degree in Business Administration (Strategic Management).

Rita Almanza

Loan Servicing Operations Manager for Farm and Home Purchases since April 2008

Ms. Almanza has 25 years of Program experience with the Department and two years of experience with the California Department of Housing and Community Development. Ms. Almanza's experience includes: Contract of Purchase origination, underwriting, appraisal, title and escrow, collections, foreclosure and repossessed property (real estate owned ("REO")) functions; Farm and Home Acting Division Chief in 2009; Collection, Foreclosure & REO Unit Manager from 1999 to 2008; Farm and Home Loan Servicing Operations Manager with oversight of the Escrow Unit and all of the Contract of Purchase servicing functions since 2008; and a State Licensed Real Estate Appraiser since 1992.

Mark Lennon

Deputy Secretary for Administration since October 2011

Mr. Lennon is a Lieutenant Commander in the United States Navy Reserve and has over a decade of management and technology consulting experience in State government. Mr. Lennon's experience includes: Reservist with the Office of Naval Intelligence and recalled to active duty for a combat deployment in support of Operation Iraqi Freedom with a Navy SEAL Team from 2010 to 2011; independent consultant from 2009 to 2010; Managing Director for Blackstone Technology Group from 2006 to 2009; Senior Manager at Delegata from 2005 to 2006; Manager at Deloitte Consulting from 2001 to 2005; and Intelligence Officer in 1997, serving on active duty until 2001. Mr. Lennon holds a Master of Science Degree in Government from the London School of Economics and a Bachelor of Arts degree in Political Science from the University of California San Diego.

Joy Hempstead

Assistant Deputy Secretary, Financial Services Division since May 2004

Ms. Hempstead has over 30 years of administrative services experience and knowledge which includes organizational management analysis, human resources, contracts and various areas in financial services. Ms. Hempstead's experience includes: Assistant Deputy Secretary at the Financial Services Division since May 2004; Division Chief of the Human Resources Office from 1996 to 2004; and Manager of the Equal Opportunity Employment Office in 1995. In 2009 Ms. Hempstead completed the certified program in Foundations of Public Policy at the University of California, Davis, and has also completed various other management, financial and administrative certification programs.

Marian "Denise" Lewis

Acting Chief Counsel of Legal Affairs

Marian "Denise" Lewis is the Acting Chief Counsel for the Department effective January 3, 2012. Ms. Lewis' experience includes: member of the Legal Affairs Division for the Department since 2005; instructor for the State Personnel Board; Staff Counsel for the California Department of Corrections and Rehabilitation where her duties included handling bond related issues; in-house counsel for Financial Pacific Insurance Company, handling a wide range of insurance defense matters, including construction defect, wrongful death, premises liability, and other various types of tort litigation; and attorney with the law firm of Tennant & Ingram, handling insurance defense and plaintiff's personal injury matters. Ms. Lewis holds a Juris Doctor from Lincoln Law School and a Bachelor of Arts degree in Criminal Justice from

California State University, Sacramento, and is a member of the California State and Sacramento County Bar Associations.

SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS

General

Revenue Bonds (including the Offered Revenue Bonds) are special obligations of the Department payable solely from, and equally and ratably secured with other Revenue Bonds by a pledge of, (i) an undivided interest in the assets of the 1943 Fund other than (x) proceeds of Veterans G.O. Bonds and (y) any amounts in any Rebate Account, (ii) the Bond Reserve Account and (iii) the Loan Loss Account. **State law provides that such undivided interest in the assets of the 1943 Fund is secondary and subordinate to the obligation of the 1943 Fund to pay or reimburse debt service on the Veterans G.O. Bonds, as described below. The Department has no taxing power. Neither the faith and credit nor the taxing power of the State or any political subdivision thereof is pledged to the payment of the principal of or the interest on the Revenue Bonds.**

The 1943 Fund

The components of the 1943 Fund are (i) proceeds derived from the sale of Revenue Bonds, (ii) proceeds from the sale of Veterans G.O. Bonds, (iii) amounts receivable under all Contracts of Purchase and from sales of properties subject to cancelled Contracts of Purchase, (iv) temporary investments, cash and funds and (v) certain other miscellaneous assets. Proceeds of Veterans G.O. Bonds may not be applied to payment of principal of, and interest or any redemption premium on, Revenue Bonds. The holders of Revenue Bonds are not entitled to compel the sale of Contracts of Purchase and the properties to which they relate, but are entitled to receive payment out of the Revenues derived from those Contracts of Purchase and properties, subject to the prior claims, if any, of the Veterans G.O. Bonds for and of the State for reimbursement of debt service payments made on Veterans G.O. Bonds.

In addition to financing Contracts of Purchase and paying or reimbursing debt service on the Veterans G.O. Bonds and Revenue Bonds, as described below, moneys in the 1943 Fund are used to pay administrative costs of the Department and to fund certain losses.

For financial information concerning the 1943 Fund, see “SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT’S DISCUSSION” and also see APPENDIX A – “FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2011 AND 2010 AND INDEPENDENT AUDITORS’ REPORT.”

The Act and the Veterans Code provide that the undivided interest created by Resolution RB-1 in favor of the holders of Revenue Bonds in the assets of the 1943 Fund is secondary and subordinate to the interest of the people of the State and the holders of Veterans G.O. Bonds.

The Veterans Code establishes in the State Treasury the Veterans’ Bond Payment Fund, a revolving special fund, and requires that on the dates when funds are to be remitted to bondholders for the payment of debt service on Veterans G.O. Bonds, there shall be transferred to the Veterans’ Bond Payment Fund to pay the debt service on such Veterans G.O. Bonds all of the money in the 1943 Fund (but not in excess of the amount of debt service then due and payable). If the money transferred from the 1943 Fund to the Veterans’ Bond Payment Fund on the remittance dates is less than the debt service then due and payable, the balance is paid by the

General Fund. The 1943 Fund is required to transfer to the General Fund of the State (the “General Fund”) out of the 1943 Fund, as soon as it becomes available, the balance paid by the General Fund together with interest thereon from the remittance date until paid, at the same rate of interest as borne by the applicable Veterans G.O. Bonds, compounded semiannually. Until such amounts are paid to the General Fund, no payments may be made on Revenue Bonds other than from amounts then in the Bond Reserve Account and, if any, in the Loan Loss Account. These rights with respect to the 1943 Fund do not grant any lien on the 1943 Fund or the moneys therein to the holders of any Veterans G.O. Bonds. The 1943 Fund has always maintained moneys in an amount sufficient to make the required debt service payments on Veterans G.O. Bonds and Revenue Bonds.

As of December 31, 2011, \$1,138,610,000 of new issue Veterans G.O. Bonds are authorized but not issued and there were \$757,560,000 aggregate principal amount of Veterans G.O. Bonds outstanding. As of December 31, 2011, there were Outstanding under Resolution RB-1 \$524,160,000 aggregate principal amount of Revenue Bonds. In addition, the Department has caused the redemption of \$13,000,000 of the Outstanding Revenue Bonds on February 1, 2012 and has caused the Trustee to issue redemption notices for the redemption of \$14,230,000 of the Outstanding Revenue Bonds on March 1, 2012. Under the Act, Revenue Bonds in an aggregate principal amount not to exceed \$1,500,000,000, at any given time, may be outstanding. The Legislature may increase the amount of Revenue Bonds issuable under the Act or may decrease such amount to an amount not less than the amount of Revenue Bonds then outstanding. Voters in the State or the Legislature, as applicable, may authorize increases in the amount of issuable Veterans G.O. Bonds. Additional information about outstanding Veterans G.O. Bonds and Revenue Bonds is in APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds.”

For additional information regarding the existing interest rates of, and setting interest rates on, Contracts of Purchase, see “THE PROGRAM – Contracts of Purchase – Interest Rates” and APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase.”

Bond Reserve Account

Resolution RB-1 requires the establishment and maintenance of a Bond Reserve Account from available Revenues, in an amount at least equal to the Bond Reserve Requirement. Resolution RB-1 creates a lien in favor of the holders of Revenue Bonds on amounts in the Bond Reserve Account which are not in excess of the Bond Reserve Requirement (as defined below). Resolution RB-1 establishes the Bond Reserve Requirement as of any date of calculation to be an amount equal to the aggregate of the amounts established by each Series Resolution authorizing outstanding Revenue Bonds, at least equal in the aggregate to 3% of the aggregate Outstanding principal amount of Revenue Bonds with interest rates fixed to the maturity thereof (the “Bond Reserve Requirement”). For purposes of calculating the Bond Reserve Requirement, the Series Resolutions established (1) with respect to Outstanding Revenue Bonds, amounts of 3% to 7% of the Outstanding principal amount of such Revenue Bonds; and (2) with respect to the Offered Revenue Bonds, an amount equal to 3% of the Outstanding principal amount thereof. Amounts in the Bond Reserve Account shall be used solely for the purposes of paying the principal of and interest on Revenue Bonds or making Mandatory Sinking Account Payments (but only in the event that no other moneys other than certain moneys in the Revenue Bond

Series Proceeds Subaccounts or Revenue Bond Series Proceeds Recycling Subaccounts are available therefor). Resolution RB-1 directs that amounts on deposit in the Bond Reserve Account as of any date in excess of the Bond Reserve Requirement be transferred at the request of the Department to the Loan Loss Account, the Revenue Account or the Proceeds Account.

As of December 31, 2011, the Bond Reserve Requirement was approximately \$16,544,600 and the amount on deposit in the Bond Reserve Account was at least equal to the Bond Reserve Requirement. No change to the Bond Reserve Requirement will be required due to the issuance of the Offered Revenue Bonds.

Although the Department initially used cash to fund the Bond Reserve Requirement with respect to Outstanding Revenue Bonds, the Series Resolutions authorizing the issuance of the Outstanding Revenue Bonds and the Offered Revenue Bonds provide that Cash Equivalents may replace such cash in the future. Resolution RB-1 permits Series Resolutions authorizing Additional Revenue Bonds to provide that Cash Equivalents be used to fund the Bond Reserve Requirement with respect to the Series of Bonds so authorized. See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Additional Investments.”

APPENDIX B includes audited financial statements of the Bond Reserve Account.

Loan Loss Account

There are currently no amounts on deposit or required to be on deposit in the Loan Loss Account. No deposits will be required in connection with the issuance of the Offered Revenue Bonds. See “—Additional Revenue Bonds” for a discussion of certain matters with regard to the Loan Loss Account. See also APPENDIX I – “SUMMARY OF CERTAIN PROVISIONS OF RESOLUTION RB-1 – Loan Loss Account (Section 408).”

Cash Flow Statements and Program Operating Procedures

Resolution RB-1 requires that the Department file a Cash Flow Statement with the Trustee (i) upon adoption of a Series Resolution authorizing Additional Revenue Bonds or amending Resolution RB-1 or any Series Resolutions or upon adoption of a Supplemental Resolution, (ii) upon the issuance of any series of Veterans G.O. Bonds, (iii) when required pursuant to any Series Resolution or Supplemental Resolution, (iv) upon any change in the Program Operating Procedures described below and (v) in connection with compliance with the requirements described below under “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – Maintenance of Fund Parity.” Resolution RB-1 permits the Department to file a new or amended Cash Flow Statement at any time. Resolution RB-1 requires that any Cash Flow Statement be the subject of a Rating Confirmation if it does not include all the scenarios included in the Cash Flow Statement previously on file with the Trustee.

Resolution RB-1 requires that a Cash Flow Statement consist of a Certificate of the Department containing the conclusion of an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal on Revenue Bonds and Expenses, under each of the scenarios included in the cash flow projections attached thereto. Under Resolution RB-1, “Revenues” means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect of the Contracts of Purchase, (ii)

interest earnings received on the investment of amounts to the extent deposited in the Revenue Account under Resolution RB-1, (iii) amounts transferred to the Revenue Account from the Bond Reserve Account or the Loan Loss Account and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and Liquidation/Insurance Proceeds, except to the extent not included as “Revenues” pursuant to the provisions of any Series Resolution.

Resolution RB-1 requires that a Cash Flow Statement will (i) take into account the financial position of the 1943 Fund, the Bond Reserve Account, and the Loan Loss Account as of the stated starting date of the projection, (ii) reflect all the significant transactions that have occurred in the period commencing with such starting date and ending with a date no more than ninety (90) days prior to the date of such projections, (iii) be consistent with Resolution RB-1 and (iv) assume compliance with the then-current Program Operating Procedures. For each scenario included therein, Resolution RB-1 requires that the Cash Flow Statement set forth the assumptions on which it is based including, without limitation, the following:

- (a) the timing and terms of issuance or remarketing of Revenue Bonds and Veterans G.O. Bonds;
- (b) the timing of the acquisition of Contracts of Purchase and the interest rates thereon and maturities thereof;
- (c) the timing and amounts of the receipt of payments of scheduled principal of and interest on Contracts of Purchase;
- (d) the timing and amounts of prepayments on Contracts of Purchase;
- (e) the timing and amount of defaults on Contracts of Purchase and disposition or recovery prices of defaulted Contracts of Purchase, which assumption may be based on a specified model of default frequency and loss severity as a function of Contract of Purchase portfolio characteristics;
- (f) the investment return on Accounts and subaccounts, to the extent that amounts on deposit will not be subject to an investment agreement;
- (g) the performance by the Department’s counterparty with respect to obligations under an enhancement agreement or arrangement for Supplemental Contract of Purchase Coverage or investment of funds;
- (h) the types of Primary Contract of Purchase Coverage and Supplemental Contract of Purchase Coverage; and
- (i) the Loan Loss Requirement.

According to Resolution RB-1, the Department will not be in default under Resolution RB-1 merely because a Cash Flow Statement shows that projected Revenues will be insufficient to provide for timely payments of interest on and principal of Revenue Bonds and Expenses, but is required to take all reasonable actions to eliminate such deficiency.

The Program Operating Procedures are operating policies of the Department governing discretionary activities under Resolution RB-1. Resolution RB-1 requires the Department to administer the Program and perform its obligations under Resolution RB-1 in accordance in all

material respects with the then-current Program Operating Procedures. The Program Operating Procedures may be amended if (1) a Cash Flow Statement is delivered to the Trustee and (2) an opinion of nationally recognized bond counsel is delivered to the Trustee to the effect that such amendment or action taken pursuant to such amendment will not affect the exemption of interest on Revenue Bonds from the gross income of the holders thereof for Federal income tax purposes.

Cash Flow Statements to be Delivered in Connection with the Offered Revenue Bonds

As a condition to the issuance of the Offered Revenue Bonds, the Department will provide the Trustee with a Cash Flow Statement in the form required by Resolution RB-1. The Cash Flow Statement will consist of the conclusion by an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of scheduled interest and principal on Revenue Bonds and Expenses, under each of the scenarios included in the cash flow projections attached thereto (the "Delivery Cash Flow Projections"). The Delivery Cash Flow Projections will be prepared by cfX Incorporated ("cfX"), pursuant to its engagement as Quantitative Consultant to the Department. The Delivery Cash Flow Projections and the conclusions of cfX contained in its accompanying cash flow letter will be based solely on information provided to cfX by the Department and the Trustee and certain assumptions provided to cfX by the Department and upon scenarios generally specified by the Rating Agencies to be tested; cfX makes no representation with respect to the accuracy of such information or as to the reasonableness of such assumptions and scenarios.

The Delivery Cash Flow Projections will be based on the financial condition of the 1943 Fund as of June 30, 2011 (as presented in the audited financial statements of the 1943 Fund as of June 30, 2011) and will reflect significant financial transactions within the 1943 Fund through December 31, 2011, as explained to cfX by the Department. The Delivery Cash Flow Projections will reflect (i) the assumed delivery of the Offered Revenue Bonds as part of the overall financing plan (but no additional future issuance of either Revenue Bonds or Veterans G.O. Bonds) and (ii) the initial application of proceeds of the Offered Revenue Bonds in accordance with the Resolution.

The Delivery Cash Flow Projections will include each of the respective scenarios generally specified and included in the final presentations to the respective Rating Agencies in connection with the Department's application for an appropriate rating on the Revenue Bonds, including the Offered Revenue Bonds. Such scenarios reflect a combination of assumptions required by the respective Rating Agencies to be used with respect to future market conditions and behavior of eligible and participating veterans under such market conditions. cfX makes no representation with respect to the sufficiency of Revenues to provide for timely payments of interest and principal on Revenue Bonds and Veterans G.O. Bonds or Expenses under any scenario not presented in the Delivery Cash Flow Projections. Among other assumptions, the Delivery Cash Flow Projections will include alternative scenarios as required by each Rating Agency under which:

- (i) A specified level of prepayments is received with respect to Contracts of Purchase, based on underlying annualized constant prepayment rates.
- (ii) As of specified dates, no additional Contracts of Purchase are funded and unexpended amounts are applied to the redemption of Revenue Bonds and Veterans G.O. Bonds.

(iii) A specified level of unreimbursed losses is incurred with respect to defaulted Contracts of Purchase.

The projections and assumptions contained in this Official Statement were prepared by the Department assuming that the Department will not receive any payments under the Radian Policies (as defined below).

Each scenario in the Delivery Cash Flow Projections will reflect future transactions expected to be executed by the Department and the Trustee (among others) with respect to: (i) the application for Program purposes of amounts in the Proceeds Account established under Resolution RB-1, (ii) the collection and deposit of Revenues, (iii) the investment of amounts on deposit in various Accounts in both specified and unspecified investments, (iv) the transfer of funds between Accounts, (v) the payment of Expenses and (vi) the redemption of Revenue Bonds and Veterans G.O. Bonds. All of the scenarios included in Delivery Cash Flow Projections assume that the Department and the Trustee execute such transactions on a timely basis in conformance with the requirements of Resolution RB-1, the Offered Bonds Series Resolution, the Series Resolutions authorizing the issuance of prior and future Series of Revenue Bonds, the Program Operating Procedures, and the providers of third party investment contracts. cfX can provide no assurance that such actions will be timely taken.

Each scenario in the Delivery Cash Flow Projections will reflect future performance by third parties under investment and insurance contracts and will assume no default in performance.

Neither the Department's independent auditors, nor any other independent accountants, have compiled, examined or performed any procedures with respect to the Delivery Cash Flow Projections, nor have any such auditors or accountants expressed any opinion or any other form of assurance on such Delivery Cash Flow Projections or their achievability.

Certain information in this Official Statement is based upon projections and assumptions about, among other things, the rate of prepayment of Contracts of Purchase, the level of defaults, foreclosures and losses on Contracts of Purchase. In addition, the structuring of each Series of Revenue Bonds and the preparation of Cash Flow Statements involves the making of similar projections and assumptions. These projections and assumptions are subject to risks and uncertainties, including risks and uncertainties outside the control of the Department. The accuracy of such projections and assumptions is subject to known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from such projections and assumptions. Differences in actual results from projections may be difficult to recognize in a timely manner for purposes such as the adjustment of requirements relating to Contracts of Purchase. Material differences could result in a variety of unpredictable consequences which could adversely affect the ability of the Department to pay debt service on Revenue Bonds.

Maintenance of Fund Parity

Resolution RB-1 requires that the Department cause a calculation to be made of Fund Parity, as evidenced in a Certificate of the Department filed with the Trustee as of the last day of each Fiscal Year (and upon receipt of the audited financial statements of the 1943 Fund), or more frequently in the discretion of the Department. If any such calculation shall not reflect that Fund Parity at least equals the "Applicable Fund Parity Percentage" set forth in the Program Operating

Procedures (the current Program Operating Procedures establish this percentage as 25%) (provided that any percentage which is less than 50% shall be the subject of a Rating Confirmation) of the then outstanding principal amount of Revenue Bonds, all Revenues in excess of Accrued Debt Service on Revenue Bonds and Veterans G.O. Bonds shall thereafter be applied to redeem Revenue Bonds of the Series and in the manner reflected in a current Cash Flow Statement, until (and if) the Department files with the Trustee a new Certificate of the Department reflecting a calculation of Fund Parity that at least equals such Applicable Fund Parity Percentage; *provided, further, however*, that no such Cash Flow Statement and no such redemption shall be required if the Department shall have provided a Rating Confirmation to the Trustee. The Department Certificate filed as of June 30, 2011 reflected Fund Parity in excess of the Applicable Fund Parity Percentage, which was 25%.

Under Resolution RB-1, “Fund Parity” means, on any determination date: (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the Accounts established under Resolution RB-1 and any Series Resolution or Supplemental Resolution and (ii) the aggregate principal amount of all Revenue Bonds Outstanding and all Veterans G.O. Bonds outstanding (plus accrued interest), reduced by (b) allowances and reserves for loss coverage on Contracts of Purchase, loss coverage on properties subject to Contracts of Purchase, and life and disability coverage on persons obligated under Contracts of Purchase, as specified in the Program Operating Procedures. See “THE PROGRAM — Life and Disability Insurance” regarding changes to the Department’s life and disability coverage.

Resolution RB-1 provides that “Accrued Debt Service” means, as of any date of determination and, as the context of Resolution RB-1 requires, with respect to all Revenue Bonds and Veterans G.O. Bonds, the sum of:

(a) the aggregate amount of scheduled interest and principal (except to the extent principal is otherwise to be redeemed pursuant to clause (b) or (c) below) to become due after such date but on or before the end of the current Debt Service Year, less the product of (i) the number of whole months remaining in the current Debt Service Year and (ii) the Monthly Debt Service Requirement;

(b) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the Revenue Account; and

(c) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding Debt Service Year under the terms of any Series Resolution or Supplemental Resolution or resolution of issuance governing Veterans G.O. Bonds, to the extent that such obligation arises on account of amounts on deposit in the Revenue Account.

Under Resolution RB-1, “Monthly Debt Service Requirement” means, as of any date of determination, one-twelfth of the aggregate amount of scheduled interest and principal to become due during the Debt Service Year in which such date falls, as computed on the first day of such Debt Service Year.

Additional Revenue Bonds

Resolution RB-1 permits the issuance of Additional Revenue Bonds to carry out the provisions of the Act and other statutes enacted in support of the Program or to refund all or part

of the then Outstanding Revenue Bonds or then outstanding Veterans G.O. Bonds. Any Additional Revenue Bonds issued under Resolution RB-1 (except for bonds which are subordinate obligations) will be on a parity with the then Outstanding Revenue Bonds, and will be entitled to the equal benefit, protection and security of the provisions, covenants and agreements of Resolution RB-1. Additional Revenue Bonds may have payment dates which differ from those of the Outstanding Revenue Bonds and the Offered Revenue Bonds. Upon the issuance of any such Additional Revenue Bonds, Resolution RB-1 requires the deposit into the Bond Reserve Account and the Loan Loss Account such amounts as are necessary to increase the amounts therein to, respectively, the Bond Reserve Requirement or the Loan Loss Requirement. Such deposit may be made from the 1943 Fund, the proceeds of sale of the Additional Revenue Bonds or any other lawful source, or through the use of Cash Equivalents as provided in the Series Resolution authorizing the issuance of the Additional Revenue Bonds. Under Resolution RB-1, issuance of Additional Revenue Bonds is conditioned upon delivery of a Cash Flow Statement and Rating Confirmation and upon certification that no Event of Default under Resolution RB-1 shall have occurred and be continuing.

Additional Veterans G.O. Bonds authorized by the voters of the State may be issued by the State from time to time to provide funds for the Program or to refund outstanding Veterans G.O. Bonds, subject to the delivery of a Cash Flow Statement. See “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – The 1943 Fund” for a discussion of authorized but unissued bonds.

SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT’S DISCUSSION

Selected Financial Data of the 1943 Fund

The following table (the “Selected Financial Data”) contains selected financial data of the 1943 Fund for fiscal years ended June 30, 2011 and 2010 which has been derived from the financial statements of the 1943 Fund audited by Deloitte & Touche LLP, independent auditors, whose report thereon appears in APPENDIX A, and the Department’s accounting records. The Selected Financial Data contains the comparable financial data of the 1943 Fund for fiscal years ended June 30, 2009, 2008 and 2007 which has been derived from the audited financial statements of the 1943 Fund that are not included herein.

This selected financial data for the fiscal years ended June 30, 2011 and 2010 should be read in conjunction with the financial statements and notes thereto of the 1943 Fund contained in said APPENDIX A and the Department’s Discussion of Financial Data contained herein.

Non-GAAP Financial Measures

In addition to the results reported in accordance with generally accepted accounting principles for governmental units as presented by the Governmental Accounting Standards Board, as in effect from time to time in the United States (“GAAP”) included in this Official Statement, the Department has provided information regarding: net lending and financing activities assets, net insurance activities liabilities, bond interest expense, net interest income (expense), net lending/financing activities income (expense), net administrative activities expense, and net insurance activities income as calculated and as presented in the Selected

Financial Data. These non-GAAP measures, when read in conjunction with the audited financial statements of the 1943 Fund, provide useful information by offering:

- The ability to make more meaningful period-to-period comparisons of the 1943 Fund's on going operating results;
- the ability to better identify trends in the 1943 Fund's underlying business;
- a better understanding of how the Department plans and measures the 1943 Fund's underlying business; and
- an easier way to compare the 1943 Fund's most recent results of operations against investor and analyst financial models.

Bond interest expense, net interest income (expense), net lending/financing activities income (expense), net administrative activities expense and net insurance activities income should not be considered a substitute or an alternative to these computations (or similar computations) calculated in accordance with and required by GAAP.

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	For Fiscal Years Ended on				
	June 30, 2011	June 30, 2010	June 30, 2009	June 30, 2008	June 30, 2007
ASSETS AND LIABILITIES RELATED TO LENDING AND FINANCING ACTIVITIES:					
CASH AND INVESTMENTS					
Cash and amounts on Deposit in SMIF	\$ 87,909	\$ 241,004	\$ 286,141	\$ 533,866	\$ 640,905
Guaranteed Investment Contracts	10,046	36,701	29,776	25,842	30,101
	<u>\$ 97,955</u>	<u>\$ 277,705</u>	<u>\$ 315,917</u>	<u>\$ 559,708</u>	<u>\$ 671,006</u>
DUE FROM VETERANS DEBENTURE REVENUE FUND					
OTHER CURRENT ASSETS	\$ 19,742	\$ 28,753	\$ 32,089	\$ 32,132	\$ 32,112
NET OTHER NON-CURRENT ASSETS	8,966	11,213	11,810	13,104	14,705
ADVANCE TO POOLED INSURANCE FUND	2,983	4,527	3,606	3,421	3,849
	26,766	--	--	--	--
CONTRACTS OF PURCHASE					
Performing Contracts	\$ 1,342,471	\$ 1,516,481	\$ 1,701,943	\$ 1,674,651	\$ 1,529,993
Non Performing Contracts	28,855	34,265	32,099	12,619	5,193
Total	<u>\$ 1,371,326</u>	<u>\$ 1,550,746</u>	<u>\$ 1,734,042</u>	<u>\$ 1,687,270</u>	<u>\$ 1,535,186</u>
Allowance For Contract Losses	\$ (16,972)	\$ (16,543)	\$ (13,927)	\$ (9,743)	\$ (8,567)
Reduction of REO to Fair Value	(10,108)	(10,993)	(9,103)	(1,994)	(1,055)
Total	<u>\$ (27,080)</u>	<u>\$ (27,536)</u>	<u>\$ (23,030)</u>	<u>\$ (11,737)</u>	<u>\$ (9,622)</u>
BONDS PAYABLE					
General Obligation Bonds and Notes	\$ (799,475)	\$ (1,002,225)	\$ (1,172,330)	\$ (1,335,095)	\$ (1,335,470)
Revenue Bonds	(546,660)	(677,430)	(694,805)	(717,010)	(673,235)
Total	<u>\$ (1,346,135)</u>	<u>\$ (1,679,655)</u>	<u>\$ (1,867,135)</u>	<u>\$ (2,052,105)</u>	<u>\$ (2,008,705)</u>
OTHER CURRENT LIABILITIES					
	(4,525)	(8,098)	(8,364)	(8,067)	(9,155)
Net Lending & Financing Activities Assets	<u>\$ 149,998</u>	<u>\$ 157,655</u>	<u>\$ 198,935</u>	<u>\$ 223,725</u>	<u>\$ 229,376</u>
ASSETS AND LIABILITIES RELATED TO INSURANCE ACTIVITIES:					
LIFE AND DISABILITY COVERAGE					
Cash Reserve for Life and Disability	\$ 5,650	\$ 5,650	\$ 5,590	\$ 5,403	\$ 5,324
Insurance Loss Reserves	--	(1,711)	(5,490)	(6,761)	(8,881)
Total	<u>\$ 5,650</u>	<u>\$ 3,939</u>	<u>\$ 100</u>	<u>\$ (1,358)</u>	<u>\$ (3,557)</u>
FIRE AND HAZARD COVERAGE					
Deposits with Insurance Administrators	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000
Accrued Liabilities	--	(875)	(428)	(1,504)	(1,173)
Total	<u>\$ 1,000</u>	<u>\$ 125</u>	<u>\$ 572</u>	<u>\$ (504)</u>	<u>\$ (173)</u>
Net Insurance Activities Liabilities	<u>6,650</u>	<u>4064</u>	<u>672</u>	<u>(1,862)</u>	<u>(3,730)</u>
FUND EQUITY	<u>\$ 156,648</u>	<u>\$ 161,719</u>	<u>\$ 199,607</u>	<u>\$ 221,863</u>	<u>\$ 225,646</u>
SUMMARY INFORMATION					
Total Assets	\$ 1,507,000	\$ 1,852,000	\$ 2,081,000	\$ 2,290,000	\$ 2,254,000
Total Liabilities	\$ 1,351,000	\$ 1,690,000	\$ 1,881,000	\$ 2,068,000	\$ 2,028,000
Total Number of Contracts of Purchase	9,786	11,097	12,552	13,299	13,825

SELECTED FINANCIAL DATA OF THE 1943 FUND
(Dollars in Thousands)

	For Fiscal Years Ended on				
	June 30, 2011	June 30, 2010	June 30, 2009	June 30, 2008	June 30, 2007
NET INCOME (EXPENSE) FROM LENDING AND FINANCING ACTIVITIES:					
INTEREST INCOME					
Interest on Contracts	\$ 80,412	\$ 91,222	\$ 99,058	\$ 93,234	\$ 88,424
Interest on Investments	3,049	3,595	10,783	27,809	30,697
Transfers of Interest From Veterans Debenture Revenue Fund	2,142	1,365	1,478	1,683	1,713
Total	\$ 85,603	\$ 96,182	\$ 111,319	\$ 122,726	\$ 120,834
BOND INTEREST EXPENSE⁽¹⁾	\$ (69,312)	\$ (86,022)	\$ (101,576)	\$ (106,829)	\$ (105,528)
Net Interest Income (Expense)	\$ 16,291	\$ 10,160	\$ 9,743	\$ 15,897	\$ 15,306
AMORTIZATION OF BOND PREMIUM/DISCOUNT	(2,966)	(3,497)	(1,467)	(1,382)	(1,113)
Total	\$ (2,966)	\$ (3,497)	\$ (1,467)	\$ (1,382)	\$ (1,113)
CONTRACTS OF PURCHASE					
PMI	\$ 0	\$ 0	\$ 0	\$ (833)	\$ (502)
Net Gain/(Loss) on Sale of REO	(13,773)	(12,900)	(3,468)	(962)	165
Decrease(Increase) in Allowance for Contract Losses	(9,592)	(19,575)	(11,293)	(2,115)	(1,421)
Total	\$ (23,365)	\$ (32,475)	\$ (14,761)	\$ (3,910)	\$ (1,758)
Net Lending/Financing Activities Income (Expense)	\$ (10,040)	\$ (25,812)	\$ (6,485)	\$ 10,605	\$ 12,435
NET (EXPENSE) FROM ADMINISTRATIVE ACTIVITIES					
Operating Revenues	\$ 4,576	\$ 1,930	\$ 1,289	\$ 3,196	\$ 3,507
Operating Expenses	(12,992)	(15,901)	(18,246)	(16,442)	(15,045)
Net Administrative Activities Expense	\$ (8,416)	\$ (13,971)	\$ (16,957)	\$ (13,246)	\$ (11,538)
NET INCOME (EXPENSE) FROM INSURANCE ACTIVITIES					
Life and Disability Coverage	\$ 0	\$ 592	\$ (461)	\$ 57	\$ 138
Fire and Hazard Coverage	0	1,303	1,647	(1,200)	1,308
Transfer from Disaster Indemnity	13,385	0	0	0	0
Net Insurance Activities Income (Expense)	\$ 13,385	\$ 1,895	\$ 1,186	\$ (1,143)	\$ 1,446
TOTAL EXCESS (DEFICIENCY) OF REVENUES AND TRANSFERS OVER EXPENSES	\$ (5,071)	\$ (37,888)	\$ (22,256)	\$ (3,783)	\$ 2,343
FUND EQUITY	\$ 156,648	\$ 161,719	\$ 199,607	\$ 221,863	\$ 225,646

⁽¹⁾ Excludes amortization of bond premium/discount.

Department's Discussion of Financial Data

Included as part of the financial statements contained in APPENDIX A is the section entitled "Management's Discussion and Analysis of Financial Position and Results of Operations" which presents management's discussion in relation to the financial statements of the 1943 Fund for the fiscal years ended June 30, 2011 and June 30, 2010 and the changes from prior periods (the "Management Discussion and Analysis"). The Selected Financial Data of the 1943 Fund appearing on the preceding two pages are presented to provide a summary of the financial position and operations over a longer period of time, and a presentation of the significant changes that have occurred. Dollar amounts therein have been rounded. Certain limited aspects of the Selected Financial Data are discussed below. This discussion should be read in conjunction with the Management Discussion and Analysis and with APPENDIX C – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA."

For the fiscal year ended June 30, 2007 the Program, and therefore the financial performance of the 1943 Fund, benefited from both the improvements in the market environment and the implementation by the Department of strategies to mitigate the impact of adverse market conditions, including an increased emphasis on the quality control of underwriting of Contracts of Purchase and an increase in Department resources for collections and foreclosures. The Selected Financial Data reflect the changing conditions in the capital market environment in which the Department operates. The California and United States housing and financial markets experienced substantial turmoil as early as 2007. There was a sharp decline in home prices and rising numbers of foreclosures, which led to a decline in the solvency of many financial and corporate firms as well as declines in the availability of credit and global stock prices. There were a significant number of job losses. The national economy continues to face several economic challenges. The financial performance of the 1943 Fund demonstrated an excess of revenues and transfers over expenses of \$2,343,000 for the fiscal year ended June 30, 2007 due, in part, to higher interest rates.

During the period leading up to 2008, the Department continued its policy of using repayments of Contracts of Purchase financed with Pre-Ullman Moneys (as defined below) to finance new Contracts of Purchase, rather than using such repayments for the retirement of outstanding Veterans G.O. Bonds and Revenue Bonds. The enactment of the Heroes Earnings Assistance and Relief Tax Act of 2007 (the "HEART Act") in June 2008 expanded the pool of veterans who are eligible for Contracts of Purchase financed with QVMB Proceeds (as defined below). Since the enactment of the HEART Act, funds attributable to repayments of Contracts of Purchase financed with Pre-Ullman Moneys have been used for the retirement of outstanding Veterans G.O. Bonds and Revenue Bonds. This has resulted in a reduction of the Department's cash on deposit in the Surplus Money Investment Fund in the State Treasury ("SMIF").

The Department has faced challenges from declining yields on its funds invested in the SMIF, including funds attributable to repayments of Contracts of Purchase pending the use of such funds for the retirement of outstanding Veterans G.O. Bonds and Revenue Bonds or for the financing of new Contracts of Purchase. For the fiscal year ended June 30, 2008, the average SMIF yield was approximately 4.36%. For the fiscal year ended June 30, 2011, the average SMIF yield had decreased to approximately 0.49%. The declines in the average SMIF yield negatively impacted the Department's interest income. During the period from July 1, 2009 through June 30, 2011, repayments on Contracts of Purchase exceeded new Contract of Purchase originations, resulting in an influx of cash, much of which was invested in the SMIF.

The Department has sought to reduce the Department's cash and amounts on deposit in the SMIF to diminish the effect on the 1943 Fund of lowered interest income on such deposits compared to the interest associated with the retired Veterans G.O. Bonds and Revenue Bonds. During this period the Department has used cash to reduce the amounts of Veterans G.O. Bonds and Revenue Bonds outstanding. The Department's cash and amounts on deposits in SMIF were \$533,866,000 as of June 30, 2008, \$241,004,000 as of June 30, 2010, and had declined to \$87,909,000 as of June 30, 2011.

The balance of Veterans G.O. Bonds and Revenue Bonds payable from the 1943 Fund declined to \$1,346,135,000 as of June 30, 2011 from a high of \$2,052,105,000 (inclusive of commercial paper) as of June 30, 2008. This decline included \$730,970,000 of Veterans G.O. Bonds and Revenue Bonds retired from amounts made available during prior periods and the use of repayments of Contracts of Purchase financed with Pre-Ullman Moneys, QVMB Proceeds and QMB Proceeds (as defined below) for the retirement of outstanding Veterans G.O. Bonds and Revenue Bonds and the addition of \$25,000,000 from Veterans G.O. Bonds issued in June 2010.

As credit policies for the refinancing of loans in the conventional mortgage market tightened in response to the California and United States housing and financial markets turmoil, the Department has not experienced a large number of prepayments of Contracts of Purchase refinanced by conventional mortgages. The balance of Contracts of Purchase held under the 1943 Fund increased for each of the fiscal years described in the Selected Financial Data from \$1,535,186,000 as of June 30, 2007 to \$1,734,042,000 as of June 30, 2009. However, during the fiscal years ended June 30, 2010 and June 30, 2011, the balance of Contracts of Purchase held under the 1943 Fund declined to \$1,550,746,000 and \$1,371,326,000, respectively, as repayments of Contracts of Purchase continued while the Department originated fewer Contracts of Purchase. Along with the increase in the balance of Contracts of Purchase held under the 1943 Fund through June 30, 2009, the average interest rate on such Contracts of Purchase also increased. For the fiscal year ended June 30, 2008, the average interest rate on outstanding Contracts of Purchase was approximately 5.80%, which increased to approximately 5.90% for the fiscal year ended June 30, 2009. As of June 30, 2011 the average interest rate on outstanding Contracts of Purchase was approximately 5.70%. The decrease is due primarily to the repayment of higher interest rate Contracts of Purchase.

More recently, the Department and the financial performance of the 1943 Fund benefited by the implementation by the Department of strategies to mitigate the impact of adverse market conditions, including an increased emphasis on the quality control of underwriting of Contracts of Purchase and an increase in Department resources for collections and foreclosures.

Fiscal Year Ended June 30, 2011

Notwithstanding the continuing national financial difficulties, the deterioration of the California housing market and high unemployment rates, during the fiscal year ended June 30, 2011, the asset-to-liability ratio of the 1943 Fund increased and the number of underperforming Contracts of Purchase decreased slightly.

The Program operations revenues over Program operations expenses increased \$16,644,000 from a deficiency of \$12,911,000 for the fiscal year ended June 30, 2010 to an excess of \$3,733,000 for the fiscal year ended June 30, 2011, respectively. Interest revenue from Contracts of Purchase decreased by \$10,810,000 from \$91,222,000 for the year ended June 30, 2010 to \$80,412,000 for the fiscal year ended June 30, 2011, due to a decrease in the number of new Contracts of Purchase in the portfolio. Interest revenues on investments and other revenues increased by \$231,000 from \$4,960,000 for the fiscal year ended June 30, 2010 to \$5,191,000 for the fiscal year ended June 30, 2011. This increase is primarily due to advanced interest payments on investment contracts transferred from the Veterans Debenture Revenue Fund and recognition of the reserves transferred from the Veterans Disaster Indemnity Fund to the Disaster Indemnity Account in the Pooled Self-Insurance Funds. See “THE PROGRAM – Pooled Self-Insurance Fund.” Net program operation expenses decreased \$27,223,000 from \$109,093,000 the fiscal year ended June 30, 2010 to \$81,870,000 for the fiscal year ended June 30, 2011. This is due to a decrease of \$17,241,000 in interest expense related to a decrease in bonds outstanding, and a decrease of \$9,983,000 in the provision for Program losses. The sale of repossessed properties resulted in a loss of \$13,773,000 for the fiscal year ended June 30, 2011 compared to a loss of \$12,900,000 for the fiscal year ended June 30, 2010 due to a reduction in property values from loans made primarily in the calendar years 2005, 2006 and 2007. The 1943 Fund’s holdings of repossessed properties, net of allowances for losses, decreased from \$23,272,000 as of June 30, 2010 to \$18,747,000 as of June 30, 2011. Total excess of revenues and transfers over expenses increased correspondingly; after a one time increase in revenue of \$13,385,000 related to the insurance program, there was a deficiency of revenues and transfers over expenses of \$5,071,000 for the fiscal year ended June 30, 2011, as compared to a deficiency of \$37,888,000 for the fiscal year ended June 30, 2010.

In the previous three fiscal years, the number of non-performing Contracts of Purchase had increased each year but remained moderate when compared to the rest of the California housing market, presumably due in large part to the Department’s practice of manual underwriting and offering only fixed rate Contracts of Purchase. The Department’s Contracts of Purchase products and underwriting criteria have not changed over the five-year period. The amount of non-performing Contracts of Purchase compared to five years ago, has increased as the problems in the California housing and job markets have continued. For the fiscal year ended June 30, 2011, the aggregate principal amount of non-performing Contracts of Purchase decreased to \$28,855,000. As of June 30, 2010, the aggregate principal amount of the non-performing Contracts of Purchase was \$34,265,000.

Likewise, the Department’s losses on Contracts of Purchase (identified in the above “SELECTED FINANCIAL DATA OF THE 1943 FUND” as net gain/loss on the sale of REO and decrease/increase in the allowance for contract losses) has worsened compared to five years ago. For the fiscal year ended June 30, 2011, the aggregate losses on Contracts of Purchase were \$23,365,000 compared with the aggregate losses on Contracts of Purchase of \$1,758,000 for the fiscal year ended June 30, 2007. However, the Department reduced aggregate losses on Contracts of Purchase from \$32,475,000 for the fiscal year ended June 30, 2010 to \$23,365,000 for the fiscal year ended June 30, 2011. Annually, the Department establishes an allowance for uncollectible Contracts of Purchase and reduces the book value of REO to fair value established through a provision charged to operations. The Department’s management believes these adjustments will be adequate to absorb losses with respect to Contracts of Purchase based, among other things, on prior loss experience and the outstanding aggregate principal amount of

Contracts of Purchase. For the fiscal years ended June 30, 2007, 2008, 2009 and 2011, these adjustments exceeded the aggregate losses on Contracts of Purchase. For the fiscal year ended June 30, 2010, the aggregate losses on Contracts of Purchase of \$32,475,000 exceeded the adjustments of \$27,536,000. With the uncertainty in the California housing market and continued high unemployment statistics, there can be no assurances that the number of non-performing Contracts of Purchase and losses on Contracts of Purchase will not increase in the future. See “—Mitigating Market Factors.”

Despite the national financial difficulties, the declines in the California housing markets and high unemployment, certain aspects of the 1943 Fund, including the assets-to-liability ratio and the interest rates on outstanding Contracts of Purchase, have improved slightly. The principal balance of the Contracts of Purchase held under the 1943 Fund decreased by approximately 12% in the fiscal year ended June 30, 2011 due to a decreased amount of funded loans. The balance of Veterans G.O. Bonds and Revenue Bonds payable from the 1943 Fund decreased to \$1,346,135,000 as of June 30, 2011 from \$1,679,655,000 as of June 30, 2010 due to the Department’s use of cash for the retirement of outstanding Veterans G.O. Bonds and Revenue Bonds.

The fund balance account of the 1943 Fund decreased from \$161,719,000 as of June 30, 2010 to \$156,649,000 as of June 30, 2011. The percentage of retained earnings of the 1943 Fund to total assets and total liabilities increased from 109.57% at June 30, 2010 to 111.60% as of June 30, 2011. See – “Investments in the Surplus Money Investment Fund,” APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments.”

Events Subsequent to Fiscal Year Ended June 30, 2011

On October 1, 2011, the Department caused the redemption of approximately \$17,525,000 of Revenue Bonds. On December 1, 2011, the Department caused the redemption of approximately \$13,195,000 of Revenue Bonds. On December 13, 2011, the Department issued \$97,120,000 principal amount of its Home Purchase Revenue Bonds, 2011 Series A (Non-AMT) and \$4,030,000 principal amount of its Home Purchase Revenue Bonds, 2011 Series B (AMT) for the purpose of, among other things, refunding certain then Outstanding Revenue Bonds. In addition, the Department has caused the redemption of \$13,000,000 of the Outstanding Revenue Bonds on February 1, 2012 and has caused the Trustee to issue redemption notices for the redemption of \$14,230,000 of the Outstanding Revenue Bonds on March 1, 2012. See “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – The 1943 Fund” regarding the Department’s Outstanding Revenue Bonds and outstanding Veterans G.O. Bonds.

Mitigating Market Factors

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

- Interest rates on Contracts of Purchase originated after January 1, 2011 are fixed for the entire term of the loan. Interest rates on Contracts of Purchase originated prior to January 1, 2011 are fixed, subject to periodic adjustment as described in “THE PROGRAM—Interest Rates” below.

- The Department requires that, at the time of financing, Program participants reside in the home purchased under the Contracts of Purchase.
- The Department's underwriting requirements, according to an internal unaudited survey by the Department, have resulted in average borrower Fair Isaac Corporation (FICO) credit scores at the time of origination in excess of 725 for transactions originated since January 1, 2004.
- Since 2009, all new Contracts of Purchase require a minimum 1.25% funding fee to offset the cost of the USDVA Guaranty or for deposit in the Primary Mortgage Insurance Account.
- Based on information obtained in the course of the Department's management of delinquencies and cancellations, a significant percentage of non-performance with respect to Contracts of Purchase appears to be due to job loss, death in family and divorce.
- Certain of the Department's Contracts of Purchase are guaranteed by the USDVA. See "THE PROGRAM – USDVA Guaranty Program; Loan Insurance" and APPENDIX C - "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase – Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011."
- The Department is participating in the Keep Your Home California program. See "THE PROGRAM – Contracts of Purchase – Keep Your Home California."

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

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

planning may be based, including, among other things, the rate of repayment of Contracts of Purchase, levels of defaults and delinquencies and losses on Contracts of Purchase; (k) the issuance and structuring of any additional Veterans G.O. Bonds or Additional Revenue Bonds; (l) the implementation of any new programs of the Department; and (m) changes in law, including changes which may affect the timing and the amount the Department may recover from Contracts of Purchase. The Department expects that there will be significant variations in results in future periods, including additional periods in which there may be a deficit of revenues over expenses. Consideration should be given to these factors, among others, in connection with the purchase of the Offered Revenue Bonds. See “FORWARD LOOKING STATEMENTS.”

Investments in the Surplus Money Investment Fund

The Department is permitted to participate in the SMIF, an investment fund established under the California Government Code, which invests money according to an investment policy established by the State Treasurer’s Office. The Department invests a material portion of its cash in the SMIF. All investments, including those in the SMIF, contain certain risks, some of which may be material. Such risks include, but are not limited to, a lower rate of return than expected and loss or delayed receipt of principal. These risks may be mitigated, but are not eliminated, by limitations imposed on the portfolio management process by the State Treasurer’s investment policies, which may change from time to time. See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments.”

THE OFFERED REVENUE BONDS

General

The Offered Revenue Bonds will be issued as fully-registered bonds in initial denominations of \$5,000 or any integral multiple thereof in book-entry form. The Offered Revenue Bonds will mature in the years and bear interest at the rates set forth on the inside front cover page hereof.

The Offered Revenue Bonds are subject to redemption prior to maturity, as described below.

Interest

Interest on the Offered Revenue Bonds will accrue from the date of delivery and is payable on June 1 and December 1 of each year, commencing June 1, 2012 at the respective rates shown on the inside front cover page hereof. Interest will be calculated on the basis of a 360-day year consisting of twelve 30-day months. See APPENDIX D – “DTC AND BOOK-ENTRY ONLY SYSTEM.”

None of the Department, the State Treasurer or the Underwriters can or do give any assurances that Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”) will perform its obligations as described in this Official Statement. None of the Department, the State Treasurer or the Underwriters is responsible or liable for the failure of DTC to make any payments or give any notice to a Beneficial Owner with respect to the Offered Revenue Bonds or any error or delay relating thereto.

Redemption

Optional Redemption

The Offered Revenue Bonds shall be subject to redemption at any time on or after June 1, 2021 at the option of the Department, from any source of available funds, in whole or in part, by such maturity or maturities as may be selected by the Department in its sole discretion (and by lot within a maturity) at a Redemption Price of par together with accrued interest to the redemption date.

Redemption from Mandatory Sinking Account Payments

The Offered Revenue Bonds maturing on December 1, 2028 (the “Term Bond”) are subject to mandatory redemption prior to their stated maturities, in part, by lot, at a Redemption Price of par plus accrued interest to the date fixed for redemption, without premium, from Mandatory Sinking Account Payments, on the dates and in the amounts as set forth in the following table:

Offered Revenue Bonds Maturing December 1, 2028

Date (December 1)	Mandatory Sinking Account Payments
2026	\$ 17,800,000
2027	16,200,000
2028 [†]	13,465,000

[†] Stated maturity

Pursuant to the Resolution, if less than all of the Term Bonds of a maturity are purchased or called for redemption (other than in satisfaction of Mandatory Sinking Account Payments), the Trustee will credit the principal amount of such Term Bonds that are so purchased or redeemed against applicable remaining Mandatory Sinking Account Payments (including the principal amounts due on the respective maturity dates, as shown above) as directed by the Department or, if no direction is given, then against all applicable remaining Mandatory Sinking Account Payments in the proportion that the then-remaining balance of each such Mandatory Sinking Account Payment (including the principal amount due on the respective maturity date, as shown above) bears to the total of all applicable Mandatory Sinking Account Payments (including the principal amounts due on the respective maturity dates, as shown above).

Special Redemption from Excess Revenues

The Offered Revenue Bonds are subject to special redemption at the option of the Department in whole or in part on any date, at a Redemption Price of par, plus interest accrued thereon to the date fixed for redemption in an amount equal to Excess Revenues. The Offered Revenue Bonds to be so redeemed shall be such maturities, and such amounts within a maturity (and by lot within a maturity), as shall be selected by the Department.

Excess Revenues (defined in APPENDIX I – “SUMMARY OF CERTAIN PROVISIONS OF RESOLUTION RB-1 – Definitions (Section 103)”) can include prepayments and repayments on Contracts of Purchase funded by Revenue Bonds and Veterans G.O. Bonds, investment earnings and insurance receipts, and amounts on deposit in the Bond Reserve Account and, if any, Loan Loss Account in excess of their respective requirements and also includes Revenues which had been set aside to be recycled into new Contracts of Purchase.

Revenues which had been set aside to be recycled into new Contracts of Purchase, if any, will be deposited to a Recycling Subaccount. Resolution RB-1 permits Excess Revenues to be applied to redeem Revenue Bonds and General Obligation Bonds.

See “—Information Regarding Prepayments” below for additional information regarding prepayments of Contracts of Purchase.

All payments on Contracts of Purchase are deposited in the 1943 Fund and applied to pay or reimburse the State’s General Fund for debt service on the Veterans G.O. Bonds, to pay debt service on Revenue Bonds, for mandatory redemptions of Veterans G.O. Bonds and Revenue Bonds and Program and Department expenses. The Department, subject to applicable bond authorizing resolutions, may apply Excess Revenues to redeem any Veterans G.O. Bonds or Revenue Bonds eligible for redemption. The Department’s decision to apply Excess Revenues to redeem bonds, to finance new Contracts of Purchase, or to any other permitted purpose depends on many factors, including applicable bond authorizing resolution requirements, demand for Contracts of Purchase, debt service cost savings, investment earnings and Federal Tax Code requirements. See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Veterans G.O. Bonds and Revenue Bonds – Selected Information With Respect to Veterans G.O. Bonds and Revenue Bonds.” The Department also collects certain premiums from veterans in respect of the Fire and Hazard Insurance Program and Disaster Indemnity Program. See “THE PROGRAM – Property Insurance.”

Information Regarding Prepayments

The Department’s actual past prepayment experience for existing Contracts of Purchase is set forth in APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience.”

For qualified mortgage bonds (which do not include Pre-Ullman bonds such as the Offered Revenue Bonds) issued or to be issued after 1988, the Federal Tax Code prohibits repayments (including prepayments) of principal of Contracts of Purchase financed with the proceeds of an issue of such bonds to be used to make additional Contracts of Purchase after 10 years from the date of issuance of such bonds (or the date of issuance of original bonds in the case of refundings), after which date such amounts must be used to redeem such bonds of the issue, except for a \$250,000 *de minimis* amount. See “TAX MATTERS – Federal Tax Matters.”

The Federal Tax Code requires a payment to the United States from certain veterans whose Contracts of Purchase are originated after December 31, 1990 with the proceeds of qualified mortgage bonds (which do not include Pre-Ullman bonds such as the Offered Revenue Bonds). Since such requirement remains in effect with respect to any Contracts of Purchase originated after December 31, 1990 with proceeds of the applicable Revenue Bonds, for a period ending nine years after the execution of such Contracts of Purchase, the Department is unable to predict what effect, if any, such requirement will have on the origination or prepayment of Contracts of Purchase to which such provision applies.

Redemption Notice

The Resolution requires that at least fifteen (15) but not more than ninety (90) days before a redemption date for Revenue Bonds, the Trustee must cause a notice of any such redemption, either in whole or in part, to be mailed, first class postage prepaid, to all registered owners of the Revenue Bonds to be redeemed at their addresses as they appear on the registration books kept by the Trustee, as Bond Registrar. Each such notice shall set forth the date fixed for redemption, the Redemption Price to be paid, the place or places where amounts due upon such redemption will be payable and, if less than all of the Revenue Bonds then Outstanding shall be called for redemption, the Series (or subseries), the maturities and the distinctive numbers, if any, and CUSIPs of such Revenue Bonds to be redeemed and, in the case of Revenue Bonds to be redeemed in part only, the portion of the principal amount thereof to be redeemed. In case any Revenue Bond is to be redeemed in part only, the notice of redemption which relates to such Revenue Bond shall state also that on or after the redemption date, upon surrender of such Revenue Bond, a new Revenue Bond of the same maturity and Series (and subseries, if applicable), bearing interest at the same rate and in principal amount equal to the unredeemed portion of such Revenue Bond, will be issued.

In addition, if the notice of redemption is conditional, the notice shall set forth in summary terms, the conditions precedent to such redemption and that if such conditions shall not have been satisfied on or prior to the redemption date, said notice shall be of no force and effect and such Revenue Bonds shall not be redeemed. If the conditions are not satisfied, the redemption shall not be made and the Trustee shall within a reasonable time thereafter give notice, in the manner in which the notice of redemption was given, that such conditions were not satisfied. An affidavit of the Trustee of mailing shall be conclusive and binding upon the Department and owners of the Revenue Bonds. No defect in the notice of redemption or mailing thereof (including any failure to mail such notice) to any owner of Revenue Bonds will affect the validity of the redemption proceedings for any other owner of Revenue Bonds.

In accordance with the Offered Bonds Series Resolution, the Offered Revenue Bonds are being issued in book-entry form only, and redemption notices shall be given at the times and in the manner required by DTC. DTC is responsible for notifying Direct Participants, and Direct Participants and Indirect Participants are responsible for notifying Beneficial Owners (as defined herein). Neither the Trustee nor the Department is responsible for sending notices to Beneficial Owners or for the consequences of any action or inaction by the Trustee or the Department as a result of the response or failure to respond by DTC or its nominee as Bondholder. See APPENDIX D – “DTC AND BOOK-ENTRY ONLY SYSTEM.”

ESTIMATED SOURCES AND USES OF THE OFFERED REVENUE BONDS

The sources of funds and the uses thereof in connection with the Offered Revenue Bonds, after expected transfers and exchanges, are expected to be approximately as set forth below.

ESTIMATED SOURCES	
Offered Revenue Bond Par Amount	\$ 220,435,000
Available amounts in the 1943 Fund	<u>7,534,858</u>
TOTAL ESTIMATED SOURCES	\$ 227,969,858
ESTIMATED USES	
Payment of Refunded Bonds ⁽¹⁾	\$ 225,839,673
Underwriters' Discount	1,417,185
Costs of issuance	<u>713,000</u>
TOTAL ESTIMATED USES	\$ 227,969,858

⁽¹⁾ Includes amounts for payment of accrued interest and redemption premium for the Refunded Bonds.

THE PROGRAM

History

The Department began making low interest rate farm and home financing available to veterans after World War I, following the enactment by the Legislature of the California Veterans Welfare Act of 1921. In 1943, the Legislature enacted the 1943 Act which modified the Program to meet new needs of veterans. The 1943 Act was superseded by the Veterans Farm and Home Purchase Act of 1974 (the "1974 Act") which again modified the Program. The 1943 Act established the 1943 Fund in the State Treasury, which is the principal fund utilized by the Program.

General

Under the Program, the Department acquires residential property to be sold to eligible veterans under Contracts of Purchase. Generally, a Contract of Purchase creates a land sale contract which is analogous to a loan from the Department to the veteran. See "—Contracts of Purchase – General." In the discussions pertaining to the Program and Contracts of Purchase which follow, these Contracts of Purchase or land sale arrangements may be referred to as loans.

The description of the Program hereunder is a description of the Program as it currently exists under the Veterans Code and the Department's implementation thereof, both of which are subject to change. The Program is also subject to the Federal Tax Code, as noted below.

Since its inception, the Program has assisted approximately 421,494 veterans to purchase farms and homes throughout the State and home improvement loans through long-term farm and housing Contracts of Purchase.

Program Financing

Since its inception, the Program has been financed from the sales of Revenue Bonds and Veterans G.O. Bonds as well as surplus revenues under the Program not needed at any given time to meet the then-current bond retirement schedules and operating costs. As of December 31, 2011, there were approximately 9,208 Contracts of Purchase outstanding with a remaining principal balance of approximately \$1.289 billion. As of December 31, 2011, the Department had approximately 17 pending applications for Contracts of Purchase in the total principal amount of approximately \$1.9 million. See APPENDIX C – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase" and "—Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments."

Certain Statutory Requirements

Certain requirements of the Veterans Code and the Federal Tax Code are discussed below.

Veterans Code

To participate in the Program, an applicant must meet qualifications established under the Veterans Code relating to status as a veteran. The Veterans Code allows the Department to finance Contracts of Purchase for:

(a) veterans who have served, generally, at least ninety consecutive days on active duty in the Armed Forces of the United States, unless sooner discharged because of a service-connected disability, have received an honorable discharge or been released from active duty under honorable conditions and have performed any portion of such service during one of the following periods:

(i) April 6, 1917 through November 11, 1918; December 7, 1941 through December 31, 1946; or June 27, 1950 through January 31, 1955 (such veterans are referred to as “Earlier War Veterans”);

(ii) February 28, 1961 through August 4, 1964 if the veteran served in the Republic of Vietnam during that period; or August 5, 1964 through May 7, 1975 (all veterans referred to in this clause (ii) are “Vietnam Era Veterans”); or

(iii) on or after August 2, 1990, through a date as yet to be determined by the President of the United States on which the territories in and around the Arabian Peninsula cease to be designated as a place where the Armed Forces of the United States are engaged in combat; at any time in Somalia, or in direct support of the troops in Somalia, during Operation Restore Hope, regardless of the number of days served; or at any time (regardless of the number of days served on active duty) in a campaign or expedition for service in which a medal was authorized by the United States Government (such veterans are referred to as “Recent War Veterans”);

(b) any member of the reserves or National Guard who (i) is called to, and released from, active duty or active service, regardless of the number of days served, (ii) is called during any period when a presidential executive order specifies the United States is engaged in combat or homeland defense and (iii) has received an honorable discharge or was released from active duty or active service under honorable conditions;

(c) any person who has served in the Merchant Marine Service of the United States and has been granted veteran status by the United States Secretary of Defense under Title IV of the GI Improvement Act of 1977 (Public Law 95-202, as amended);

(d) any person who qualifies under the Federal Tax Code for financing from Revenue Bonds or Pre-Ullman Moneys of the Department and who served in the active military, naval or air service for a period of not less than ninety consecutive days and who received an honorable discharge or was released from active duty under honorable conditions (such veterans are referred to as “Peacetime Veterans”); and

(e) any person who qualifies under the Federal Tax Code for financing from Revenue Bonds or Pre-Ullman Moneys of the Department and is at the time of

application for benefits a member of the California National Guard or a reserve component of any branch of the United States Armed Forces who has enlisted or been commissioned in that service for a period of not less than six years and has completed a minimum of one year of satisfactory service.

Certain veterans who have served in the recent conflicts in Iraq and Afghanistan qualify for participation in the Program under the Veterans Code. The qualifications specified in the Veterans Code are subject to change by the Legislature.

Federal Tax Code

The Federal Tax Code prescribes limitations on the use of moneys from certain sources for the financing of Contracts of Purchase. Such Federal Tax Code limitations reduce the pool of veterans eligible to receive Contracts of Purchase financed from certain sources. See APPENDIX H – “CERTAIN FEDERAL TAX CODE REQUIREMENTS.” Based on the current Federal Tax Code, the moneys that may be available to finance Contracts of Purchase from time to time are separated into three classes:

(a) “Pre-Ullman Moneys” (derived from certain moneys in the 1943 Fund, certain proceeds of Pre-Ullman (as defined below) Revenue Bonds and Veterans G.O. Bonds, and certain future issues of taxable bonds, if any), which can finance Contracts of Purchase for those veterans who qualify under the applicable provisions of the Veterans Code. (“Pre-Ullman” refers to the period prior to enactment of Federal Tax Code programmatic restrictions on the use of proceeds of tax-exempt bonds to finance mortgage loans.) The QMB Loan Eligibility Requirements (as defined below) do not apply to Contracts of Purchase financed by Pre-Ullman Moneys. The Department has implemented a policy (which is subject to change) to make Pre-Ullman Moneys available for Earlier War Veterans, Vietnam Era Veterans, Recent War Veterans and Peacetime Veterans;

(b) “Qualified Veterans’ Mortgage Bond Proceeds” or “QVMB Proceeds” (derived exclusively from proceeds of Veterans G.O. Bonds), which can finance Contracts of Purchase for any veteran who (i) qualifies under the Veterans Code; (ii) served on active duty; and (iii) applied for financing before the day 25 years after the last date on which such veteran left active service. The QMB Loan Eligibility Requirements (as defined below) do not apply to Contracts of Purchase financed by moneys derived exclusively from proceeds of Veterans G.O. Bonds. These proceeds can finance Contracts of Purchase for any veterans; and

(c) “Qualified Mortgage Bond Proceeds” or “QMB Proceeds” (derived principally from Revenue Bond proceeds other than Pre-Ullman Revenue Bond proceeds), which can finance Contracts of Purchase for any veterans who (i) qualify under the Veterans Code and (ii) meet the QMB Loan Eligibility Requirements. “QMB Loan Eligibility Requirements” include, among other things, and subject to certain exceptions contained in the Federal Tax Code, that borrowers (i) either (y) not have had a present ownership interest in their principal residence during the three-year period preceding the date of financing or (z) have not previously received financing of their Contracts of Purchase from the

proceeds of Qualified Mortgage Revenue Bonds pursuant to an exception for veterans to the requirement described in (y) (the “First Time Home Buyer Requirement”) or meet certain waiver conditions to the First Time Home Buyer Requirement, (ii) are eligible to finance the purchase of their residence with a purchase price not in excess of limits stated in the Federal Tax Code, (iii) must not have family incomes in excess of limits stated in the Federal Tax Code, (iv) may not use the proceeds of the financing to refinance an existing mortgage loan and (v) may use the proceeds of the financing solely for the purpose of financing one-family or one-to-four family dwelling units meeting certain criteria.

All financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the First Time Home Buyer Requirement.

Limits on Purchase Price

Veterans Code

The amount the Department finances is reflected in the Contract of Purchase as the “purchase price.” Under the Veterans Code, the maximum purchase price to the Department of an existing home or the sum to be expended by the Department pursuant to a Contract of Purchase for a home to be constructed may not exceed 125% of the current maximum loan limit for a single-family home, set by Federal National Mortgage Association, commonly know as Fannie Mae (“Fannie Mae”). At present, the Fannie Mae loan limit for a single-family home ranges between \$417,000 and \$625,500 depending on the county. Department policy limits the maximum purchase price to the Department of an existing home or for a home to be constructed to \$521,250. Under the Veterans Code, the maximum sum to be expended by the Department pursuant to a Contract of Purchase for a farm may not exceed 150% of the current maximum loan limit set by Fannie Mae. Department policy limits the maximum purchase price to the Department of a farm to \$625,500. Under the Veterans Code, the maximum purchase price to the Department of a mobile home located on or to be located on a leased or rented site in a mobile home park is \$175,000. The maximum purchase price for any home may be increased by an additional \$5,000 for certain purposes. As of December 31, 2011 the average principal balance of the Department’s Contracts of Purchase then outstanding was approximately \$140,000.

Federal Tax Code

The Federal Tax Code imposes maximum purchase prices on properties that are the subject of Contracts of Purchase financed by QMB Proceeds which are periodically adjusted when required by the Federal Tax Code. No Federal Tax Code purchase price limits apply to Contracts of Purchase financed from Pre-Ullman Moneys or QVMB Proceeds. These Federal Tax Code requirements vary depending upon where the property is located, if it is in a targeted or non-targeted area and whether it is a new or existing home.

The maximum purchase price under the Program is, therefore, the maximum amount permitted under the Veterans Code or, if the Contract of Purchase is being financed by QMB Proceeds, the lesser of the maximum amount permitted under the Veterans Code or the maximum amount permitted under applicable provisions of the Federal Tax Code.

Income Limits

Although the Veterans Code does not impose maximum income limits, the Federal Tax Code imposes maximum income limits applicable only to veterans obtaining Contracts of Purchase financed by QMB Proceeds. The income limits vary by statistical area and family size. No maximum income limits apply to veterans obtaining Contracts of Purchase financed by Pre-Ullman Moneys or QVMB Proceeds.

Allocation of Lendable Monies

For veterans who qualify for Contracts of Purchase from two or more of the financing sources described under “—Certain Statutory Requirements – Federal Tax Code,” above, the Department may select the source of funds to be used in its sole discretion. As of the date of this Official Statement Pre-Ullman Moneys are available through the prior issuance of Revenue Bonds and Veterans G.O. Bonds to finance Contracts of Purchase and QVMB Proceeds and QMB Proceeds are not available to finance Contracts of Purchase. The Department’s current policy is as follows:

- Contracts of Purchase for all veterans who qualify for financing with QMB Proceeds are funded from QMB Proceeds, when available.
- Contracts of Purchase for all other eligible veterans are funded first from QVMB Proceeds and then Pre-Ullman Moneys, when available.
- Available QMB Proceeds or recycling funds are used to fund Contracts of Purchase for National Guard or reserves members who are only eligible for those funds under State law. See “—Certain Statutory Requirements – Veterans Code.”

The Federal Tax Code includes certain procedures that an issuer of Qualified Mortgage Bonds may undertake to satisfy QMB Loan Eligibility requirements, but requires that 95% or more of the proceeds of each bond issue be used in full compliance with the loan eligibility restrictions.

Administration of the Program

General

Through the Program the Department finances the purchase of new and existing single-family homes, condominiums, farms and mobile homes, and the making of home improvements with respect to properties covered by existing Contracts of Purchase, subject to applicable restrictions. See “—Certain Statutory Requirements.”

Origination

The Department originates Contracts of Purchase through Department staff at its headquarters and field offices and through certain mortgage brokers and mortgage lenders approved by the Department. The Department uses an integrated loan processing and financial information system (“Mitas”) for origination and servicing of all Contracts of Purchase. All Contracts of Purchase are serviced by the Department. See “—Contracts of Purchase - Delinquencies and Cancellations.” The Department is in the process of upgrading the Mitas system to provide enhanced workflow management, document imaging, use of online account information, online payment options and online originations. An origination begins with the collection and evaluation of data regarding the veteran and the property to be acquired under the

Contract of Purchase. This evaluation includes an examination of the qualifications of the veteran applying for participation in the Program, a credit analysis of the veteran and the receipt of an appraisal for the applicable property.

If originated outside of the Department's headquarters, after an initial screening, the application and related data are forwarded to a centralized underwriting unit at the Department's headquarters for processing.

The history of the Department's originations of Contracts of Purchase is set forth in APPENDIX C – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience."

Underwriting Credit Analysis

The Department limits availability of financing to veterans on the basis of their personal credit status. The Department's manual underwriting process is centralized at the Department's headquarters and is comprised of the following: (i) review credit history, (ii) verify liabilities, (iii) identify and establish sources of verifiable income, (iv) determine housing expenses, including assessments, maintenance, utilities and taxes, (v) determine debt-to-income ratio, (vi) determine amount and source of down payment, (vii) verify assets required for costs to complete the transaction and (viii) verify that the collateral is acceptable. In evaluating these factors, it is the Department's policy to decide in favor of the veteran applicant if the Department determines that there is adequate security for the Contract of Purchase. See APPENDIX C – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience."

Contracts of Purchase with the United States Department of Veterans Affairs ("USDVA") guarantees require additional documentation in excess of the documents required for other Contracts of Purchase transactions specific to USDVA entitlement and indebtedness. See "—USDVA Guaranty Program; Loan Insurance."

The Department's underwriting requirements, according to an internal unaudited survey by the Department, have resulted in average borrower FICO credit scores at the time of origination in excess of 725 for transactions originated since January 1, 2004.

Subordinate Lending

The Veterans Code permits the Department to finance permanent home and property improvements for veterans with no existing financing or subordinate to existing financing (provided by lenders other than the Department) through the use of a deed of trust as the financing instrument. However, at present the Department does not provide financing for permanent home and property improvements for veterans that is subordinate to existing financing provided by lenders other than the Department. The Department permits the financing of down payments with subordinate financing.

Contracts of Purchase

General

Under a Contract of Purchase, the veteran has the benefits of ownership as the equitable owner of the property, but title to the property and improvements thereon is held by the Department as the legal owner until the final principal payment is made on the Contract of

Purchase. Property subject to a Contract of Purchase may not be transferred, assigned, encumbered, leased, let or sublet without the written consent of the Department. Any such permitted encumbrance must be junior or secondary to the Department's interest in the property.

Variation in the Terms of Contracts of Purchase

The terms of the Contracts of Purchase funded by Pre-Ullman Moneys, QVMB Proceeds or QMB Proceeds are substantially identical except as follows:

- Interest rates on Contracts of Purchase originated after January 1, 2011 have been and are expected to be fixed for the entire term of the loan. Interest rates on Contracts of Purchase originated prior to January 1, 2011 are fixed, subject to periodic adjustment as described in “—Interest Rates” below.
- The Federal Tax Code requires that Contracts of Purchase financed with QMB Proceeds include (a) more restrictions imposed on the right of a purchaser to assume the obligations under a Contract of Purchase than a Contract of Purchase financed by Pre-Ullman Moneys or QVMB Proceeds and (b) certain Federal Tax Code recapture provisions not included in Contracts of Purchase funded from other sources.

See also QMB Loan Eligibility Requirements under “—Certain Statutory Requirements – Federal Tax Code.”

Down Payment Requirements – Term of Contracts of Purchase

General

The Veterans Code, in certain cases, requires a veteran obtaining a Contract of Purchase to make an initial payment of at least 2% of either the purchase price or the market value of the property, whichever is less. Department policy requires a veteran obtaining a Contract of Purchase to make an initial payment of at least 3% of the purchase price, unless the veteran obtains a full USDVA Guaranty. In either case, the Veterans Code permits the balance of the purchase price to be amortized over a period fixed by the Department not exceeding 40 years. However, pursuant to Department policy, the Department issues all new Contracts of Purchase for a term of 30 years unless a shorter term is requested and except that certain Contracts of Purchase for mobile homes have shorter terms. See “—Mobile Homes Contracts of Purchase.”

USDVA Guaranteed Contracts of Purchase

If a veteran obtains a full USDVA Guaranty, subject to the Department's underwriting criteria, the Veterans Code permits such veteran to obtain a Contract of Purchase which does not require a down payment. In such cases the purchase price, including USDVA Guaranty fees, may be amortized over a period fixed by the Department, not exceeding 30 years and 32 days.

Interest Rates

The Department does not enter into Contracts of Purchase with low, adjustable introductory interest rates designed to attract potential borrowers (sometimes known as “teaser rates”) or with balloon payments. All outstanding Contracts of Purchase have been entered into with interest rates as follows:

Pre-January 1999 Contracts of Purchase

Contracts of Purchase originated prior to January 1, 1999 (“pre-1999 Contracts of Purchase”) bear interest at a rate which is set by the Department and may be changed with the approval of the Board and the Veterans’ Finance Committee. Most pre-1999 Contracts of Purchase currently bear interest at a rate of 6.95%. The Veterans Code requires that, generally, all pre-1999 Contracts of Purchase bear the same interest rate and that such interest rate can be changed annually as deemed necessary. The effective date of a higher rate of interest on pre-1999 Contracts of Purchase may occur only once in any calendar year unless a finding is made by the Board and the Veterans’ Finance Committee that such additional action is necessary to protect the solvency of the 1943 Fund.

Post-December 1998 – December 2010 Contracts of Purchase

Contracts of Purchase originated on or after January 1, 1999 and prior to January 1, 2011 (“post-1998 Contracts of Purchase”) are not required to be uniform with respect to interest rates and the Department may modify interest rates applicable to post-1998 Contracts of Purchase, which may be fixed or variable, and the methodology and timing for determining or modifying interest rates applicable to post-1998 Contracts of Purchase, from time to time, subject to the approval of the Board and the Veterans’ Finance Committee. The interest rates on post-1998 Contracts of Purchase may be adjusted by the Department up to one-half of one percent (0.5%) over the term of the applicable post-1998 Contracts of Purchase.

Post-December 2010 Contracts of Purchase

Pursuant to Department policy all Contracts of Purchase entered into by the Department on or after January 1, 2011, have fixed interest rates which may not be adjusted by the Department over the term of such Contracts of Purchase.

As of December 31, 2011 interest rates for new Contracts of Purchase are as follows:

**Interest Rates for New Contracts of Purchase
As of December 31, 2011**

<u>Interest Rate</u>	<u>Funding Source</u>
5.25%	QMB Proceeds
5.50	QVMB Proceeds
5.95	Pre-Ullman Moneys

Source: Department of Veterans Affairs.

See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Selected Principal Flows with respect to Contracts of Purchase Funded by both Veterans G.O. Bonds and Revenue Bonds – Reservation Rates on new Contracts of Purchase” for historical interest rates for new Contracts of Purchase. See also “PLAN OF FINANCE.”

Interest Rate Setting

Interest rates on Contracts of Purchase are expected to be established, from time to time, based on various factors deemed appropriate by the Department, subject in all cases to the requirements of the Veterans Code and Resolution RB-1 for the filing of a Cash Flow Statement and conformity with Program Operating Procedures. See APPENDIX C – “CERTAIN

DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Selected Principal Flows with respect to Contracts of Purchase Funded by both Veterans G.O. Bonds and Revenue Bonds.” See also “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – Cash Flow Statements and Program Operating Procedures” and “—Cash Flow Statements to be Delivered in Connection with the Offered Revenue Bonds.”

Origination Fees for Contracts of Purchase

The Department collects an origination fee equal to 1% of the purchase price of the property in addition to any down payment which may be required in connection with a Contract of Purchase. The origination fee is collected at close of escrow on all new Contracts of Purchase and must be paid in escrow. If the Contract of Purchase is originated through an approved mortgage broker or mortgage lender, the origination fee is paid to the mortgage broker or mortgage lender through the escrow. If the Contract of Purchase is originated through the Department, the origination fee is retained by the Department.

Prepayment Penalties

There are no prepayment penalties on any Contracts of Purchase. The Department’s actual past prepayment experience for existing Contracts of Purchase is set forth in APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Contracts of Purchase Origination and Principal Repayment Experience.”

Delinquencies and Cancellations

Economic Considerations

Since 2007, events in the national and global economy and financial markets, including falling home prices, limited credit availability, financial instability, failures of banks and other major financial institutions, a downturn in consumer spending, declining real property and investment values and increased job losses, among other factors, have weighed heavily on the global, national and State economies, particularly in the State housing market. The declines in residential real estate values have resulted in reduced home equity and higher loan-to-value ratios. Higher loan-to-value ratios generally result in lower recoveries on foreclosure, and an increase in losses above those that would have been realized had property values remained stable or continued to increase after origination. Generally, the Department does not track the amount of home equity or loan-to-value ratios for homes under Contracts of Purchase. Reductions in home equity or loan-to-value ratios for homes under Contracts of Purchase may result in an increase in losses after the cancellation of a Contract of Purchase.

High loan-to-value ratios, recessive economic trends and high levels of unemployment in the United States continue to be primary indicators of delinquencies, foreclosures and cancellations. The continuing effects of the recent economic recession, including depressed property values and high unemployment, could increase the likelihood of delinquencies, foreclosures and cancellations in other economic areas. A general unavailability of credit and sustained job losses or an increase in job losses may adversely affect the overall economy in ways that result in increased delinquencies, foreclosures, cancellations and REO of the Contracts of Purchase.

The mortgage and residential real estate markets periodically face uncertainties that create risk for market participants, including the Department. General market uncertainties that exist from time to time include interest rate volatility, changes in tolerance for credit risk, unavailability of certain mortgage products, decline or instability in residential real estate values, concerns about the financial health and market participation of Fannie Mae and Freddie Mac and other secondary mortgage market participants, changes in legislative requirements relating to mortgage lending disclosure and the exercise of mortgage remedies, the health of various financial institutions, insurance companies and other market participants and the health of the residential construction industry. Many sectors of the California residential real estate market have experienced, to varying degrees, increasing mortgage loan delinquency and foreclosure rates and declines in the market value of residences. The increase in delinquencies and foreclosures has not been limited to so-called “subprime” mortgage loans, which are generally made to borrowers with impaired credit made to borrowers often with limited documentation but has also affected mortgage loans generally and so-called “prime” mortgage loans, which are generally made to borrowers with relatively higher credit who frequently provide full documentation.

Delinquency and Cancellation Data

As of December 31, 2011 (i) approximately 4.05% of the outstanding number of the Department’s Contracts of Purchase were 30 to 60 days delinquent (or approximately 5.00% of the then outstanding principal amount of the Department’s Contracts of Purchase); (ii) approximately 3.96% of the outstanding number of the Department’s Contracts of Purchase were more than 60 days delinquent (or approximately 5.05% of the then outstanding principal amount of the Department’s Contracts of Purchase); (iii) approximately 0.83% of the outstanding number of the Department’s Contracts of Purchase were foreclosed upon or cancelled (or approximately 1.12% of the then outstanding principal amount of the Department’s Contracts of Purchase); and (iv) approximately 0.64% of the outstanding number of the Department’s Contracts of Purchase were REO in inventory (or approximately 0.81% of the then outstanding principal amount of the Department’s Contracts of Purchase). As of September 30, 2011 (i) approximately 3.76% of the outstanding number of the Department’s Contracts of Purchase were 30 to 60 days delinquent (or approximately 4.65% of the then outstanding principal amount of the Department’s Contracts of Purchase); (ii) approximately 3.80% of the outstanding number of the Department’s Contracts of Purchase were more than 60 days delinquent (or approximately 4.83% of the then outstanding principal amount of the Department’s Contracts of Purchase); (iii) approximately 0.89% of the outstanding number of the Department’s Contracts of Purchase were foreclosed upon or cancelled (or approximately 1.30% of the then outstanding principal amount of the Department’s Contracts of Purchase); and (iv) approximately 0.67% of the outstanding number of the Department’s Contracts of Purchase were REO in inventory (or approximately 0.85% of the then outstanding principal amount of the Department’s Contracts of Purchase).

With respect to USDVA guaranteed Contracts of Purchase, as of December 31, 2011: (i) approximately 5.71% of the outstanding number of the Department’s Contracts of Purchase guaranteed by the USDVA were 30 to 60 days delinquent (or approximately 6.67% of the then outstanding principal amount of the Department’s Contracts of Purchase guaranteed by the USDVA); (ii) approximately 6.04% of the outstanding number of the Department’s Contracts of Purchase guaranteed by the USDVA were more than 60 days delinquent (or approximately 6.49% of the then outstanding principal amount of the Department’s Contracts of Purchase

guaranteed by the USDVA); and (iii) approximately 0.85% of the outstanding number of the Department's Contracts of Purchase guaranteed by the USDVA had been cancelled, transferred and purchased by, the USDVA (or approximately 1.01% of the then outstanding principal amount of the Department's Contracts of Purchase guaranteed by the USDVA). With respect to USDVA guaranteed Contracts of Purchase, as of September 30, 2011: (i) approximately 5.24% of the outstanding number of the Department's Contracts of Purchase guaranteed by the USDVA were 30 to 60 days delinquent (or approximately 5.92% of the then outstanding principal amount of the Department's Contracts of Purchase guaranteed by the USDVA); (ii) approximately 6.00% of the outstanding number of the Department's Contracts of Purchase guaranteed by the USDVA were more than 60 days delinquent (or approximately 6.37% of the then outstanding principal amount of the Department's Contracts of Purchase guaranteed by the USDVA); and (iii) approximately 1.96% of the outstanding number of the Department's Contracts of Purchase guaranteed by the USDVA had been cancelled, transferred and purchased by, the USDVA (or approximately 1.98% of the then outstanding principal amount of the Department's Contracts of Purchase guaranteed by the USDVA). See "—USDVA Guaranty Program; Loan Insurance."

The delinquency and foreclosure rates as of September 30, 2011 noted in the preceding paragraphs exceed the delinquency and foreclosure rates as reported in the September 30, 2011 National Delinquency Survey published by the Mortgage Bankers Association of America (the "Survey") for USDVA guaranteed loans in California for the same period. Pursuant to the Survey, with respect to USDVA guaranteed loans as of September 30, 2011 (i) approximately 2.38% of the outstanding number of loans in California and 3.32% nationally were 30 to 60 days delinquent (the Survey does not report outstanding principal amounts), (ii) approximately 2.54 % of the outstanding number of loans in California and 3.60% nationally were more than 60 days delinquent; and (iii) 1.40% of the outstanding number of loans in California and 2.25% nationally were cancelled, transferred and purchased by the USDVA. Pursuant to the Survey, with respect to prime loans as of September 30, 2011 (i) approximately 2.00% of the outstanding number of loans in California and 2.30% nationally were 30 to 60 days delinquent, (ii) approximately 4.24% of the outstanding number of loans in California and 3.03% nationally were more than 60 days delinquent; and (iii) 3.11% of the outstanding number of loans in California and 3.37% nationally were foreclosures in inventory. In comparison, the outstanding total number of the Department's Contracts of Purchase that were foreclosed upon or cancelled was substantially lower at 0.89% as of September 30, 2011. In the Survey, loans are categorized as prime loans or otherwise based upon the Survey respondents' internal classifications.

With respect to Contracts of Purchase insured under the Radian Policies (as defined below) as of December 31, 2011: (i) approximately 4.98% of the outstanding number of the Department's Contracts of Purchase insured under the Radian Policies were 30 to 60 days delinquent (or approximately 5.60% of the then outstanding principal amount of the Department's Contracts of Purchase insured under the Radian Policies); (ii) approximately 5.01% of the outstanding number of the Department's Contracts of Purchase insured under the Radian Policies were more than 60 days delinquent (or approximately 6.10% of the then outstanding principal amount of the Department's Contracts of Purchase insured under the Radian Policies); (iii) approximately 1.46% of the outstanding number of the Department's Contracts of Purchase insured under the Radian Policies had been foreclosed upon or cancelled (or approximately 1.86% of the then outstanding principal amount of the Department's Contracts of Purchase insured under the Radian Policies); and (iv) approximately 1.17% of the outstanding number of the Department's Contracts of Purchase insured under the Radian Policies were REO

in inventory (or approximately 1.38% of the then outstanding principal amount of the Department's Contracts of Purchase insured under the Radian Policies). See "—USDVA Guaranty Program; Loan Insurance – Primary Mortgage Insurance."

As of December 31, 2011, Contracts of Purchase entered into from 2005 through and including 2008 accounted for approximately 32.73% of the total number of the Department's Contracts of Purchase (or approximately 48.37% of the then outstanding principal amount of the Department's Contracts of Purchase). As of December 31, 2011, Contracts of Purchase entered into from 2005 through and including 2008 accounted for approximately 47.41% of the total number the Department's delinquent Contracts of Purchase (or approximately 63.58% of the then outstanding principal amount of the Department's delinquent Contracts of Purchase).

For the fiscal year ended June 30, 2011, the Department experienced approximately \$14.4 million in loan losses resulting from REO sales and approximately \$10.2 million in loan losses resulting from short sales. Gains or losses on REO sales, short sales, and USDVA Guaranty claims with losses can be expected to fluctuate based on the market and other considerations during the period that the Offered Revenue Bonds are outstanding. For the six month period ended December 31, 2011, the Department experienced approximately \$6.5 million in loan losses from REO sales and approximately \$5.2 million in loan losses from short sales and USDVA Guaranty claims with losses. See "—USDVA Guaranty Program; Loan Insurance – USDVA Guaranty Program" regarding limitations of USDVA Guaranties and factors which may cause a lender to incur a loss on a Contract of Purchase guaranteed by the USDVA.

In connection with its audited financial statements, an allowance for uncollectible Contracts of Purchase is established through a provision charged to operations. The allowance is an amount that the Department's management believes will be adequate to absorb losses with respect to Contracts of Purchase based, among other things, on prior loss experience and the outstanding aggregate principal amount of Contracts of Purchase. See APPENDIX A – "FINANCIAL STATEMENTS OF THE 1943 FUND FOR FISCAL YEARS 2011 AND 2010 AND INDEPENDENT AUDITORS' REPORT" and APPENDIX C – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Cancellations and Delinquencies."

Department Procedures for Addressing Delinquencies and Cancellations

The following is a description of the Department's procedures for addressing delinquencies and cancellations, which procedures are subject to change while the Offered Revenue Bonds are Outstanding.

If a veteran fails to comply with any of the terms of a Contract of Purchase the Department may terminate the Contract of Purchase and be released from all obligations thereunder, at law or in equity. In such event, the veteran's rights under the Contract of Purchase may be forfeited and all payments made by the veteran prior to termination of the Contract of Purchase by the Department would be deemed to be rental paid for occupancy of the property by the veteran. In the event the veteran's rights under the Contract of Purchase are forfeited, the Department takes possession of the property for the purposes of reselling it. The Department may, for good cause, permit the postponement from time to time, and upon such terms as it deems proper, of the payment of the whole or any part of any installment.

If a veteran does not make a payment by the 16th day of the month in which the payment is due, the payment is considered “late.” Mitas is to generate a reminder letter automatically if payment is not received by the 20th day of the month, which advises the veteran that payment has not been received. If payment is not received by the 30th day of the month, a second reminder letter is to be issued and the Contract of Purchase installment payment is considered “delinquent.” After the second reminder letter is issued the Department’s staff also initiates telephone contact with the veteran. If the Contract of Purchase installment payment remains delinquent 60 days, a Notice of Intent to Cancel Contract (“NICC”) is issued to notify the veteran that the Contract of Purchase may be cancelled at the end of a 30-day notice period unless the Contract of Purchase installment payment is brought current. Department personnel continue to initiate telephone contact with veterans with delinquent Contract of Purchase installment payments. If the veteran has not paid by the 70th day of the delinquency, a letter is to be issued reminding the veteran that he or she must bring the Contract of Purchase installment payment current within 30 days of the NICC date (the “70 Day Reminder Letter”). A schedule for liquidation of delinquent Contract of Purchase installment payments satisfactory to the Department is arranged during this period; however, if the Contract of Purchase installment payment remains delinquent 21 days after the issuance of the 70 Day Reminder Letter and no schedule for liquidation of delinquent installment payments has been agreed upon, the Department may begin cancellation of the Contract of Purchase. If a schedule of liquidation has been agreed to with respect to a Contract of Purchase and the veteran makes all regularly scheduled installment payments and liquidation payments on a timely basis, the Department does not initiate cancellation of the Contract of Purchase.

The Collections, Foreclosure and REO Unit at the Department’s headquarters monitors the delinquency throughout this process, orders a title search to identify any junior lienholders and then commences pre-cancellation processing in accordance with the California Code of Regulations. Junior lienholders are sent notices giving them 30 days (40 days in the case of Federal tax liens) to protect their interest by beginning foreclosure proceedings. If the Contract of Purchase installment payment is not brought current during the notice period to junior lienholders and no junior lienholder proceeds with a foreclosure action to protect its interest, the Department’s Collections, Foreclosure and REO Unit cancels the Contract of Purchase and a Notice of Cancellation is mailed to the veteran and recorded with the applicable county recorder. The Department’s Foreclosure Unit then takes steps to evict occupants and clear any remaining liens. If judicial action is required, the case is referred to the Department’s Law Division for additional processing. In some cases, foreclosure on defaulted Contracts of Purchase may be deferred or delayed due to high volume of foreclosures or other factors. If moratoriums on foreclosures are enacted in California, such moratoriums may cause delays and increased expenses associated with foreclosures may increase realized losses.

If a Contract of Purchase guaranteed by the USDVA goes into default, the USDVA has the option of purchasing the related property for a percentage of the property’s appraised value and paying on the USDVA Guaranty or only paying the claim. If the USDVA elects to only pay the claim, the related property becomes Department REO. After the sale of the property, either to USDVA or through Department REO, the USDVA will pay an amount based upon the veteran’s entitlement under its USDVA Guaranty toward the lesser of the unpaid principal, accrued interest and foreclosure expenses or the original loan amount within the USDVA-approved limits.

After all remaining liens are removed and the property is vacant, the repossessed property is repaired and improved, if necessary and feasible, and is marketed through the Department's Collections, Foreclosure and REO Unit which uses a Pre-Advertising Listing ("PAL") program. Under the PAL program the property is listed for sale with a licensed real estate broker or agent, at an overall commission rate which typically does not exceed 6%. The Department is required to advertise and accept sealed offers during a 2-week period, after which the property may be sold to the highest acceptable bidder (best net return). If no acceptable bids are received, the property continues to be marketed by the listing real estate agent or broker until an acceptable offer is received and the property is sold. All sales of REO assets are required to be conducted in accordance with the California Code of Regulations.

If a veteran is struggling to make payments on a Contract of Purchase the Department may enter into a repayment agreement ("Repayment Agreement") with the veteran. Generally, a Repayment Agreement is used to implement a short-term restructuring of the payments under the Contract of Purchase, to accommodate temporary financial difficulties. As of December 31, 2011 the Department had Repayment Agreements in place for approximately 1.18% of the total then outstanding number of Contracts of Purchase (or approximately 1.48% of the then outstanding principal amount of the Department's Contracts of Purchase).

Additionally, if a veteran is able to demonstrate financial hardship to the Department, the Department may modify the Contract of Purchase to assist the veteran. Modifications may extend the term of the Contract of Purchase up to a 40 year term for most Contracts of Purchase and up to a 30 year term for a Contract of Purchase financing a mobile home in a mobile home park. When extending the term of the Contract of Purchase the Department reduces the monthly installment payments. In cases where the veteran has already defaulted on the Contract of Purchase at the time of the veteran's hardship assistance request, the Department may allow the veteran to make reduced payments under a Repayment Agreement for six months. Thereafter, the Department may approve a hardship deferral of the outstanding delinquent interest (and in rare cases, principal) on the Contract of Purchase. In such cases the delinquent interest (or principal) is due and payable upon the sale of the property, further encumbrance of the property or upon the maturity of the loan. In some cases the Department may also re-amortize the past due principal. As of December 31, 2011, 222 Contracts of Purchase were subject to hardship deferrals.

The Department permits a sale of a property in which the proceeds from the sale of the property will not be sufficient to pay the remaining amounts due under the Contract of Purchase (a distress sale or short sale) in situations where the Department determines significant hardship will occur if the holder of a Contract of Purchase is not permitted to enter into a short sale. Situations where short sale may be permitted include, job relocation, a divorce which requires sale of the property, loss of employment or illness.

To be considered for a short sale, the Department requires a contract holder to submit a written explanation of the hardship and supporting documentation, including financial records. The Department reviews all estimated costs involved in the proposed short sale and only permits reasonable costs to be included in the short sale. In connection with the evaluation of a short sale the Department obtains the market value of the property through an appraisal, broker opinion of value or comparative market analysis report, as the Department determines appropriate. The Department compares the proposed short sale with the Department's projected recovery from the property as REO taking into consideration whether the Contract of Purchase is subject to a

USDVA Guaranty or the Radian Policies (as defined below) and the amounts that may be realized in connection with a claim thereunder. USDVA approval is not required for a short sale and if the Contract of Purchase is subject to a USDVA Guaranty and the short sale is completed, the Department is permitted to submit a claim with the USDVA. If the Contract of Purchase is subject to a USDVA Guaranty and the Department sells the property as a Department REO, claim monies can be received and are also considered in the analysis. If the Contract of Purchase is subject to the Radian Policies, then the short sale requires Radian approval. Once Radian approves the short sale, Radian informs the Department of the claim amount approved for payment. Claim monies to be received for a Radian insured Contract of Purchase sold as a Department REO are also considered in the analysis. Upon consideration of the various options the Department pursues the most cost effective approach that provides the greatest benefit to the Department. The Department requires the parties to the short sale to execute, under the penalty of perjury, a transaction certification statement certifying that the sale is a true “arms length” transaction. No sales proceeds are permitted to go to the holder of the Contract of Purchase.

For the six-month period ended December 31, 2010, approximately 0.24% of the outstanding number of the Department’s Contracts of Purchase were approved for short sales (or approximately 0.10% of the then outstanding principal amount of the Department’s Contracts of Purchase). For the six-month period ended December 31, 2011, approximately 0.27% of the outstanding number of the Department’s Contracts of Purchase were approved for short sales (or approximately 0.14% of the then outstanding principal amount of the Department’s Contracts of Purchase).

The Federal Relief Act and the California Relief Act (each as described below) also require certain extensions of Contracts of Purchase terms. See “—Legislative Protection of Veterans” herein. The Department’s policies regarding delinquencies and cancellations conform to USDVA Guaranty program requirements and Radian (as defined below) guidelines.

The federal government, State and local governments, consumer advocacy groups and others continue to urge modifications of mortgage loans to avoid foreclosure, and federal, State and local governmental authorities have enacted and continue to propose numerous laws and regulations relating to mortgage loans generally and to foreclosure actions in particular. Any of these laws or regulations may delay foreclosure or provide new defenses to foreclosure or result in reduced payments by borrowers, permanent forgiveness of debt and increased prepayments due to the availability of government-sponsored refinancing initiatives. In addition, in certain cases judicial decisions have delayed or prevented foreclosure.

Further, the federal government has undertaken a number of measures designed to address the current economic difficulties facing the United States including relief programs established by the USDVA. Additional measures and legislation may be considered by the federal government, or the State Legislature, which measures may affect the Program, the Revenue Bonds or the Contracts of Purchase. While some of these measures may benefit the Program, no assurance can be given that the Program, the Revenue Bonds or the Contracts of Purchase will not be adversely effected by such measures.

See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Cancellations and Delinquencies” for additional information regarding the status of Contracts of Purchase.

Keep Your Home California

The California Housing Finance Agency formed the CalHFA Mortgage Assistance Corporation, a separate nonprofit public benefit corporation, to act as an institution eligible to receive applicable Federal funding. This affords access to Federal funding through the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets established by the United States Department of the Treasury in connection with federal programs authorized under the Emergency Economic Stabilization Relief Act of 2008 and the Troubled Asset Relief Program. CalHFA Mortgage Assistance Corporation has received nearly \$2 billion in Federal awards to fund its Keep Your Home California program through 2017. The Keep Your Home California program consists of four programs: the Unemployment Mortgage Assistance Program, the Mortgage Reinstatement Assistance Program, the Principal Reduction Program and the Transition Assistance Program. The Department has elected to participate in each of the programs.

The Unemployment Mortgage Assistance Program provides mortgage payment assistance to eligible homeowners who have experienced an involuntary job loss and are receiving California unemployment benefits. Benefit assistance through the Unemployment Mortgage Assistance Program may be up to \$3,000 per month and is permitted to last up to nine months. The maximum assistance per household is \$27,000. CalHFA Mortgage Assistance Corporation has allocated approximately \$875 million for the Unemployment Mortgage Assistance Program.

The Mortgage Reinstatement Assistance Program provides assistance to eligible homeowners who, because of a financial hardship, are delinquent and seek assistance to reinstate a delinquent first mortgage loan. Benefit assistance through the Mortgage Reinstatement Assistance Program is permitted up to \$20,000 to cover principal, interest, taxes and insurance and may include delinquent homeowners' association dues. CalHFA Mortgage Assistance Corporation has allocated approximately \$160 million for the Mortgage Reinstatement Assistance Program.

The Principal Reduction Program provides assistance to eligible homeowners who have experienced an economic hardship and a severe decline in the home's value. Homeowners who qualify for the Principal Reduction Program may be eligible for up to \$50,000 in assistance. The Principal Reduction Program is designed for participating lenders/servicers to provide a dollar-for-dollar match for principal reduction up to \$100,000. As a servicer of loans funded by qualified tax-exempt bonds, the Department is not required to match principal reduction funds, as other servicers are required to do. CalHFA Mortgage Assistance Corporation has allocated approximately \$772 million for the Principal Reduction Program.

The Transition Assistance Program provides one-time funds to help eligible homeowners relocate into new housing after executing a short sale or deed-in-lieu of foreclosure program. The Transition Assistance Program is permitted to provide up to \$5,000 in transition assistance per household. CalHFA Mortgage Assistance Corporation has allocated approximately \$2.3 million for the Transition Assistance Program.

Eligibility for Keep Your Home California programs may be limited by, among other things, current unpaid principal balance of applicable loans, owner occupancy, date of loan origination and available program funds. Program exclusions also apply.

Assistance provided in connection with the Unemployment Mortgage Assistance Program, Mortgage Reinstatement Assistance Program and Principal Reduction Program (where CalHFA Mortgage Assistance Corporation receives less than 100% match by the applicable lender/servicer) is structured as a non-recourse, non-interest bearing subordinate loan in favor of CalHFA Mortgage Assistance Corporation secured by a junior lien on the applicable home. At the conclusion of three years, the subordinate loan will be released. In the event of a sale or refinancing of the property, the contract holder is required to repay the subordinate loan when there are sufficient proceeds.

Since January 2011, the Department has participated in the Keep Your Home California program and as of December 31, 2011 has received approximately \$1,267,527 benefiting approximately 113 Contracts of Purchase, as follows: (i) approximately \$438,647 from the Unemployment Mortgage Assistance Program benefiting approximately 40 Contracts of Purchase, (ii) approximately \$184,579 from the Mortgage Reinstatement Assistance Program benefiting approximately 22 Contracts of Purchase, (iii) approximately \$639,301 from the Principal Reduction Program benefiting approximately 50 Contracts of Purchase; and (iv) approximately \$5,000 from the Transition Assistance Program benefiting approximately 1 Contract of Purchase.

Late Fees

Late charges are applied to Contracts of Purchase that have a remaining amount due of \$25 or more at the close of any account month. The late charge imposed on Contracts of Purchase originated before October 1984 is \$10. The late charge imposed on Contracts of Purchase originated during and after October 1984 is 4% of the principal and interest portion of the installment, consistent with late charges authorized by the USDVA.

Additional Financing

Any veteran who qualifies under the Veterans Code and the Federal Tax Code may be granted a subsequent Contract of Purchase so long as any previous Contract of Purchase has been paid in full or the veteran lost his or her interest in the previous Contract of Purchase through divorce or dissolution of marriage.

Mobile Homes Contracts of Purchase

The Veterans Code permits the Department to issue Contracts of Purchase for the purchase of mobile homes. If the mobile home is located on land for which the Department obtains title, the Contract of Purchase is treated by the Department in substantially the same manner as Contracts of Purchase to finance the purchase of single family residences. If the mobile home is located where the Department does not obtain title to the land, the Contract of Purchase is issued by the Department only where the mobile home is in a qualified mobile home park. In such cases the Contract of Purchase is issued with a term of less than thirty years and an interest rate which is 1% higher than the interest rate for Contracts of Purchase issued to finance the purchase of single family residences. Mobile home parks are qualified by Department underwriting staff on a case-by-case basis based on a review of the appraisal, condition of the park, other minimum property standards and the park's rental agreement. The Department also requires the mobile home park management to approve the transaction.

As of December 31, 2011, approximately 7.24% of the then outstanding total number of the Department's Contracts of Purchase financed mobile homes in a mobile home park (or

approximately 3.22% of the then outstanding principal amount of the Department's Contracts of Purchase).

As of December 31, 2011, (i) approximately 5.25% of the outstanding number of the Department's Contracts of Purchase financing mobile homes in a mobile home park were 30 to 60 days delinquent (or approximately 5.45% of the then outstanding principal amount of the Department's Contracts of Purchase financing such mobile homes); (ii) approximately 5.25% of the outstanding number of the Department's Contracts of Purchase financing mobile homes in a mobile home park were more than 60 days delinquent (or approximately 5.62% of the then outstanding principal amount of the Department's Contracts of Purchase financing such mobile homes); (iii) approximately 1.50% of the outstanding number of the Department's Contracts of Purchase financing mobile homes in a mobile home park had been foreclosed upon or cancelled (or approximately 1.74% of the then outstanding principal amount of the Department's Contracts of Purchase financing such mobile homes); and (iv) approximately 2.85% of the outstanding number of the Department's Contracts of Purchase financing mobile homes in a mobile home park were REO in inventory (or approximately 3.27% of the then outstanding principal amount of the Department's Contracts of Purchase financing such mobile homes).

In April 2009, the Department revised its policies to limit financing of mobile homes in mobile home parks due to an increase in the percentage of the Department's REO in mobile home parks. New single-wide units may be financed for up to 15 years and a 15% down payment is required. New multi-wide units may be financed for up to 20 years and a 10% down payment is required. Used multi-wide units may be financed for the lesser of 20 years or the economic life expectancy of the unit and a 15% down payment is required. No financing is available for used single-wide units or mobile homes which are over 20 years old.

See APPENDIX C – "CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011" and "—Cancellations and Delinquencies" for additional information.

Home Improvement Contracts of Purchase

The Veterans Code permits the Department to finance permanent home and property improvements. Currently, when a home improvement Contract of Purchase is issued, the amount of total financing, including the balance of the original Contract of Purchase, the amount of the improvement Contract of Purchase and any other encumbrances, is not permitted to exceed 90% of the improved market value of the property. The Department relies on current market data from a third party information provider to develop formal opinions of value for a determination of the improved market value of the property. Typically the total loan-to-value ratio at origination of a home improvement Contract of Purchase is lower than 90%.

The Department distributes the proceeds from a home improvement Contract of Purchase either to the contractors (or vendors) directly as the improvements are completed or to the veteran as reimbursement for actual construction costs. For a home improvement Contract of Purchase which is subordinate to an existing Contract of Purchase, a separate Contract of Purchase covering only the improvements is executed. The subordinate Contract of Purchase bears interest at the same rate as the veteran's existing Contract of Purchase where the home improvement Contract of Purchase was entered into prior to January 1, 2005, or at current Department rates where the home improvement Contract of Purchase was entered into on or after

January 1, 2005. Home improvement Contracts of Purchase are issued with a term of up to 25 years. Generally, the terms of the original Contract of Purchase and the home improvement Contract of Purchase mature separately and do not exceed 40 years from their respective origination dates. An origination fee of 1.5% of the home improvement Contract of Purchase amount is assessed. Except in the case of hardship or in connection with safety concerns, home improvement Contracts of Purchase, generally, are not approved for veterans who have had significant delinquencies in the 12 months immediately preceding the application.

The maximum home improvement Contract of Purchase for veterans funded with QMB Proceeds is \$15,000. Home improvement Contracts of Purchase funded with Pre-Ullman Moneys or QVMB Proceeds are available up to a maximum of \$150,000. Subsequent home improvement Contracts of Purchase may be granted, if funds are available to the Department, so long as there is only one home improvement Contract of Purchase per veteran outstanding at any time. Currently, approximately 1% of the total principal balance of all Contracts of Purchase are derived from home improvement Contracts of Purchase. As of December 31, 2011, the average principal balance of the Department's home improvement Contracts of Purchase then outstanding was approximately \$21,483.

As of December 31, 2011, approximately 8.09% of the then outstanding total number of the Department's Contracts of Purchase financed permanent home and property improvements (or approximately 1.24% of the then outstanding principal amount of the Department's Contracts of Purchase).

See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011” for additional information.

Construction Contracts of Purchase

Contracts of Purchase entered into to finance the purchase of a building site and construction of a home are also available. Qualifying sites include undeveloped land, lots in subdivision developments and sites in non-profit self-help developments. Mobile homes in parks do not qualify. Construction of the improvements must be performed by a contractor licensed in the State. The Department does not submit Contracts of Purchase that finance home construction for USDVA Guaranty.

As of December 31, 2011, approximately 5.25% of the then outstanding total number of the Department's Contracts of Purchase financed the purchase of a building site and construction of a home (or approximately 7.16% of the then outstanding principal amount of the Department's Contracts of Purchase).

See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011” for additional information.

Pooled Self-Insurance Fund

In October 2009, the Veterans Code was amended to permit the creation of a pooled self-insurance fund (the “Pooled Self-Insurance Fund”) to allow the Department to pool certain of its funds and accounts. The Pooled Self-Insurance Fund has been established in the State Treasury and is comprised of moneys of the Department previously on deposit in the Disaster Indemnity Fund, the Fire and Hazard Insurance Account, the Legacy Self-Insured Disability Coverage

Account and the Primary Mortgage Insurance Account, each as defined below. Under the Veterans Code, if claims under one Pooled Self-Insurance Fund account exceed funds available in such account, the Department is permitted to borrow from other Pooled Self-Insurance Fund accounts within the Pooled Self-Insurance Fund rather than draw on the 1943 Fund. The Department is also permitted to borrow from the 1943 Fund upon declaration of emergency by the Secretary. Amounts borrowed from other Pooled Self-Insurance Fund Accounts or the 1943 Fund must be repaid within three years. As of the date of this Official Statement, the Department has not borrowed from the 1943 Fund as permitted by the Veterans Code. The Veterans Code also requires the Department to manage rates charged to the holders of Contracts of Purchase for each account in the Pooled Self-Insurance Fund, so that each account is self-sufficient. Under the Veterans Code, the Department is permitted to insure or reinsure the risks payable out of the Pooled Self-Insurance Fund. The Department has insured risks payable out of the Disaster Indemnity Fund and the Fire and Hazard Insurance Account. See also “—USDVA Guaranty Program; Loan Insurance” and “—Life and Disability Insurance.”

USDVA Guaranty Program; Loan Insurance

Significant principal amounts of Contracts of Purchase in the Department’s portfolio are not covered by a USDVA Guaranty or primary mortgage insurance. See APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase – Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011.”

USDVA Guaranty Program

The Servicemen’s Readjustment Act of 1944, as amended, permits a veteran (or in certain instances the veteran’s spouse) to obtain a guaranty from the USDVA covering mortgage financing for the purchase or construction of certain dwelling units at interest rates permitted by the USDVA (a “USDVA Guaranty”). The USDVA Guaranty Program sets loan guaranty limits depending on the size of the loan and the location of the property and permits the guaranty of mortgage loans of up to 30 years and 32 days’ duration unless the USDVA, in its sole discretion, approves an extension. Under the USDVA Guaranty Program, the maximum USDVA Guaranty on a loan is an amount equal to 25% of the applicable USDVA limit. The USDVA loan limit for loans originated on or after January 1, 2012 is generally \$104,250 (equal to 25% of \$417,000, the general Fannie Mae loan limit for single-family homes); however the USDVA loan limit for loans originated for homes in certain counties, including many counties in California, on or after January 1, 2012, may be as high as \$156,375 (equal to 25% of \$625,500, the general Fannie Mae loan limit for single-family homes for such counties). See “—Certain Statutory Requirements – Limits on Purchase Price,” above. The liability on the USDVA Guaranty is reduced or increased *pro rata* with any reduction or increase in the amount of indebtedness, but in no event will the amount payable on the USDVA Guaranty exceed the amount of the original USDVA Guaranty. Notwithstanding the dollar and percentage limitations of the USDVA Guaranty, a mortgage holder will ordinarily suffer a monetary loss only where the difference between the unsatisfied indebtedness and the proceeds of a foreclosure sale of a mortgaged property is greater than the original USDVA Guaranty, as adjusted. Periods without interest payments prior to foreclosure increase the potential for losses. In the event of a default in the payment of a USDVA guaranteed loan, but prior to a suit or foreclosure, USDVA may, at its option, pay to the mortgage holder of such defaulted loan the unpaid balance of the obligation plus accrued interest and receive an assignment of the loan and the security for such loan. For information regarding

the amount of Contracts of Purchase guaranteed by the USDVA, see “—Primary Mortgage Insurance” and APPENDIX C - “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase – Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011.”

Prior to 1998, Contracts of Purchase were not insured or guaranteed by the USDVA or any private primary mortgage insurer. The Department took steps to reduce Program risk, and as of March 10, 1998, the Department was approved by the USDVA as a “non-supervised lender with automatic processing authority,” which approval allows the Department to underwrite and approve USDVA guaranteed loans without obtaining prior USDVA approval. Generally, for all new Contracts of Purchase the Department requires veterans to apply for a USDVA Guaranty except with respect to Contracts of Purchase for construction, for rehabilitation, for home improvement or for mobile homes in a mobile home park. See “—Primary Mortgage Insurance.”

The Department has obtained, and continues to obtain, USDVA Guarantees (i) since 2002 on all Contracts of Purchase with loan-to-value ratios (“LTVs”) greater than 97% and (ii) since 2009 on Contracts of Purchase where the veteran qualifies for the USDVA Guaranty, regardless of LTV. The Department previously provided Radian Guaranty Inc. (“Radian”) primary mortgage insurance for new Contracts of Purchase not guaranteed by the USDVA with LTVs in excess of 80%, but is no longer entering into Contracts of Purchase to be insured by Radian.

The USDVA is a department of the United States of America. On August 5, 2011, S&P lowered its long-term sovereign credit rating on the United States of America to “AA+” from “AAA.” S&P’s long-term rating outlook is “negative.” On November 28, 2011, Fitch affirmed its long-term issuer default rating on the United States of America of “AAA” with an outlook of “negative.” On August 2, 2011, Moody’s confirmed its long-term rating for the United States of America of “Aaa” with an outlook of “negative.” The foregoing ratings on the United States of America were still in effect as of February 2, 2012.

Primary Mortgage Insurance

The Department’s primary mortgage insurer has been Radian which is a wholly-owned subsidiary of Radian Group Inc., an insurance holding company listed on the New York Stock Exchange. As of February 2, 2012, Moody’s had assigned Radian an insurance financial strength rating of “Ba3” and had placed such rating on review for downgrade. On January 30, 2012, S&P lowered its financial strength rating with respect to Radian to “B” (outlook negative) from “B+” (outlook negative), and such rating was still in effect as of February 2, 2012. Ratings reflect each respective rating agency’s current assessments of the creditworthiness of Radian and its ability to pay claims on its policies of insurance. An explanation of the significance of such ratings may be obtained from the respective rating agencies. There is no assurance that the ratings will continue for any given period of time or that they will not be revised, qualified or withdrawn entirely by such ratings agencies if, in their judgment, circumstances so warrant.

The Department purchased a policy of primary mortgage insurance from Radian (the “Original Radian Policy”) for a pool of certain then-existing Contracts of Purchase with LTVs exceeding 80% originated before February 1, 1998. Thereafter, the Department purchased an additional policy of primary mortgage insurance from Radian (the “Additional Radian Policy,”

and together with the Original Radian Policy, the “Radian Policies”) which provides similar coverage on certain Contracts of Purchase issued after February 1, 1998 as provided in the Original Radian Policy. The Radian Policies provide coverage for aggregate losses incurred on covered Contracts of Purchase following property disposition, above an aggregate 2% deductible. Under the Radian Policies the aggregate 2% deductible is defined as the total loss remaining after property disposition of the applicable Contracts of Purchase of an applicable subgroup. As many of the Contracts of Purchase insured under the Original Radian Policy have high originally insured balances but have been paid down significantly over the life of such Contracts of Purchase, the Department does not anticipate that it will incur losses on such Contracts of Purchase in excess of the 2% deductible. However, as of December 31, 2011, the aggregate 2% deductible under the Additional Radian Policy was approximately \$24.4 million. The Department has calculated that its accumulated losses with respect to Contracts of Purchase insured under the Additional Radian Policy are approximately \$36.9 million. The Department has tendered a claim to Radian for the balance of approximately \$12.5 million. Radian has disputed that all accumulated losses incurred in connection with Contracts of Purchase insured under the Additional Radian Policy should accrue to the applicable deductible. Rather, Radian has taken the position that only those losses which Radian would be obligated to cover under the applicable Radian Mortgage Insurance Coverage Ratios described below should accrue to the applicable deductible and has not made payments to the Department based on the claims tendered by the Department. The Department is working to resolve this dispute and may take further legal action. The Department cannot predict the outcome of this dispute at this time.

After meeting the aggregate 2% deductible, in settlement of any claim Radian may at its option elect to pay the Department (i) the entire amount of the loss upon the Department delivering title to the applicable property to Radian or (ii) the percentage of the loss specified in the applicable certificate of insurance and in accordance with the applicable mortgage coverage ratios under which the Contract of Purchase is insured, in which case the Department will retain title to the applicable property.

The coverage levels in the table below apply to Contracts of Purchase covered by the Additional Radian Policy. For these purposes, the loan-to-value ratio is calculated using the original appraised value of the applicable property.

Radian Mortgage Insurance Coverage Ratios

<u>LTV Category</u>	<u>% of Coverage</u>
97.01% to 100.00%	35%
95.01% to 97.00%	35%
90.01% to 95.00%	30%
85.01% to 90.00%	25%
80.01% to 85.00%	17%

Source: Department of Veterans Affairs.

Since April 1, 2008, the Department has ceased insuring new Contracts of Purchase with Radian. Instead, where primary mortgage insurance would have been used with respect to a Contract of Purchase the Department has charged the veteran an amount equal to the amount which would have been collected by the Department in respect of a Radian Policy, but has retained such payments in a primary mortgage insurance account (the “Primary Mortgage Insurance Account”). As of December 31, 2011, there was approximately \$4,082,293 in the Primary Mortgage Insurance Account. As of December 31, 2011, the balance of Contracts of

Purchase to which the Primary Mortgage Insurance Account applies was approximately \$88,328,506.

The Department is currently in the process of identifying options for primary mortgage insurance options, obtaining Federal Housing Administration insurance for new Contracts of Purchase and reinsuring the Pooled Self-Insurance Fund to diversify the portfolio. See “—Pooled Self-Insurance Fund.” No assurance can be given that the Department will be able to obtain replacement primary mortgage insurance or whether such insurance will be available at commercially reasonable premiums.

For information regarding the principal amount of Contracts of Purchase covered by the Radian Policies, see APPENDIX C – “CERTAIN DEPARTMENT FINANCIAL INFORMATION AND OPERATING DATA – Contracts of Purchase – Existing Contracts of Purchase – Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011.”

Funding of USDVA Guaranty or Primary Mortgage Insurance Account

At the time of origination of each Contract of Purchase the Department collects a funding fee of 1.25% to 3.3% of the Contract of Purchase amount based on the LTV to offset the cost of the USDVA Guaranty or for deposit in the Primary Mortgage Insurance Account. For USDVA guaranteed loans, the funding fee may be added to the purchase price provided it does not exceed the effective maximum loan amount. Veterans obtaining loans described immediately above who are ineligible for a full USDVA Guaranty must have adequate remaining partial USDVA Guaranty entitlement to obtain a 25% USDVA Guaranty. With respect to Contracts of Purchase eligible for a USDVA Guaranty, this fee is paid to the USDVA for the cost of the USDVA Guaranty. If the veteran or the property is not eligible for a USDVA Guaranty, the funding fee is retained by the Department, and such funding fees are deposited by the Department into the Primary Mortgage Insurance Account. Any change to the foregoing insurance and guaranty expectations may require an amendment to the Department’s Program Operating Procedures and delivery of a new Cash Flow Statement.

Property Insurance

The Veterans Code and long-standing Department policy have both required the veteran holding a Contract of Purchase to maintain certain insurance with respect to the property covered by a Contract of Purchase. Insurance must be in the amount and under the conditions specified by the Department. In the cases of physical losses, the coverage is provided by the Department up to a specified deductible amount and thereafter by insurance companies selected by the Department. The insurance programs are as follows:

Fire and Hazard Coverage

Under its Fire and Hazard Insurance Program, the Department carries \$48 million in reinsurance and retains a \$2 million per occurrence deductible for fire and hazard losses. Funds for the Fire and Hazard Insurance Program are collected from the holder of the Contract of Purchase and amounts collected are deposited in the Fire and Hazard Insurance Account within the Pooled Self-Insurance Fund (the “Fire and Hazard Insurance Account”). Liabilities of the Fire and Hazard Insurance Program are payable solely from the Fire and Hazard Insurance Account. See “—Reinsurance.”

Fire and Hazard Insurance replacement cost coverage (for participants in the Program) is adjusted annually to reflect increased building costs. It is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. A \$250 deductible, payable by the veteran, applies to each loss. Claims must be submitted within 12 months of the loss to be considered for payment. If there are more than three claims in a revolving five year period, the deductible is increased to \$1,000. Claims adjustments and payments are made on behalf of the Department and processed by a third party claims adjuster.

The Fire and Hazard Insurance Program does not cover mobile homes, condominiums or planned unit development properties which should be covered by blanket insurance policies maintained by a homeowners' association. Veterans financing condominiums or planned unit development properties that are not covered by blanket insurance policies maintained by homeowners' associations are covered by the Fire and Hazard Insurance Program. Veterans financing mobile homes are required to secure their own coverage. Veterans in all other housing types are required to participate in the Fire and Hazard Insurance Program.

If the veteran participates in the Fire and Hazard Insurance Program, the veteran is required to pay a premium (charged to the veteran's account) which includes, among other things, (i) a portion of the reinsurance premium, (ii) an amount attributable to the funding of a reserve fund for the Department's self-insured deductible and (iii) an amount attributable to costs of claims adjusting. The current annual premium is equal to \$0.145 per \$100 of insured value, which is divided equally in monthly installments.

The amount in the Fire and Hazard Insurance Account as of December 31, 2011 was approximately \$2,578,433. See “—Pooled Self-Insurance Fund.”

The Department contracted with Marsh Risk Consulting to conduct a California Wildfire Exposure Analysis in August 2009. The California Wildfire Exposure Analysis concluded that the probable maximum exposure risk to the properties insured under the Program from multiple wildfires in a single year would not exceed \$17.1 million. The California Wildfire Exposure Analysis and the catastrophe modeling upon which the conclusions in the analysis are based are subject to certain limitations and assumptions including assumptions with respect to inflationary costs, environmental facts, structures, occupancy vulnerability and certain historical loss data. No assurances can be given that the conclusion made in the California Wildfire Exposure Analysis will be accurate.

Disaster Indemnity Coverage

Under its Disaster Indemnity Program, the Department carries \$46 million in reinsurance and retains a \$4 million per occurrence deductible for earthquake and flood losses. Funds for the Disaster Indemnity Program are collected from the holder of the Contract of Purchase and amounts collected are deposited in the Disaster Indemnity Account within the Pooled Self-Insurance Fund (the “Disaster Indemnity Account”). Liabilities of the Disaster Indemnity Plan are payable solely from the Disaster Indemnity Account. See “—Reinsurance.”

Replacement cost coverage for participants in the Disaster Indemnity Program is adjusted annually to reflect increased building costs. It is maintained on a guaranteed replacement cost basis for homes and on an actual cash value basis for outbuildings. The deductible for flood losses is \$500, and the deductible for earthquake losses is the greater of \$500 or 5% of the amount of loss.

Every veteran in the Program must participate in the Disaster Indemnity Program and is presently required to pay an annual premium of \$.15 per \$100 of insured value (divided equally in monthly installments) plus any additional assessments as may be required to sustain the Disaster Indemnity Account.

The amount in the Disaster Indemnity Account as of December 31, 2011 was approximately \$16,545,744. See “—Pooled Self-Insurance Fund.”

The Department contracted with Marsh Risk Consulting to conduct an Earthquake Exposure Analysis in August 2009. The Earthquake Exposure Analysis concluded that the expected loss for a 500-year return period is \$110.6 million including the risk of fire after damage following the earthquake event. The Earthquake Exposure Analysis and the modeling upon which the conclusions in the analysis are based are subject to certain limitations and assumptions including assumptions with respect to inflationary costs, environmental facts, structure construction and values representing replacement cost. No assurances can be given that the conclusions made in the Earthquake Exposure Analysis will be accurate.

Reinsurance

As of September 1, 2011, the Department obtained reinsurance for losses of the Fire and Hazard Insurance Program and Disaster Indemnity Program from a consortium of 10 insurers led by Lloyd’s of London. As of September 1, 2011, each insurer was rated A- XIV or better by AM Best Co. The Fire and Hazard Insurance Program/Disaster Indemnity Program reinsurance provides \$48 million of coverage in excess of the Department’s \$2 million per occurrence deductible for fire and hazard losses (see “—*Fire and Hazard Coverage*”) and \$46 million in excess of the Department’s \$4 million per occurrence deductible for earthquake and flood losses (see “—*Disaster Indemnity Coverage*”). The policy extends through September 1, 2012 and is renewable annually. The one-year premiums for the policies are \$501,550 and \$2,341,700, respectively. Under the policy, loss payments reduce the limit of coverage afforded by the amounts paid by the reinsurers, however, the limit of coverage may be reinstated upon the payment by the Department of an additional premium calculated at pro rata of the premium as to the amount reinstated.

Life and Disability Insurance

Legacy Self-Insured Life and Disability Plan

Prior to 1996, the Department self-insured for life and disability coverage for the holders of Contracts of Purchase from the 1943 Fund. Following a period of significant and recurring losses incurred by the 1943 Fund, in 1996 the Department replaced most of its self-insured life and disability insurance program with an interim life and disability insurance plan. In 1998, the interim plan was replaced with a long-term life insurance and disability plan provided by Pacific Life and Annuity Company (“Pacific Life”). In 2003, the Pacific Life plan was replaced by a five-year life insurance and disability plan provided by Standard Insurance Company which has since been renewed and will expire in January 2013. All holders of Contracts of Purchase who had life and disability coverage (exclusive of those receiving self-insured disability benefits as of the termination date of the self-insured plan in 1996) under the insured Pacific Life plan were transferred automatically to the Standard Insurance Company plan. As of December 31, 2011, the Department continues to self-insure approximately 29 veterans who were already receiving disability benefits at the time the foregoing life and disability plan was implemented, with

benefits equal to the amount of the monthly Contract of Purchase payment at the time of their disability. As of December 31, 2011, the aggregate principal balance of the applicable Contracts of Purchase was less than \$1 million. For those veterans, benefits continue under the provisions of the self-insured plan until the beneficiary returns to active employment or dies, or at the point when the loan balance is fully paid off. Loss reserves for the Department's self-insured obligations are presently booked and actuarially based. The Department holds funds in the Legacy Self-Insured Disability Coverage Account in the Pooled Self Insurance Fund (the "Legacy Self-Insured Disability Coverage Account") to pay all benefits under the self-insured plan. As of December 31, 2011, the amount in the Legacy Self-Insured Disability Coverage Account was \$2,207,678. See "—Pooled Self-Insurance Fund" and "SELECTED FINANCIAL DATA OF THE 1943 FUND AND DEPARTMENT'S DISCUSSION."

Current Life and Disability

Notable elements of the current life and disability insurance plan include life insurance with a maximum benefit of five-year principal and interest under the mandatory life coverage. Disability coverage, which is now optional, has a 90-day waiting period with a maximum 24-month benefit, unless the injury was the result of an accident, which would allow for a maximum 60-month benefit. The foregoing benefits continue to age 62 for disability and age 70 for life benefit. Additional life, spousal and disability coverage can be purchased by the holders of the Contracts of Purchase and billed with their monthly home loan payments.

Legislative Protection of Veterans

Federal law provides certain protections to military personnel on active duty, reservists and members of the National Guard ordered to report for military service under the Servicemembers' Civil Relief Act of 2003, formerly known as The Soldiers' and Sailors' Civil Relief Act of 1940 (the "Federal Relief Act"). Under the Federal Relief Act, a servicemember may seek a stay (or a court may on its own motion grant a stay) of any court action or proceeding. The Federal Relief Act provides that if a servicemember obtained a Contract of Purchase and is later recalled to active duty, then during the period of military service the interest rate on the Contract of Purchase cannot exceed 6% (unless the ability of the servicemember to pay interest in excess of 6% is not materially impaired by such military service). Accordingly, the effect of any application of the Federal Relief Act in most cases would be a reduction in the applicable interest rate of less than one percent or no reduction at all.

Pursuant to the California Military Families Financial Relief Act (the "California Relief Act"), members of the United States Military Reserves or the California National Guard called to active duty as part of the Iraq and Afghanistan conflicts may defer payments on obligations secured by mortgages and certain other obligations, including Contracts of Purchase, for the lesser of (i) 180 days or (ii) the period of active duty plus 60 calendar days. The California Relief Act requires that reservists desiring to take advantage of such deferments provide notice to their lender and meet certain income requirements, and the deferral shall apply only to those payments due subsequent to the notice provided to the lender. The California Relief Act also requires lenders, such as the Department, to extend the term of loans subject to deferment by the length of the deferral, and prohibits foreclosure or repossession of property during a deferment period.

Under the Program, deferrals required by the California Relief Act are accounted for by the Department through the creation of a deferred balance on the loan account. The Department anticipates that few loans affected by the California Relief Act will be paid in full through regular amortization and that those that are not delinquent, foreclosed upon or canceled will be prepaid prior to the end of the term, making an extension of the Contract of Purchase term unnecessary. If a Contract of Purchase affected by the California Relief Act is covered by a USDVA Guaranty, the Department will request the USDVA's approval to extend the loan term, if necessary. To date, the Department has received fewer than forty notices from reservists requesting California Relief Act deferrals and there has been no material impact on the 1943 Fund. See “—Contracts of Purchase – Delinquencies and Cancellations” herein.

External Reviews of the Program

The Program and the Department have been the subject of external reviews. The most recent reviews are briefly explained below.

Bureau of State Audits

The Bureau of State Audits (“BSA”) periodically audits the Department’s USDVA Guaranty program as part of the State’s regular Single Audit required under the Single Audit Act of 1984 and the California Government Code. The most recent such audit took place in 2010 which detailed certain deficiencies in reporting under the USDVA’s policies and recommended that the Department enhance its procedures with respect to identifying borrowers that have cured payment defaults and reporting such events to the USDVA. The Department is working with the USDVA to ensure timely and complete reporting of information in accordance with USDVA’s policies. Additional information regarding BSA audits may be obtained from the BSA at www.bsa.ca.gov. Nothing contained on such website is incorporated into this Official Statement.

USDVA

The USDVA Loan Guaranty Monitoring Unit (the “USDVA Auditors”) periodically audits the Department to determine, among other things, whether the Department is compliant with the laws, regulations and policies governing USDVA guaranties. The most recent audit took place in 2009 and detailed certain deficiencies regarding non-compliance with charges to certain veterans of disallowed fees and charges and circumstances where all property requirements or special conditions required by the appraisal or USDVA were not met prior to requesting the USDVA Guaranty. The Department responded to the findings and implemented new procedures in response thereto. The USDVA Auditors have accepted the Department’s responses as satisfactory and requiring no additional action. Reports of the USDVA Auditors and the Department’s responses thereto are available by contacting the Department’s Bond Finance Division at P.O. Box 942895, Sacramento, California 94295-0001, telephone (916) 503-8012. Nothing contained in such reports of the USDVA or the Department’s response thereto is incorporated into this Official Statement.

TAX MATTERS

Federal Tax Matters

The requirements of applicable Federal tax law must be satisfied with respect to the Offered Revenue Bonds in order that interest on the Offered Revenue Bonds not be included in gross income for Federal income tax purposes retroactive to the date of issuance thereof. The

loan eligibility requirements described in APPENDIX H – “CERTAIN FEDERAL TAX CODE REQUIREMENTS” apply to the Contracts of Purchase to be financed with proceeds of the Offered Revenue Bonds. The Federal Tax Code establishes other requirements described below which will apply to the Offered Revenue Bonds. Failure to so use all of such proceeds and to comply with other requirements of the Federal Tax Code with respect to the Offered Revenue Bonds could cause interest on the Offered Revenue Bonds to be included in gross income for Federal income tax purposes retroactive to their date of issuance.

Requirements Imposed on the Offered Revenue Bonds

The first general requirement of the Federal Tax Code applicable to the Offered Revenue Bonds is that the aggregate amount of private activity bonds (exclusive of qualified veterans’ mortgage bonds) that may be issued by the Department in any calendar year (or previous years’ carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. The Offered Revenue Bonds are within the applicable limit for the Department.

The Federal Tax Code requires that the effective interest rate on Contracts of Purchase financed with the lendable proceeds of qualified mortgage bonds may not exceed the yield on the issue by more than 1.125% (1.50% for the Offered Revenue Bonds, which are Pre-Ullman Bonds) and the effective interest rate on Contracts of Purchase (see “Other Requirements Imposed by the Federal Tax Code – Yield Limitations and Rebate” in APPENDIX H), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States. The Department has covenanted to comply with these requirements and has established procedures to determine the amount of excess earnings, if any, that must be rebated to the United States or to veterans. See “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – The 1943 Fund” and “THE PROGRAM – Contracts of Purchase” for discussions of provisions of the Veterans Code which affect the Department’s ability to establish and to change interest rates on Contracts of Purchase.

The Department has covenanted in the Resolution to do and perform all acts and things permitted by law and necessary or desirable to assure that interest paid on the Offered Revenue Bonds shall not be included in gross income for Federal income tax purposes.

Opinion of Bond Counsel to the Department

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Department, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Offered Revenue Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Federal Tax Code and (ii) interest on the Offered Revenue Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Federal Tax Code; such interest, however, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel to the Department has relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Department in connection with the Offered Revenue Bonds, and Bond Counsel to the Department has assumed compliance by the Department with certain ongoing covenants to comply with applicable requirements of the

Federal Tax Code to assure the exclusion of interest on the Offered Revenue Bonds from gross income under Section 103 of the Federal Tax Code.

Bond Counsel to the Department expresses no opinion regarding any other Federal or, except as stated below under “– State Tax Matters,” state tax consequences with respect to the Offered Revenue Bonds. Bond Counsel to the Department renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update, revise or supplement its opinion to reflect any action thereafter taken or not taken, or any facts or circumstances that may thereafter come to its attention, or changes in law or in interpretations thereof that may thereafter occur, or for any other reason. Bond Counsel to the Department expresses no opinion on the effect of any action thereafter taken or not taken in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Offered Revenue Bonds, or under state and local tax law.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the Offered Revenue Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of an Offered Revenue Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Offered Revenue Bonds.

Prospective owners of the Offered Revenue Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and Railroad Retirement benefits, individuals otherwise eligible for the earned income tax credit and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is excluded from gross income for Federal income tax purposes. Interest on the Offered Revenue Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Federal Tax Code.

Information reporting requirements apply to interest paid on tax-exempt obligations, including the Offered Revenue Bonds. In general, such requirements are satisfied if the interest recipient completes, and provides the payor with, a Form W-9, “Request for Taxpayer Identification Number and Certification,” or if the recipient is one of a limited class of exempt recipients. A recipient not otherwise exempt from information reporting who fails to satisfy the information reporting requirements will be subject to “backup withholding,” which means that the payor is required to deduct and withhold a tax from the interest payment, calculated in the manner set forth in the Federal Tax Code. For the foregoing purpose, a “payor” generally refers to the person or entity from whom a recipient receives its payments of interest or who collects such payments on behalf of the recipient.

If an owner purchasing an Offered Revenue Bond through a brokerage account has executed a Form W-9 in connection with the establishment of such account, as generally can be expected, no backup withholding should occur. In any event, backup withholding does not affect the excludability of the interest on the Offered Revenue Bonds from gross income for Federal income tax purposes. Any amounts withheld pursuant to backup withholding would be allowed

as a refund or a credit against the owner's Federal income tax once the required information is furnished to the Internal Revenue Service.

State Tax Matters

Bond Counsel to the Department is of the opinion that, under existing law, the interest on the Offered Revenue Bonds is exempt from personal income taxes of the State. A complete copy of the proposed form of opinion to be rendered by Bond Counsel with respect to the Offered Revenue Bonds is contained in APPENDIX F.

Miscellaneous

Tax legislation, administrative actions taken by tax authorities, or court decisions, whether at the Federal or state level, may adversely affect the tax-exempt status of interest on the Offered Revenue Bonds under Federal or state law and could affect the market price or marketability of the Offered Revenue Bonds.

Prospective purchasers of the Offered Revenue Bonds should consult their own tax advisors regarding the foregoing matters.

LITIGATION

At the respective times of the delivery of and payment for the Offered Revenue Bonds, the Department shall deliver, or cause to be delivered (1) a certificate of the Attorney General of the State to the effect that, except as described in this Official Statement, to her knowledge, no material litigation is pending (with service of process having been accomplished) or, to her knowledge, threatened (a) seeking to restrain or enjoin the sale, issuance or delivery of any of the Offered Revenue Bonds or the undertaking of any activities which the Department has undertaken or will undertake pursuant to the Purchase Contract (as defined below) with respect to the Offered Revenue Bonds; (b) contesting the authorization for, or the validity of, the Offered Revenue Bonds, the Resolution or the Purchase Contract; or (c) challenging the entitlement to their respective offices of the officers who caused the Offered Revenue Bonds to be executed and delivered; and (2) an opinion of Acting Chief Counsel to the Department to the effect that there is no action, suit or proceeding pending (with service of process having been accomplished) or, to her knowledge, threatened against the Department involving any of the property or assets of the 1943 Fund, the Bond Reserve Account or the Loan Loss Account that involves the possibility of any judgment or uninsured liability which may result in any material adverse change in the business, properties or assets or in the condition, financial or otherwise, of the 1943 Fund, the Bond Reserve Account or the Loan Loss Account; and that, with respect to the officers who executed the Offered Revenue Bonds on behalf of the Department, to the best of her knowledge, the title of said officers to their respective offices is not being contested or questioned.

UNDERWRITING

The Offered Revenue Bonds are being purchased by an underwriting syndicate consisting of J.P. Morgan Securities LLC, acting as representative, and the other underwriters named on the cover page hereof (collectively, the "Underwriters"). The Underwriters have agreed to purchase the Offered Revenue Bonds for a purchase price of \$219,017,814.82 (which represents the principal amount of the Offered Revenue Bonds, less an Underwriters' discount of \$1,417,185.18).

The Purchase Contract relating to the Offered Revenue Bonds provides, among other things, that (i) the Underwriters will purchase all of the Offered Revenue Bonds if any of the Offered Revenue Bonds are purchased and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such Purchase Contract including, among others, the approval of certain legal matters by counsel. The Underwriters may offer and sell the Offered Revenue Bonds to certain dealers and others at yields higher than the yields stated on the inside front cover page hereof. The offering prices may be changed from time to time by the Underwriters.

Certain of the Underwriters have provided letters to the State Treasurer and the Department, which letters are attached hereto as APPENDIX J, relating to their respective retail distribution practices or other affiliations for inclusion in this Official Statement. Neither the State Treasurer nor the Department guarantees the accuracy or completeness of the information contained in such letters, and the information set forth in each letter is not construed as a representation of the State Treasurer, the Department or any Underwriter other than the Underwriters named therein.

CERTAIN LEGAL MATTERS

Legal matters incident to the authorization, issuance, sale and delivery of the Offered Revenue Bonds to the Underwriters are subject to the approval of the Honorable Kamala D. Harris, Attorney General of the State, and of Hawkins Delafield & Wood LLP, Bond Counsel to the Department. The issuance and acceptance of the Offered Revenue Bonds are conditioned upon delivery by Bond Counsel to the Department of an approving opinion in substantially the form set forth in APPENDIX F hereto and by the Attorney General of an approving opinion in substantially the applicable form set forth in APPENDIX G hereto. Polsinelli Shughart LLP serves as Disclosure Counsel to the Department. Certain legal matters will be passed upon for the Underwriters by their counsel, Kutak Rock LLP.

INDEPENDENT AUDITORS

The financial statements of the 1943 Fund as of and for the years ended June 30, 2011 and June 30, 2010, in APPENDIX A to this Official Statement have been audited by Deloitte & Touche LLP, independent auditors, as stated in their reports appearing therein.

The financial statements of the Veterans Debenture Revenue Fund as of and for the years ended June 30, 2011 and June 30, 2010, in APPENDIX B to this Official Statement have been audited by Deloitte & Touche LLP, independent auditors, as stated in their reports appearing therein.

LEGALITY FOR INVESTMENT

The Act provides that the Offered Revenue Bonds shall be legal investments in California for all trust funds, funds of all insurance companies, banks (both commercial and savings), trust companies, state school funds, and pension funds, public or private. The Act also provides that any money or funds which may by law be invested in bonds of the State may be invested in the Offered Revenue Bonds and that whenever any bonds of the State may by law be used as security for the performance of any act or the deposit of any public money, the Offered Revenue Bonds may be so used.

FORWARD-LOOKING STATEMENTS

The statements contained in this Official Statement, which includes the Appendices hereto, that are not purely historical and relate to future results, are forward-looking statements, including statements regarding the Department's expectations, hopes, intentions or strategies regarding the future. When used in this Official Statement, the words "estimate," "forecast," "intend," "expect," "plan," "budget" and similar expressions identify forward-looking statements. Such statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those contemplated in such forward-looking statements. Prospective investors should not place undue reliance on forward-looking statements. All forward-looking statements included in this Official Statement are based on information available to the Department on the date hereof, and the Department assumes no obligation to update any such forward-looking statements.

The forward-looking statements herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, and legislative, judicial and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among other things, future economic and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the Department. Any of such assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Official Statement would prove to be accurate.

RATINGS

The Offered Revenue Bonds have received ratings of "Aa3" by Moody's Investors Service, Inc., "AA-" by Fitch Ratings and "AA" by Standard & Poor's Rating Services, a Standard & Poor's Financial Services LLC business.

An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant. Any revision or withdrawal of a credit rating could have an effect on the market prices and marketability of the Offered Revenue Bonds. The Department cannot predict the timing or impact of future actions by the rating agencies.

CONTINUING DISCLOSURE

The Department has covenanted in an Amended and Restated Master Continuing Disclosure Undertaking (the "Master Continuing Disclosure Undertaking"), for the benefit of the Bondowners and Beneficial Owners of Subject Bonds (each as defined in APPENDIX E), to provide certain financial information and operating data relating to the Department (the "Annual Financial Information") by not later than the first day of the tenth calendar month following the end of the Department's then-current fiscal reporting period, commencing with the reporting period ended June 30, 2012, and to provide notices of the occurrence of certain enumerated events. The Master Continuing Disclosure Undertaking requires that the Annual Financial

APPENDIX A

**FINANCIAL STATEMENTS OF THE 1943 FUND
FOR FISCAL YEARS 2011 AND 2010
AND INDEPENDENT AUDITORS' REPORT**

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

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

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

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	2-12
FINANCIAL STATEMENTS FOR THE YEARS ENDED JUNE 30, 2011 AND 2010:	
Balance Sheets	13
Statements of Revenues, Expenses, and Changes in Fund Equity	14
Statements of Cash Flows	15
Notes to Financial Statements	16-25

INDEPENDENT AUDITORS' REPORT

California Veterans Board
State of California
Sacramento, California

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

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

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

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

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

Deloitte + Touche LLP

October 14, 2011

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

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

Introduction – The Department of Veterans Affairs

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

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

Fiscal Year 2011 Compared to Fiscal Year 2010

Condensed Balance Sheets

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

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

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

- Total cash, cash equivalents and investments decreased by \$179 million from \$284 million at June 30, 2010 to \$105 million at June 30, 2011. The decrease is a principally due to bond calls and significantly lower interest earned on investments.
- Net receivables under contracts of purchase decreased by \$175 million from \$1.500 billion at June 30, 2010 to \$1.325 billion at June 30, 2011. The change was due to payments received and a decrease in the number of new contracts of purchase added to the portfolio.
- All other receivables and assets increased by \$9 million from \$68 million at June 30, 2010 to \$77 million at June 30, 2011.

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

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

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

Condensed Statements of Revenues and Expenses

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

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

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

- Interest revenue from contracts of purchase decreased by \$10.8 million from \$91.2 million for the year ended June 30, 2010 to \$80.4 million for the year ended June 30, 2011, due to a decrease in the number of new contracts of purchase to the portfolio.
- Interest revenues on investments and other revenues increased by \$0.2 million from \$5.0 million for the year ended June 30, 2010 to \$5.2 million for the year ended June 30, 2011. This increase is primarily due to advanced interest payments on GIC investment accounts transferred from the Veterans Debenture Revenue Fund and recognition of the reserves transferred from the Veterans Indemnity Fund.

- Net program operation expenses decreased \$27.2 million from \$109.1 million for the year ended June 30, 2010 to \$81.9 million for the year ended June 30, 2011. This is due to a decrease of \$17.2 million in interest expense related to a decrease in bonds outstanding, and a decrease of \$10.0 million in the provision for program losses.
- The sale of repossessed properties resulted in a loss of \$13.8 million for the year ended June 30, 2011 compared to a loss of \$12.9 million for the year ended June 30, 2010 due to a reduction in property values from loans made primarily in the calendar years 2005, 2006 and 2007. The Funds' holdings of repossessed properties, net of allowances for losses decreased from \$23.3 million as of June 30, 2010 to \$18.7 million as of June 30, 2011.

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

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

Overview of Loan Portfolio

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

Loans are made after an underwriting process that includes, but is not limited to: a review of credit history, verifiable income and the amount and source of down payment. In general, credit scores of approved applicants are above the average. Loans with an initial loan to value (LTV) of greater than 80% are required to be insured, either through private mortgage insurance or through the guarantee program of the United States Department of Veterans Affairs (USDVA). Loans with a LTV of 97% or greater are required to be insured through the USDVA guaranty program. Under the 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, 2011, interest rates on loans outstanding ranged from 4.25% to 9.75%. While the Department has the limited ability to adjust the interest rates, post-1999 loans can be adjusted by 0.5% if needed and pre-1999 loans can be adjusted with no rate cap, the policy of the Department has been to leave the interest rate fixed at the rate in effect when the loan was originated.

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

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

Allowances for Uncollectible Loans and Losses on Other Real Estate Owned

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

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

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

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

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

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

Segregated Insurance Reserves

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

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

The four sub-accounts are:

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

Economic Factors Facing Veterans Farm & Home Building Fund of 1943

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

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

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

Fiscal Year 2010 Compared to Fiscal Year 2009

Condensed Balance Sheets

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

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

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

- Total cash, cash equivalents and investments decreased by \$38 million from \$322 million at June 30, 2009 to \$284 million at June 30, 2010. The decrease is a principally due to bond calls and significantly lower interest earned on investments.
- Net receivables under contracts of purchase decreased by \$188 million from \$1.688 billion at June 30, 2009 to \$1.500 billion at June 30, 2010. The change was due to payments received and a decrease in the number of new contracts of purchase added to the portfolio.

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

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

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

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

Condensed Statements of Revenues and Expenses

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

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

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

- Interest revenue from contracts of purchase decreased by \$7.9 million from \$99.1 million for the year ended June 30, 2009 to \$91.2 million for the year ended June 30, 2010, due to a decrease in the number of new contracts of purchase to the portfolio.
- Interest revenues on investments decreased by \$7.3 million from \$12.3 million for the year ended June 30, 2009 to \$5.0 million for the year ended June 30, 2010. This decrease is due to the SMIF

quarterly interest rate decreasing over the fiscal year from 1.51% at June 30, 2009 to 0.56% at June 30, 2010 combined with a decrease in the cash, cash equivalents and investments during that time.

- Net program operation expenses decreased \$5.2 million from \$114.3 million for the year ended June 30, 2009 to \$109.1 million for the year ended June 30, 2010. This is due to a decrease of \$13.5 million in interest expense related to a decrease in bonds outstanding, offset by an increase of \$8.2 million in the provision for program losses.
- The sale of repossessed properties resulted in a loss of \$12.9 million for the year ended June 30, 2010 compared to a loss of \$3.5 million for the year ended June 30, 2009 due to a reduction in property values from loans made in the calendar years 2005, 2006 and 2007. The Funds' holdings of repossessed properties, net of allowances for losses increased from \$23 million as of June 30, 2009 to \$23.3 million as of June 30, 2010.

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

- The fire and hazard insurance program experienced a decrease in net revenues of \$0.3 million due to claimed losses during the fiscal year.
- Other income decreased by \$12.6 million, including a decrease of \$0.8 million related to loan origination fees.

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

Overview of Loan Portfolio

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

Loans are made after an underwriting process that includes, but is not limited to: a review of credit history, verifiable income and the amount and source of down payment. In general, credit scores of approved applicants are above the average. Loans with an initial loan to value (LTV) of greater than 80% are required to be insured, either through private mortgage insurance or through the guarantee program of the United States Department of Veterans Affairs (USDVA). Loans with a LTV of 97% or greater are required to be insured through the USDVA guaranty program. Under the 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, 2010, interest rates on loans outstanding ranged from 4.25% to 9.75%. While the Department has the limited ability to adjust the interest rates, post-1999 loans can be adjusted by 0.5% if needed and pre-1999 loans can be adjusted with no rate cap, the policy of the Department has been to leave the interest rate fixed at the rate in effect when the loan was originated.

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

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

Allowances for Uncollectible Loans and Losses on Other Real Estate Owned

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

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

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

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

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

- Certain of the Department's Contracts of Purchase are guaranteed through the USDVA guaranty program. See "THE PROGRAM – USDVA Guaranty Program; Loan Insurance.
- Since 2009, all new Contracts of Purchase require a minimum 1.25% funding fee.

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

Economic Factors Facing Veterans Farm & Home Building Fund of 1943

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

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

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

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

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

See notes to financial statements.

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

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND EQUITY
YEARS ENDED JUNE 30, 2011 AND 2010**

(In thousands)

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

See notes to financial statements.

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

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

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

See notes to financial statements.

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

NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2011 AND 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

Use of Estimates in the Preparation of Financial Statements — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

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

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

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

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

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

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

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

Self-Insured Life and Disability Insurance Plan — Beginning in 1984, the Department operated a self-funded protection plan whereby life and disability insurance was provided to eligible contract holders. This plan was terminated on June 1, 1996. The life and disability benefits previously available to these members under the self-insured protection plan continue to be available to those contract holders who were receiving benefits at the time the plan was terminated. Loss reserves to satisfy these

obligations of the protection plan, which include future disability and life benefits were derived from an actuarial evaluation performed in 2006 that is updated internally on an annual basis. Significant actuarial assumptions and methodologies used to calculate the reserve are interest, mortality, disability, prepayment, and a long-term discount rate of 7%. Self-insured life and disability insurance loss reserve include unpaid claims, incurred but not reported claims and loss reserve. Prior to July 1, 2010, program activity was included in the Fund; during 2011 this activity was transferred to the Pooled Insurance Fund. See footnote 9.

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

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

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

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

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

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

Investment Risk Factors — Many factors can affect the value of investments. Some, such as credit risk, custodial credit risk, concentration of credit risk, and interest rate risk, may affect both equity and fixed-income securities. Equity and debt securities respond to factors such as economic conditions, individual company earnings performance, and market liquidity, while fixed-income securities are particularly sensitive to credit risks and changes in interest rates. It is the investment policy of the Fund to invest substantially all of its funds within SMIF and the remainder in investment contracts or with insurance administrators to limit the Fund’s exposure to most types of investment risk.

Credit Risk — Fixed-income securities are subject to credit risk, which is the chance that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer’s ability to make these payments will cause security prices to decline. Certain fixed-income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. At June 30, 2011 and 2010, the Fund does not have significant investments exposed to credit risk.

Custodial Credit Risk — Custodial credit risk is the risk that in the event of the failure of the custodian, the investments may not be returned. At June 30, 2011 and 2010, the Fund did not have any investments exposed to custodial credit. All investments are held by the state of California.

Concentration of Credit Risk — Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the Fund to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. At June 30, 2011 and 2010, the Fund does not have a significant concentration of credit risk.

Interest Rate Risk — Interest rate risk is the risk that the value of fixed-income securities will decline due to decreasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. At June 30, 2011 and 2010, the Fund does not have any significant debt investments that are highly sensitive to changes in interest rates.

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

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

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

3. RECEIVABLES UNDER CONTRACTS OF PURCHASE

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

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

4. LAND, IMPROVEMENTS, AND EQUIPMENT

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

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

5. BONDS PAYABLE

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

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

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

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

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

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

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

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

6. BOND REDEMPTION AND REFUNDING

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

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

7. COMMITMENTS AND CONTINGENCIES

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

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

Fiscal Years Ending June 30	
2012	\$ 52
2013	54
2014	54
2015	<u>55</u>
 Total	 <u>\$ 215</u>

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

8. EMPLOYEE BENEFIT PLANS

Public Employees’ Retirement Fund

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

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

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

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

The most recent actuarial valuation of the PERF indicated that there was an unfunded actuarial accrued liability. The amount of the underfunded liability applicable to each agency or department cannot be determined. Trend information, which presents CalPERS progress in accumulating sufficient assets to pay benefits when due, is presented in the June 30, 2008, CalPERS CAFR.

State of California Other Postemployment Benefit Plan

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

Funding Policy — The state controller's office sets the employer contribution rate based on the annual required contribution (ARC) of the employers, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) of the plan over a period not to exceed 30 years. The Fund's estimated unfunded other postemployment benefit cost was \$878,000 and \$675,000 for the years ended June 30, 2011 and 2010, respectively. The Fund recognized \$203,000 and \$194,000 in expense for the years ended June 30, 2011 and 2010, respectively.

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

9. POOLED INSURANCE FUND

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

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

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

10. SUBSEQUENT EVENTS

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

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

* * * * *

APPENDIX B

**FINANCIAL STATEMENTS OF THE VETERANS DEBENTURE REVENUE FUND
FOR FISCAL YEARS 2011 AND 2010
AND INDEPENDENT AUDITORS' REPORT**

Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California

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

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	2-4
FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2011 AND 2010:	
Balance Sheets	5
Statements of Revenues, Expenses, and Changes in Fund Equity	6
Statements of Cash Flows	7
Notes to Financial Statements	8-10

INDEPENDENT AUDITORS' REPORT

California Veterans Board
State of California
Sacramento, California

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

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

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

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

Management's Discussion and Analysis on pages 2 through 4 is not a required part of the financial statements, but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Department's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and we do not express an opinion on it.

Deloitte + Touche LLP

October 14, 2011

VETERANS DEBENTURE REVENUE FUND, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

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

Introduction & Overview — Veterans Debenture Revenue Fund, Department of Veterans Affairs, State of California

This discussion and analysis presents the highlights of financial activities and financial position for the Veterans Debenture Revenue Fund (the "Fund"), Department of Veterans Affairs, State of California (the "Department"). The analysis is designed to provide readers with information that the Fund's management believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations. It is intended to help readers see the Fund through the eyes of management. It is further designed to provide context for the financial statements and information about the Fund's operations and cash flows.

Management's Discussion and Analysis (MD&A) is based on currently known facts, decisions, and conditions that existed as of the date of the independent auditors report.

The Fund was established for the maintenance of a Bond Reserve Account as required by the revenue bond resolution of the Department. The resolution requires a reserve in an amount not less than three percent of the aggregate outstanding principal of all Revenue Bonds with interest rates fixed to maturity held by the Department.

Fiscal Year 2011 Compared to Fiscal Year 2010

Condensed Balance Sheets

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

	2011	2010	Change	% Change
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 4,191	\$ 4,191	\$ -	0.0 %
Other assets	72	123	(51)	(41.5)%
Total current assets	<u>4,263</u>	<u>4,314</u>	<u>(51)</u>	
Noncurrent assets—Investments	<u>15,551</u>	<u>24,562</u>	<u>(9,011)</u>	(36.7)%
TOTAL ASSETS	<u>\$ 19,814</u>	<u>\$ 28,876</u>	<u>\$ (9,062)</u>	
LIABILITIES & FUND EQUITY				
Current liabilities—Bond reserve due to the Veterans Farm and Home Fund of 1943	\$ 72	\$ 123	\$ (51)	(41.5)%
Noncurrent liabilities—Bond reserve due to the Veterans Farm and Home Fund of 1943	19,742	28,753	(9,011)	(31.3)%
Fund equity	<u>-</u>	<u>-</u>	<u>-</u>	0.0 %
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 19,814</u>	<u>\$ 28,876</u>	<u>\$ (9,062)</u>	

Assets, Liabilities and Fund Equity

Total assets, liabilities and fund equity decreased due to a decrease in the bond reserve as of June 30, 2011 and June 30, 2010.

Condensed Statements of Revenues and Expenses

The following table presents the statements of revenues and expenses for the Fund for the years ended June 30, 2011 and 2010, (dollars in thousands) and the change from year to year:

	2011	2010	Change	% Change
REVENUES—Income from investments	\$ 2,142	\$ 1,365	\$ 777	56.9 %
EXPENSES—Transfers out to Veterans Farm and Home Building Fund of 1943	<u>2,142</u>	<u>1,365</u>	<u>777</u>	56.9 %
OPERATING INCOME	-	-	-	0.0 %
FUND EQUITY—Beginning of year	<u>-</u>	<u>-</u>	<u>-</u>	0.0 %
FUND EQUITY—End of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	0.0 %

Revenues & Expenses

All income generated by the Fund represents amounts due to the Farm and Home Fund and accordingly has been reflected as operating transfers out in the statements of revenues, expenses and changes in fund equity.

Fiscal Year 2010 Compared to Fiscal Year 2009

Condensed Balance Sheets

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

	2010	2009	Change	% Change
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 4,191	\$ 7,396	\$ (3,205)	(43.3)%
Other assets	<u>123</u>	<u>131</u>	<u>(8)</u>	(6.1)%
Total current assets	<u>4,314</u>	<u>7,527</u>	<u>(3,213)</u>	
Noncurrent assets—Investments	<u>24,562</u>	<u>24,562</u>	<u>-</u>	0.0 %
TOTAL ASSETS	<u>\$ 28,876</u>	<u>\$ 32,089</u>	<u>\$ (3,213)</u>	
LIABILITIES & FUND EQUITY				
Current liabilities—Bond reserve due to the Veterans Farm and Home Fund of 1943	\$ 123	\$ 132	\$ (9)	(6.8)%
Noncurrent liabilities—Bond reserve due to the Veterans Farm and Home Fund of 1943	<u>28,753</u>	<u>31,957</u>	<u>(3,204.0)</u>	(10.0)%
Fund equity	<u>-</u>	<u>-</u>	<u>-</u>	0.0 %
TOTAL LIABILITIES AND FUND EQUITY	<u>\$ 28,876</u>	<u>\$ 32,089</u>	<u>\$ (3,213)</u>	

Assets, Liabilities and Fund Equity

Total assets, liabilities and fund equity decreased a minimal amount due to a decrease in other assets as of June 30, 2010 and June 30, 2009.

Condensed Statements of Revenues and Expenses

The following table presents the statements of revenues and expenses for the Fund for the years ended June 30, 2010 and 2009, (dollars in thousands) and the change from year to year:

	2010	2009	Change	% Change
REVENUES—Income from investments	\$ 1,365	\$ 1,479	\$ (114)	(7.7)%
EXPENSES—Transfers out to Veterans Farm and Home Building Fund of 1943	<u>1,365</u>	<u>1,479</u>	<u>(114)</u>	(7.7)%
OPERATING INCOME	-	-	-	0.0 %
FUND EQUITY—Beginning of year	<u>-</u>	<u>-</u>	<u>-</u>	0.0 %
FUND EQUITY—End of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	0.0 %

Revenues & Expenses

All income generated by the Fund represents amounts due to the Farm and Home Fund and accordingly has been reflected as operating transfers out in the statements of revenues, expenses and changes in fund equity.

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**BALANCE SHEETS
AS OF JUNE 30, 2011 AND 2010**

	2011	2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents:		
Cash in State Treasury	\$ 450	\$ 450
State of California's SMIF	<u>4,191,000</u>	<u>4,191,000</u>
Total cash and cash equivalents	4,191,450	4,191,450
Interest receivable — investments	<u>72,294</u>	<u>122,986</u>
Total current assets	4,263,744	4,314,436
NONCURRENT ASSETS — Investment agreements — at cost	<u>15,550,850</u>	<u>24,561,500</u>
TOTAL	<u>\$ 19,814,594</u>	<u>\$ 28,875,936</u>
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES — Due to the Farm and Home Fund	\$ 72,294	\$ 122,986
NONCURRENT LIABILITIES — Bond reserve due to the Farm and Home Fund	19,742,300	28,752,950
FUND EQUITY	<u> </u>	<u> </u>
TOTAL	<u>\$ 19,814,594</u>	<u>\$ 28,875,936</u>

See notes to financial statements.

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND EQUITY
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	2011	2010
REVENUES — Income from investments	\$2,142,052	\$ 1,365,367
EXPENSES — Transfers out to Veterans Farm and Home Building Fund of 1943	<u>2,142,052</u>	<u>1,365,367</u>
OPERATING INCOME	-	-
FUND EQUITY — Beginning of year	<u> </u>	<u> </u>
FUND EQUITY — End of year	<u>\$ -</u>	<u>\$ -</u>

See notes to financial statements.

**VETERANS DEBENTURE REVENUE FUND,
DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA**

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from investment income	\$ 2,192,744	\$ 1,365,367
Payments to other funds	<u>(11,203,394)</u>	<u>(4,569,567)</u>
Net cash used in operating activities	(9,010,650)	(3,204,200)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sales and matures of investments in agreements	<u>9,010,650</u>	<u>-</u>
CHANGE IN CASH AND CASH EQUIVALENTS	-	(3,204,200)
CASH AND CASH EQUIVALENTS:		
Beginning of year	<u>4,191,450</u>	<u>7,395,650</u>
End of year	<u>\$ 4,191,450</u>	<u>\$ 4,191,450</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES:		
Excess of revenues over expenses	\$ -	\$ -
Adjustments to reconcile net cash used in operating activities — effect of changes in assets and liabilities:		
Decrease in interest receivable and investments in agreements	50,692	9,276
Decrease in due to Veterans Farm and Home Building Fund of 1943	<u>(9,061,342)</u>	<u>(3,213,476)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (9,010,650)</u>	<u>\$ (3,204,200)</u>

See notes to financial statements.

VETERANS DEBENTURE REVENUE FUND, DEPARTMENT OF VETERANS AFFAIRS, STATE OF CALIFORNIA

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Fund — Department of Veterans Affairs, State of California (the “Department”) is a separate legal entity, acting as 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. The Board’s membership consists of the seven members, all of whom are appointed by the Governor, subject to confirmation by the State Senate. The Department is authorized to issue revenue bonds to fund low-interest farm and home loan contracts with veterans living in the state of California.

In December 1997, the Department amended the revenue bond resolution provision regarding the Bond Reserve Account in the Veterans Debenture Revenue Fund (the “Fund”). 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. To calculate the reserve requirement, the Ninth Supplemental Resolution was established with respect to the revenue bonds with interest rates fixed to maturity issued pursuant to such resolution (1997 Series A, B, and C Bonds; 1998 Series A Bonds; 1999 Series A and B Bonds; 2000 Series A, B, and C Bonds; 2001 Series A Bonds), a requirement equal to at least 7% of the outstanding principal amount of such Revenue Bonds. With respect to the 2002 Series A Bonds, the Resolution requires an amount equal to at least 5% of the outstanding principal amount of such Revenue Bonds. 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 Fund to the Veterans Farm and Home Building Fund of 1943 (“Farm and Home Fund”) at the request of the Department. Investment earnings of the Fund are transferred to the Farm and Home Fund.

At June 30, 2011 and 2010, the liabilities of the Fund represent amounts due to the Farm and Home Fund and, accordingly, are included as a receivable in the financial statements of the Farm and Home Fund.

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 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.

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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Accounting — The Fund is classified as a proprietary fund type for accounting purposes. Generally, revenues are recorded when earned and become measurable and expenses are recognized as incurred.

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 equivalents. At June 30, 2011 and 2010, cash equivalents consisted of the state of California's Surplus Money Investment Fund, carried at cost, which approximates fair value at June 30, 2011 and 2010.

Investments — All investments are reported at fair value, except for nonparticipating fixed interest investment agreements, which are valued using cost-based measures. The fair value of investments is based on published market prices and quotations from major investment brokers. Income from investments includes net unrealized appreciation or depreciation in the fair value of investments.

Revenues and Operating Transfers — Income from investments is recorded as earned. A corresponding operating transfer out is recorded to reflect the required transfer to the Farm and Home Fund.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash in State Treasury — Cash in the State Treasury represents amounts held in the Fund's general operating accounts with the State Treasury. These monies are pooled with the monies of other state agencies and invested by the State Treasurer's office. These assets are not individually identifiable. The carrying amount of the Fund's deposits in State Treasury was \$450 as of June 30, 2011 and 2010, respectively.

State of California's Surplus Money Investment Fund (SMIF) — Cash in the SMIF represents the value of the deposits in the State Treasurer's pooled investment program, which is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2011 and 2010, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value. For a complete description of the risks related to this program refer to the State of California Comprehensive Annual Financial Report that includes information about the State's pooled investment program. The carrying amount of the Fund's deposits in SMIF was \$4,191,000 as of June 30, 2011 and 2010, respectively.

Investments — Investment of bond funds is restricted by applicable California law and the various bond resolutions associated with each issuance, generally, to certain types of investments. These investments include direct obligations of the U.S. government and its agencies and investment agreements with financial institutions or insurance companies rated within the top two ratings of a nationally recognized rating service.

The Fund's investment agreements, carried at cost, were \$15,550,850 as of June 30, 2011 and \$24,561,500 as of June 30, 2010. The interest rates on investment agreements are fixed and range from 5.38% to 5.62%. The investment agreements expire from 2019 to 2028.

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 such factors as economic conditions, individual company earning performance, and market liquidity, while fixed-income securities are

particularly sensitive to credit risks and changes in interest rates. It is the investment policy of the Fund to invest substantially all of its funds within SMIF and the remainder in investment contracts or with insurance administrators to limit the Fund's exposure to most types of investment risk.

Credit Risk — Fixed-income securities are subject to credit risk, which is the chance that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed-income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. At June 30, 2011 and 2010, the Fund does not have significant investments exposed to credit risk.

Custodial Credit Risk — Custodial credit risk is the risk that in the event of the failure of the custodian, the investments may not be returned. At June 30, 2011 and 2010, the Fund did not have any investments exposed to custodial credit risk. All investments are held by the state of California.

Concentration of Credit Risk — Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the Fund to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. At June 30, 2011 and 2010, the Fund did not have a significant concentration of credit risk.

Interest Rate Risk — Interest rate risk is the risk that the value of fixed-income securities will decline due to decreasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. At June 30, 2011 and 2010, the Fund does not have any significant debt investments that are highly sensitive to changes in interest rates.

The Fund's investments include Guaranteed Investment Contracts (GICs) with insurance companies. The GICs are collateralized by investments held by the State of California on behalf of the Fund. Additionally, the Fund only invests in investment agreements issued by highly rated insurance companies and management regularly monitors the credit rating of the insurance companies issuing such investment agreements as part of monitoring the Fund's exposure to credit risk.

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

	2011	2010
Guaranteed Investment Contracts — at cost	<u>\$ 15,550,850</u>	<u>\$ 24,561,500</u>

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**APPENDIX C
CERTAIN DEPARTMENT FINANCIAL INFORMATION
AND OPERATING DATA**

Contracts of Purchase

Set forth below is certain financial information regarding Contracts of Purchase.

Existing Contracts of Purchase

The following charts describe the loan-to-value ratio of Contract of Purchase based on the original appraised value of the property, geographic distribution, high LTV distribution, and portfolio age data of Contracts of Purchase financed under the Program as of December 31, 2011 using proceeds of Veterans G.O. Bonds, Revenue Bonds and other amounts under the 1943 Fund. Current appraised value may be higher or lower than original appraised value.⁽¹⁾

Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011⁽²⁾

	<u>Uninsured</u>	<u>Original Radian Insured⁽³⁾</u>	<u>Additional Radian Insured⁽³⁾</u>	<u>VA Guaranteed</u>	<u>Total</u>
Single Family Homes					
Less than 30% LTV	\$ 34,996	\$ 1,174	\$ 182	\$ 371	\$ 36,723
30-49% LTV	78,466	6,819	699	836	86,820
50-59% LTV	87,431	14,344	2,335	2,204	106,314
60-69% LTV	132,835	27,220	9,963	6,730	176,748
70-79% LTV	69,211	18,120	98,142	29,266	214,739
Sub-total	\$ 402,939	\$ 67,677	\$ 111,321	\$ 39,407	\$ 621,344
80-84% LTV	\$ 10,663	\$ 2,780	\$ 131,993	\$ 29,596	\$ 175,032
85-89% LTV	18,869	82	46,547	40,315	105,813
90-94% LTV	40,118	-	26,426	106,702	173,246
95-97% LTV	1,815	-	-	89,533	91,348
Sub-total	\$ 71,465	\$ 2,862	\$ 204,966	\$ 266,146	\$ 545,439
Greater than 97% LTV	\$ 899	\$ 144	\$ -	\$ 35,430	\$ 36,473
Other Property Types					
Farms.....	\$ 2,428	\$ 148	\$ 1,083	\$ -	\$ 3,659
Mobile Homes in Parks	19,749	213	19,496	-	39,458
Home Improvement Loans	15,655	-	-	-	15,655
Homes under Construction	694	-	-	-	694
Sub-total	\$ 38,526	\$ 361	\$ 20,579	\$ -	\$ 59,466
Special Status Contracts of Purchase					
Real Estate Owned ⁽⁴⁾	\$ 4,306	\$ 122	\$ 6,144	\$ 380	\$ 10,952
Cancelled.....	\$ 3,159	\$ 146	\$ 7,616	\$ 3,680	\$ 14,601
Disability Program ⁽⁵⁾	\$ 598	\$ 540	\$ -	\$ -	\$ 1,138
Sub-total	\$ 8,063	\$ 808	\$ 13,760	\$ 4,060	\$ 26,691
Total Portfolio	\$ 521,892	\$ 71,852	\$ 350,626	\$ 345,043	\$ 1,289,413

⁽¹⁾ For many properties financed with Contracts of Purchase, the appraised value as of December 31, 2011, is lower than the original appraised value.

⁽²⁾ Amounts in thousands. LTV based on current Contracts of Purchase balance as of December 31, 2011, divided by original appraised value of the property, except when the Department updates the appraised value of the home when the veteran applies for a home improvement loan. In such cases, the LTV is calculated with the new appraised value.

⁽³⁾ The Radian Policies provide coverage for aggregate losses incurred on covered Contracts of Purchase following property disposition, above an aggregate 2% deductible based upon a percentage of the originally insured balances of the applicable Contracts of Purchase of an applicable subgroup. As many of the Contracts of Purchase insured under the Original Radian Policy have high originally insured balances but have been paid down significantly over the life of such Contracts of Purchase, the Department does not anticipate that it will incur losses on Contracts of Purchase in excess of the 2% deductible. However, as of December 31, 2011, the aggregate 2% deductible under the Additional Radian Policy was approximately \$24.4 million. The Department has calculated that its accumulated losses with respect to Contracts of Purchase insured under the Additional Radian Policy are approximately \$36.9 million. The Department has tendered a claim to Radian for the balance of approximately \$12.5 million, which amount Radian disputes. For more information see "THE PROGRAM – USDVA Guaranty Program Loan Insurance – Primary Mortgage Insurance."

⁽⁴⁾ Repossessed properties and delinquent Contracts of Purchase carried as REO on financial statements.

⁽⁵⁾ Contracts of Purchase where payments are made on behalf of veterans by the Department's life and disability coverage plan.

**Geographic Distribution of Contracts of Purchase
Approximate Principal Balance Outstanding
as of December 31, 2011⁽¹⁾**

County	
San Diego	\$ 141,921
Riverside	137,810
Sacramento	98,421
Los Angeles	88,150
San Bernardino	79,551
Fresno	78,376
Kern	69,985
Shasta	45,539
Solano	39,953
Orange	32,815
Kings	32,166
Placer	29,723
San Joaquin	29,114
Tulare	26,357
Butte	26,169
Other Northern California Counties....	206,580
Other Central California Counties	98,220
Other Southern California Counties....	28,563
Statewide—California	\$ 1,289,413

⁽¹⁾ Amounts in thousands.

Portfolio Age Data for Outstanding Contracts of Purchase as of December 31, 2011

Origination Date	Number of Contracts of Purchase	% of Contracts of Purchase in Portfolio	Outstanding Principal Balance ⁽¹⁾	Outstanding Principal Balance as a Percent of Total Portfolio
1998 and Prior	2,356	25.59%	\$ 99	7.71%
1999	366	3.98	36	2.76
2000	507	5.51	54	4.21
2001	154	1.67	16	1.23
2002	334	3.63	41	3.21
2003	869	9.44	147	11.39
2004	1,050	11.40	196	15.22
2005	649	7.05	110	8.56
2006	752	8.17	151	11.74
2007	778	8.45	164	12.73
2008	834	9.06	198	15.34
2009	279	3.03	43	3.36
2010	181	1.97	21	1.64
2011	98	1.06	12	0.90
Total	9,207	100.00%	\$ 1,289	100.00%

⁽¹⁾ Amounts in millions.

Contracts of Purchase⁽¹⁾ with 97% LTV⁽²⁾ or Higher as of December 31, 2011

County	USDVA Guaranteed⁽³⁾	No USDVA Guaranty or other Primary Mortgage Insurance	Total Contracts of Purchase with 97% or Higher LTV	Outstanding Balance of Contracts of Purchase with 97% or Higher LTV⁽⁴⁾
San Diego	25	0	25	\$ 9,007
Sacramento	25	0	25	6,758
Riverside	22	0	22	4,600
Kern	18	0	18	2,885
Los Angeles	18	0	18	5,934
Shasta	13	1	14	2,724
Orange	13	0	13	5,363
Fresno	12	0	12	2,719
All Other Counties ⁽⁵⁾	121	0	121	33,686
Total	267	1	268	\$ 73,676

⁽¹⁾ Includes "Single Family Homes," "Other Property Types" and "Special Status Contracts of Purchase" as described in the table titled "Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011." Excludes Home Improvement Loans, as described in the table titled "Loan-to-Value Ratio of Contracts of Purchase Based on Original Appraised Value as of December 31, 2011."

⁽²⁾ LTV based on Contracts of Purchase balance as of December 31, 2011 divided by original appraised value of the property, except where the Department has updated the appraised value of the applicable home after a veteran has applied for a home improvement loan. In most cases, the LTV is calculated with the new appraised value. For many properties financed with Contracts of Purchase, the appraised value as of December 31, 2011, is lower than the original appraised value.

⁽³⁾ See "THE PROGRAM – USDVA Guaranty Program Loan Insurance – USDVA Guaranty Program."

⁽⁴⁾ Amounts in thousands.

⁽⁵⁾ All counties not listed individually had less than 10 total contracts with a LTV of 97% or higher, as described above.

Primary Mortgage Insurance Coverage

The Contracts of Purchase insured under Radian Policies are divided into four sub-groups. The following table describes the sub-groups and outstanding Contracts of Purchase, insured under Radian Policies, as of December 31, 2011.

Group	Approximate Contracts of Purchase Origination Dates	Total Contracts of Purchase	Percentage of Radian Insured Portfolio ⁽¹⁾	Percentage of Total Portfolio ⁽¹⁾	Loan-to- Value Ratio ⁽²⁾⁽³⁾	Original Aggregate Sub- group Deductible	Remaining Aggregate Sub- group Deductible
1	Prior to 2/2/1998	655	10.96%	3.55%	55.31%	\$ 14,024,311.86	\$ 12,438,647.41
2	2/3/1998 – 10/30/1998	74	1.33	0.43	58.78	2,101,256.74	2,050,970.74
3	11/1/1998 – 9/30/2000	15	0.42	0.14	66.88	568,391.34	541,855.34
4	10/1/2000 – present	1,988	87.29	28.23	80.16	24,464,544.53	(12,485,480.95) ⁽⁴⁾
	Total	2,732	100.00%	28.79%	75.98%	\$ 41,158,504.47	

Source: Department of Veterans Affairs.

⁽¹⁾ Percentage based on outstanding Contract of Purchase principal amounts.

⁽²⁾ Calculated as the ratio of the outstanding principal amount of the aggregate Contracts of Purchase during the applicable period as compared to the aggregate original appraised value of the properties subject to such Contracts of Purchase at origination.

⁽³⁾ For many properties financed with Contracts of Purchase, the appraised value as of December 31, 2011 is lower than the original appraised value.

⁽⁴⁾ The Radian Policies provide coverage for aggregate losses incurred on covered Contracts of Purchase following property disposition, above an aggregate 2% deductible based upon a percentage of the originally insured balances of the applicable Contracts of Purchase of an applicable subgroup. As many of the Contracts of Purchase insured under the Original Radian Policy have high originally insured balances but have been paid down significantly over the life of such Contracts of Purchase, the Department does not anticipate that it will incur losses on Contracts of Purchase in excess of the 2% deductible. However, as of December 31, 2011, the aggregate 2% deductible under the Additional Radian Policy was approximately \$24.4 million. The Department has calculated that its accumulated losses with respect to Contracts of Purchase insured under the Additional Radian Policy are approximately \$36.9 million. The Department has tendered a claim to Radian for the balance of approximately \$12.5 million, which amount Radian disputes. For more information see “THE PROGRAM – USDVA Guaranty Program Loan Insurance – Primary Mortgage Insurance.”

Contracts of Purchase Origination and Principal Repayment Experience

The following tables represent, respectively, a historical picture of Contract of Purchase originations since the fiscal year ended June 30, 1990 and selected principal repayments with respect to Contracts of Purchase since the fiscal year ended June 30, 1990.

Contracts of Purchase Originated During the Fiscal Year

Fiscal Year Ending June 30	<u>Veterans G.O. Bonds</u>		<u>Pre-Ullman Moneys</u>		<u>Revenue Bonds</u>		<u>Total</u>	
	Number ⁽¹⁾	Amount	Number ⁽¹⁾	Amount	Number ⁽¹⁾	Amount	Number ⁽¹⁾	Amount
1990	2,097	\$187,445,600	--	--	522	\$38,150,800	2,619	\$225,596,400
1991	1,927	200,393,500	--	--	359	29,189,600	2,286	229,583,100
1992	1,086	111,600,500	--	--	388	34,671,600	1,474	146,272,100
1993	740	94,417,100	--	--	286	27,443,800	1,026	121,860,900
1994	843	117,213,779	--	--	337	34,740,536	1,180	151,954,315
1995	2,109	286,178,376	--	--	822	84,860,894	2,931	371,039,270
1996	762	107,751,444	--	--	222	22,723,617	984	130,475,061
1997	766	118,344,636	--	--	201	21,853,933	967	140,198,569
1998	615	99,224,002	188	\$17,716,376	164	18,871,066	967	135,811,444
1999	758	129,521,359	575	92,728,280	274	33,284,343	1,607	255,533,982
2000	1,045	185,180,534	1,725	333,328,690	708	92,214,409	3,478	610,723,633
2001	844	135,498,480	1,211	232,445,146	697	101,175,512	2,752	469,119,138
2002	334	56,887,867	416	74,915,487	204	27,178,525	954	158,981,879
2003	357	68,105,508	508	99,105,265	123	16,285,625	988	183,496,398
2004	444	97,223,818	1,173	274,187,085	165	26,109,792	1,782	397,520,696
2005	285	72,958,181	702	181,075,275	178	37,152,048	1,165	291,185,504
2006	198	48,999,641	898	230,993,270	5	831,638	1,101	280,824,549
2007	74	19,751,777	764	173,744,639	68	11,349,372	906	204,845,788
2008	214	38,721,589	428	139,470,089	417	111,589,399	1,059	289,781,076
2009	255	83,697,271	161	42,079,390	263	66,032,084	679	191,808,746
2010	34	10,805,881	31	8,170,125	74	13,122,489	139	32,098,495
2011	23	5,741,933	92	7,235,231	41	7,027,890	156	20,005,054
2012 ⁽²⁾	7	2,260,068	10	1,798,634	13	2,169,531	30	6,228,233

⁽¹⁾ Number of Contracts of Purchase originated does not include home improvement loans.

⁽²⁾ As of December 31, 2011.

Selected Principal Flows with respect to Contracts of Purchase Funded by both Veterans G.O. Bonds and Revenue Bonds (Dollar Amounts in Thousands)

Fiscal Year Ending June 30	Contracts of Purchase Funded During Year	Contracts of Purchase Prepayments During Year	Other Principal Receipts-Losses During Year	Contracts of Purchase Balance at End of Year	Average Rate		Annual Average Prepayment Rate	Annual Average Origination Rate
					on all Outstanding Contracts of Purchase	Average of Monthly FHLMC 30-year Conventional Loan Rate		
Principal Flows					Rates			
1993	\$ 121,861	\$ 273,817	\$ 105,629	\$ 2,532,294	8.0%	8.0%	10.3%	4.6%
1994	151,954	359,749	98,773	2,225,726	8.0	7.3	15.1	6.4
1995	371,039	111,984	74,706	2,410,075	7.8	8.7	4.8	16.0
1996	130,475	141,767	92,521	2,306,262	8.0	7.5	6.0	5.5
1997	140,199	111,254	106,027	2,229,180	8.0	7.9	4.9	6.2
1998	135,812	172,134	94,106	2,098,752	7.7	7.2	8.0	6.3
1999	255,534	183,776	101,254	2,069,256	6.9	6.9	8.8	12.3
2000	610,724	138,401	106,522	2,435,056	6.8	8.1	6.1	27.1
2001	469,119	189,902	91,033	2,623,241	6.8	7.5	7.5	18.5
2002	158,982	330,068	86,556	2,365,599	6.8	6.9	13.2	6.4
2003	183,496	701,785	74,643	1,772,667	6.7	5.9	33.9	8.9
2004	397,521	576,907	53,833	1,539,448	6.3	5.9	34.8	24.0
2005	291,186	272,044	70,564	1,488,026	5.9	5.8	18.0	19.2
2006	280,825	204,037	51,481	1,513,333	5.8	6.2	13.6	18.7
2007	204,846	132,207	50,403	1,535,569	5.8	6.4	8.7	13.4
2008	289,781	82,575	53,915	1,688,860	5.8	6.2	5.1	18.0
2009	191,809	84,010	56,756	1,739,903	5.9	5.6	4.9	11.2
2010	32,098	139,533	77,901	1,554,567	5.7	5.0	8.5	1.9
2011	20,005	123,520	74,199	1,376,853	5.7	4.6	8.4	1.4
2012 ⁽¹⁾	6,228	59,698	34,189	1,289,194	5.7	4.2	9.0	0.9
	\$ 4,443,494	\$ 4,389,168	\$ 1,555,011					

⁽¹⁾ As of December 31, 2011

Reservation rates on new Contracts of Purchase for period:

<u>Period</u>	<u>Veterans G.O. Bonds⁽²⁾</u>	<u>Pre-Ullman Funds⁽²⁾</u>	<u>Revenue Bonds</u>
Prior to January 1, 1999, substantially all newly originated Contracts have the same rate as the then outstanding Contracts.			
January 1, 1999 through June 30, 2000	6.65%	6.65%	5.95%
July 1, 2000 through February 28, 2001	7.50	7.95	6.95
March 1, 2001 through May 31, 2001	6.50	7.95	6.40
June 1, 2001 through August 31, 2001	6.50	7.10	6.40
September 1, 2001 through April 1, 2002	6.25	6.50	6.00
April 2, 2002 through July 31, 2002	5.90	5.50	5.80
August 1, 2002 through December 1, 2002	5.50	6.00	5.80
December 2, 2002 through June 15, 2003	4.99	5.40	5.25
June 16, 2003 through September 1, 2003	4.25	4.50	4.50
September 1, 2003 through September 15, 2003	4.25	4.99	4.50
September 16, 2003 through May 5, 2004	4.50	4.99	4.50
May 6, 2004 through June 1, 2004	4.75	5.25	4.75
June 2, 2004 through December 13, 2004	4.95	5.50	5.10
December 14, 2004 through April 3, 2005	4.95	5.50	5.50
April 4, 2005 through December 9, 2005	5.15	5.50	5.50
December 10, 2005 through February 5, 2006	5.50	5.50	5.50
February 6, 2006 through March 14, 2006	5.70	5.70	5.70
March 15, 2006 through April 25, 2006	6.00	6.00	6.00
April 26, 2006 through July 5, 2006	6.25	6.25	6.25
July 6, 2006 through December 19, 2006	6.50	6.50	6.50
December 20, 2006 through March 15, 2007	5.50	6.10	5.75
March 16, 2007 through July 9, 2007	5.50	6.10	5.25
July 10, 2007 through August 12, 2007	5.50	6.45	5.25
August 13, 2007 through October 14, 2007	5.50	6.55	5.25
October 15, 2007 through February 6, 2008	5.50	6.55	5.45
February 7, 2008 through June 25, 2008	5.50	6.10	5.45
June 26, 2008 through January 28, 2009	5.95	6.20	5.50
January 29, 2009 through February 13, 2011	5.95	6.20	5.75
February 14, 2011 through October 2, 2011	5.70	5.95	5.50
October 3, 2011 through present	5.50	6.20	5.25

⁽²⁾ Rates for Contracts of Purchase for mobile home in parks are 1% higher than the applicable established rates.

Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments

The following table shows amounts expected to be available to fund Contracts of Purchase from funds related to Veterans G.O. Bonds and Revenue Bonds. Additional monies may become available to finance Contracts of Purchase through the future issuances of Veterans G.O. Bonds and Revenue Bonds. The Department has discretion to use monies available from prior, current or future bond issues in any order of priority it chooses. As of December 31, 2011, the Department had 17 pending applications for Contracts of Purchase in the aggregate amount of approximately \$1,850,373.

Amounts Expected to be Available to Fund Contracts of Purchase⁽¹⁾

	Pre-Ullman Monies			QVMB Proceeds			QMB Proceeds			Current or Expected Investment	Contracted Investment Rate (%)
	Amount On Deposit on December 31, 2011	Amounts Expected to be Deposited or Applied to Contracts through March 1, 2012	Amount Expected to be Available on March 1, 2012	Amount On Deposit on December 31, 2011	Amounts Expected to be Deposited or Applied to Contracts through March 1, 2012	Amount Expected to be Available on March 1, 2012	Amount On Deposit on December 31, 2011	Amounts Expected to be Deposited or Applied to Contracts through March 1, 2012	Amount Expected to be Available on March 1, 2012		
Veterans G.O. Bond Proceeds and Recycling Subaccounts											
Pre-Ullman Monies.....	\$ 3,530	\$ (1,500)	\$ 2,030	\$ 0	\$ 0	\$ 0				SMIF ⁽²⁾	Variable
QVMB Reimbursement.....	1,701	\$ (1,500)	201	0	0	0				SMIF ⁽²⁾	Variable
Series CC/CD.....	0	0	0	0	0	0				SMIF ⁽²⁾	Variable
Series CE.....	0	0	0	76	(76)	0				SMIF ⁽²⁾	Variable
Other G.O. Bond Series.....	0	0	0	0	0	0				N.A.	N.A.
Total.....	\$ 5,231	\$ (3,000)	\$ 2,231	76	(76)	0					
Revenue Bond Proceeds and Recycling Subaccounts											
QMB Reimbursement.....	\$ 2,569	\$ (1,500)	\$ 1,069				\$ 0	\$ 0	\$ 0	SMIF ⁽²⁾	Variable
Series 2011A.....	0	0	0				13,000	11,252	1,748	SMIF ⁽²⁾	Variable
Other Revenue Bond Series.....	0	0	0				0	0	0	N.A.	N.A.
Total.....	\$ 2,569	\$ (1,500)	\$ 1,069				0	0	0		
Grand Total	\$ 7,800	\$ (4,500)	\$ 3,300	\$ 76	\$ (76)	\$ 0	\$ 13,000	\$ 11,252	\$ 1,748		

⁽¹⁾ Amounts in thousands.

⁽²⁾ Surplus Money Investment Fund ("SMIF"). Amounts invested in SMIF may be withdrawn and reinvested at any time. See "THE 1943 FUND – Investments in the Surplus Money Investment Fund."

⁽³⁾ A portion of these funds are, or may be, placed in several investment agreements with different providers. See "– Additional Investments" below.

Cancellations and Delinquencies

Set forth in the tables below are (i) a comparative chart of delinquent, cancelled and repossessed Contracts of Purchase and certain comparative information regarding USDVA guaranteed loans during the same period, and a breakdown of delinquencies by county and origination date, (ii) distribution of delinquencies with respect to Contracts of Purchase by County and (iii) delinquencies with respect to Contracts of Purchase by origination date.

Percentage of Number of Contracts of Purchase in the Department's Portfolio which are Delinquent	2002 ⁽¹⁾	2003 ⁽¹⁾	2004 ⁽¹⁾	2005 ⁽¹⁾	2006 ⁽¹⁾	2007 ⁽¹⁾	2008 ⁽¹⁾	2009 ⁽¹⁾	2010 ⁽¹⁾	2011 ⁽¹⁾	2012 ⁽²⁾	2012 ⁽³⁾
30-60 days ⁽⁴⁾	3.52%	3.13%	2.97%	3.18%	2.93%	2.68%	2.75%	3.30%	3.61%	3.43%	3.76%	4.05%
60+ days ⁽⁴⁾	2.43	2.03	1.43	1.48	0.85	1.13	1.64	3.30	3.68	3.72	3.80	3.96
Foreclosures in inventory (Cancelled Contracts) ⁽⁴⁾⁽⁵⁾	0.25	0.23	0.18	0.13	0.09	0.15	0.29	0.58	0.85	0.69	0.89	0.83
Real Estate in inventory ⁽⁴⁾	0.16	0.09	0.04	0.02	0.01	0.06	0.21	0.55	0.62	0.85	0.67	0.64
Percentage of Number of USDVA Guaranteed Loans in the U.S. which are Delinquent⁽⁶⁾												
30-60 days.....	4.87	4.83	4.53	4.49	3.81	3.66	3.76	3.76	3.65	3.45	3.32	(7)
60+ days.....	2.85	3.15	2.90	3.10	2.53	2.44	2.90	4.01	3.83	3.33	3.60	(7)
Foreclosures in inventory.....	1.72	1.49	1.45	1.50	1.10	1.02	1.33	2.07	2.50	2.30	2.25	(7)
Percentage of Number of USDVA Guaranteed Loans in California which are Delinquent⁽⁶⁾												
30-60 days.....	4.57	4.67	4.09	3.52	2.92	2.56	2.64	2.57	2.55	2.37	2.38	(7)
60+ days.....	2.57	2.79	2.34	2.11	1.30	1.33	1.82	2.78	3.09	2.42	2.54	(7)
Foreclosures in inventory.....	1.12	0.93	0.69	0.60	0.36	0.44	0.82	1.50	1.90	1.40	1.40	(7)
Percentage of Number of Prime Loans in the U.S. which are Delinquent⁽⁶⁾												
30-60 days.....	2.17	1.84	1.69	1.55	1.54	1.78	2.08	2.49	2.39	2.33	2.30	(7)
60+ days.....	0.83	0.67	0.63	0.60	0.70	0.85	1.65	3.52	4.27	3.04	3.03	(7)
Foreclosures in inventory.....	0.87	0.53	0.49	0.42	0.41	0.59	1.42	3.00	3.49	3.40	3.37	(7)
Percentage of Number of Prime Loans in California which are Delinquent⁽⁵⁾												
30-60 days.....	1.48	1.25	0.95	0.82	0.89	1.28	1.83	2.34	2.15	2.03	2.00	(7)
60+ days.....	0.45	0.39	0.26	0.20	0.27	0.62	2.19	5.39	6.80	4.75	4.24	(7)
Foreclosures in inventory.....	0.34	0.18	0.10	0.07	0.10	0.41	1.96	4.25	3.91	3.01	3.11	(7)
Percentage of Number of Contracts of Purchase in the Department's Portfolio which are Delinquent, Subject to Repayment/Forbearance Agreements or Cancelled Contracts												
30-60 days (Delinquent)	2.95%	2.77%	2.72%	2.96%	2.84%	2.56%	2.58%	2.86%	3.18%	3.17%	3.59%	3.77%
30-60 days (Repayment/Forbearance Agreement)	0.57	0.36	0.25	0.22	0.09	0.12	0.17	0.44	0.43	0.26	0.17	0.28
Total	3.52	3.13	2.97	3.18	2.93	2.68	2.75	3.30	3.61	3.43	3.76	4.05
60+ days (Delinquent)	1.38	1.32	1.08	1.17	0.75	1.03	1.29	2.25	2.19	2.78	2.82	3.06
60+ days (Repayment/Forbearance Agreement)	1.05	0.71	0.35	0.31	0.10	0.10	0.35	1.05	1.49	0.94	0.98	0.90
Total	2.43	2.03	1.43	1.48	0.85	1.13	1.64	3.30	3.68	3.72	3.80	3.96
Foreclosures in Inventory (Cancelled Contracts)	0.23	0.22	0.15	0.13	0.09	0.15	0.26	0.56	0.80	0.62	0.82	0.81
"Repayment/Forbearance Agreement"	0.02	0.01	0.03	0.00	0.00	0.00	0.03	0.02	0.05	0.07	0.07	0.02
Total	0.25	0.23	0.18	0.13	0.09	0.15	0.29	0.58	0.85	0.69	0.89	0.83

(1) For the Fiscal Year ended June 30.

(2) For the three months ended September 30, 2011.

(3) For the six months ended December 31, 2011.

(4) The Department has adjusted the criteria used to identify delinquent Contracts of Purchase from \$25 or more delinquent to over \$3 delinquent. The data below represents the breakout of delinquent, repayment/forbearance agreements and cancelled Contracts of Purchase. These figures include Contracts of Purchase that were the subject of forbearance or repayment agreements between the Department and the Contracts of Purchase holder.

(5) Bankruptcies are included in cancelled Contracts of Purchase statistics and do not exceed in any period more than 10% of total cancellations and bankruptcy category. Federal bankruptcy law precludes repossession action of Contracts of Purchase when veteran is in bankruptcy proceedings until the automatic stay is lifted.

(6) Source: National Delinquency Survey published by the Mortgage Bankers Association of America (the "Survey"). For 2002 data reported is for "Conventional Loans." In the Survey loans are categorized as prime loans or otherwise based upon the Survey respondents' internal classifications.

(7) Not available.

Distribution of Contracts of Purchase Delinquencies by County as of December 31, 2011⁽¹⁾⁽²⁾

County	Total Delinquent Contracts of Purchase	Contracts of Purchase Delinquent 30 days	Contracts of Purchase Delinquent 60 days	Contracts of Purchase Delinquent 90+ days	Total Delinquent Account Balance ⁽³⁾
Riverside	86	34	8	44	\$18,484
San Diego	81	34	11	36	17,001
Fresno	66	35	10	21	11,349
Sacramento	64	24	8	32	11,725
San Bernardino	62	32	12	18	8,506
Los Angeles	55	30	8	17	8,278
Kern	54	18	13	23	5,990
Shasta	45	20	10	15	7,325
San Joaquin	25	11	4	10	5,661
Tulare	25	12	5	8	4,319
Butte	21	10	4	7	2,831
Kings	20	6	8	6	3,909
Placer	19	10	3	6	4,433
Stanislaus	17	4	4	9	3,412
All Other ⁽⁴⁾	232	94	31	107	\$40,479
Total	872	374	139	359	\$153,702

⁽¹⁾ The Department has adjusted the criteria used to identify delinquent Contracts of Purchase from \$25 or more delinquent to over \$3 delinquent.

⁽²⁾ Includes REO and cancelled Contracts of Purchase.

⁽³⁾ Amounts in thousands.

⁽⁴⁾ "All Other" counties had less than 17 delinquent Contracts of Purchase outstanding.

Contracts of Purchase Delinquencies by Origination Date as of December 31, 2011⁽¹⁾⁽²⁾

Origination Year	Contracts of Purchase Delinquent 30-60 days	Outstanding Balance of Contracts of Purchase Delinquent 30-60 days ⁽³⁾	Contracts of Purchase Delinquent 60-90 days	Outstanding Balance of Contracts of Purchase Delinquent 60-90 days ⁽³⁾	Contracts of Purchase Delinquent 90+ days	Outstanding Balance of Contracts of Purchase Delinquent 90+ days ⁽³⁾	Total Contracts of Purchase Delinquent	Total Outstanding Balance of Contracts of Purchase ⁽³⁾
Pre-2004	166	\$ 15,484	64	\$ 5,704	98	\$ 9,400	328	\$ 30,588
2004	33	6,270	10	1,898	51	10,461	94	18,629
2005	29	5,193	13	2,872	42	7,371	84	15,436
2006	48	11,942	15	2,697	55	14,308	118	28,947
2007	47	12,538	15	3,896	66	14,323	128	30,757
2008	36	9,777	17	3,836	40	10,002	93	23,615
2009	8	1,893	2	892	5	787	15	3,572
2010	4	929	2	454	0	0	6	1,383
2011	3	423	1	7	2	345	6	775
Total	374	\$ 64,449	139	\$ 22,256	359	\$ 66,997	872	\$ 153,702

⁽¹⁾ Includes REO and cancelled Contracts of Purchase.

⁽²⁾ The Department has adjusted the criteria used to identify delinquent Contracts of Purchase from \$25 or more delinquent to over \$3 delinquent.

⁽³⁾ Amounts in thousands.

Veterans G.O. Bonds and Revenue Bonds

Selected Information with Respect to Veterans G.O. Bonds and Revenue Bonds

Veterans G.O. Bonds

Series	Bonds Outstanding⁽¹⁾ as of January 1, 2012	Expected Bonds Outstanding⁽¹⁾ as of May 1, 2012	Final Maturity Date of Series as of May 1, 2012	Next Optional Call as of May 1, 2012	Call Price on Such Date	Maximum Coupon subject to Optional Call	Bonds Subject to Special Redemption⁽²⁾
BR.....	\$ 100,000	\$ 100,000	December 1, 2019	Anytime	100%	5.125%	Excess Revenues
BJ11.....	100,000	100,000	December 1, 2013	Anytime	100	5.050	Excess Revenues
BZ.....	100,000	100,000	December 1, 2021	Anytime	100	5.350	Excess Revenues
CA/CB.....	199,460,000	199,460,000	December 1, 2036	June 1, 2015	100	5.050	Excess Revenues
CC/CD.....	359,160,000	359,160,000	December 1, 2040	December 1, 2015	100	4.600	Excess Revenues
CE.....	91,200,000	91,200,000	December 1, 2042	December 1, 2015	100	5.100	Excess Revenues
CF.....	71,920,000	71,920,000	December 1, 2017	N.A.	N.A.	N.A.	Excess Revenues
CG.....	24,535,000	24,535,000	December 1, 2018	N.A.	N.A.	N.A.	Excess Revenues
CH.....	10,985,000	10,985,000	December 1, 2015	N.A.	N.A.	N.A.	Excess Revenues
Sub-total	\$ 757,560,000	\$ 757,560,000					
Commercial Paper	\$ 0	\$ 0	N.A.	N.A.	N.A.	N.A.	N.A.
Total Veterans G.O. Bonds	\$ 757,560,000	\$ 757,560,000					

Veterans Revenue Bonds

Revenue Bonds Issued as Qualified Mortgage Bonds under the 1986 Code

1997 C.....	\$ 3,805,000	\$ 3,805,000	December 1, 2012	Anytime	100%	4.950%	Excess Revenues
2007 A.....	87,895,000	87,895,000	December 1, 2042	December 1, 2016	100	5.000	Excess Revenues
2007 B.....	69,280,000	55,550,000 ⁽³⁾	December 1, 2032	December 1, 2016	100	5.200	Excess Revenues
Sub-total	\$ 160,980,000	\$ 147,250,000					

Revenue Bonds Issued to Refund Bonds Issued Prior to Mortgage Subsidy Bond Tax Act of 1980

1999 A.....	\$ 6,705,000	\$ 0 ⁽³⁾⁽⁴⁾	N.A. ⁽⁴⁾				
1999 B.....	9,985,000	0 ⁽³⁾⁽⁴⁾	N.A. ⁽⁴⁾				
2003 A.....	81,295,000	0 ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾
2005 A.....	41,095,000 ⁽⁵⁾	28,095,000 ⁽⁶⁾	December 1, 2027	June 1, 2015	100%	4.800%	Excess Revenues
2006 A.....	122,950,000	0 ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾	N.A. ⁽⁴⁾
2011 A.....	97,120,000	97,120,000	December 1, 2028	June 1, 2021	100	4.500	Excess Revenues / Unexpended Proceeds
2011 B.....	4,030,000	4,030,000	December 1, 2013	N.A.	N.A.	N.A.	Excess Revenues
2012 A.....	0	220,435,000	December 1, 2028	June 1, 2021	100	3.875	Excess Revenues
Sub-total	\$ 363,180,000	\$ 349,680,000					
Total Revenue Bonds	\$ 524,160,000	\$ 496,930,000					

⁽¹⁾ With respect to Revenue Bonds, "Outstanding" is as defined in Resolution RB-1.

⁽²⁾ Excess Revenues includes, but is not limited to, principal prepayments on Contracts of Purchase.

⁽³⁾ Reflects the redemption of \$14,230,000 of Revenue Bonds from Excess Revenues on March 1, 2012 for which the Department has caused the Trustee to issue a redemption notice.

⁽⁴⁾ Reflects expected refunding with the proceeds of the Offered Revenue Bonds.

⁽⁵⁾ Includes \$13,000,000 of Revenue Bonds redeemed on February 1, 2012 and referenced in Footnote (6).

⁽⁶⁾ Reflects the redemption of \$13,000,000 of Revenue Bonds from Excess Revenues on February 1, 2012.

Additional Investments
(As of December 31, 2011)

In addition to the investments described above under “Contracts of Purchase—Amounts Expected to be Available to Fund Contracts of Purchase and Related Investments,” the following investments have been made or will be made with respect to moneys in the 1943 Fund and in the Bond Reserve Account which secures the Revenue Bonds. Additional moneys in various Funds and Accounts in the 1943 Fund have been invested in SMIF. Amounts invested in SMIF may be withdrawn and reinvested at any time. See “THE 1943 FUND – Investments in the Surplus Money Investment Fund.”

<u>Bond Series</u>	<u>Account Designation⁽¹⁾</u>	<u>Amount (000s)</u>	<u>Investment Provider⁽⁷⁾</u>	<u>Initial Investment Date</u>	<u>Investment Maturity Date</u>	<u>Interest Rate (%)</u>	<u>Bond Series</u>	<u>Account Designation⁽¹⁾</u>	<u>Amount (000s)</u>	<u>Investment Provider⁽⁵⁾</u>	<u>Initial Investment Date</u>	<u>Investment Maturity Date</u>	<u>Interest Rate (%)</u>
1999 A/B	Reserve	\$9,818	Westdeutsche Landesbank Girozentrale	3/30/99	12/1/28	5.38	BJ 11/12	Revenue	Variable ⁽³⁾	Westdeutsche Landesbank Girozentrale	12/19/00	12/1/32	5.50
1997 C	Reserve	\$5,733	Westdeutsche Landesbank Girozentrale	1/9/01	12/1/19	5.625	1997 C	Revenue/ Restricted Recoveries	Variable ⁽⁶⁾	Westdeutsche Landesbank Girozentrale	1/9/01	12/1/19	5.50
BQ/BR	Revenue	Variable ⁽²⁾	Westdeutsche Landesbank Girozentrale	4/28/99	12/1/29	5.37							

⁽¹⁾ Accounts are established in the resolutions authorizing the issuance of Revenue Bonds.

⁽²⁾ Maximum permitted amount on deposit under investment agreement is \$35,000,000.

⁽³⁾ Maximum permitted amount on deposit under investment agreement is \$25,000,000.

⁽⁴⁾ Maximum permitted amount on deposit under investment agreement is \$97,130,000.

⁽⁵⁾ As of February 2, 2012 WestLB AG, New York Branch (formerly known as Westdeutsche Landesbank Girozentrale) was rated “A3” (under review; outlook uncertain) by Moody’s and “A-” (ratings watch positive) by Fitch. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant.

APPENDIX D

DTC AND BOOK-ENTRY ONLY SYSTEM

The information concerning DTC and DTC's "Book-Entry System" has been provided by DTC for use in securities offering documents, and the State and the Department take no responsibility for the accuracy or completeness thereof. The Department and the Trustee cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners either (a) payments of interest, principal or redemption proceeds with respect to the Offered Revenue Bonds, or (b) certificates representing ownership interest in or other confirmation of ownership interest in the Offered Revenue Bonds, or that they will so do on a timely basis or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Official Statement. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC, New York, New York, will act as securities depository for the Offered Revenue Bonds. Purchasers of beneficial ownership interests in the Offered Revenue Bonds will not receive certificates representing their interests in the purchased Offered Revenue Bonds. The Offered Revenue Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered bond certificate will be issued for each maturity of the Offered Revenue Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC. If, however, the aggregate principal amount of any maturity exceeds \$500 million, one bond certificate will be issued with respect to each \$500 million of principal amount of such maturity and an additional bond certificate will be issued with respect to any remaining principal amount of such maturity.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of AA+. The DTC Rules applicable to its

Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com. Nothing contained on such web site is incorporated herein.

Purchases of Offered Revenue Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Offered Revenue Bonds on DTC's records. The ownership interest of each actual purchaser of each Offered Revenue Bond (a "Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Offered Revenue Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive bond certificates representing their ownership interests in the Offered Revenue Bonds, except in the event that use of the book-entry system for the Offered Revenue Bonds is discontinued.

To facilitate subsequent transfers, all Offered Revenue Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Offered Revenue Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Offered Revenue Bonds. DTC's records reflect only the identity of the Direct Participants to whose accounts such Offered Revenue Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Neither the Department nor the Trustee have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Offered Revenue Bonds.

Beneficial Owners of the Offered Revenue Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Offered Revenue Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Offered Revenue Bond documents. For example, Beneficial Owners of the Offered Revenue Bonds may wish to ascertain that the nominee holding the Offered Revenue Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Offered Revenue Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Offered Revenue Bonds unless authorized by a Direct Participant in accordance with DTC's procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the

Department as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Offered Revenue Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Without limiting the generality of the foregoing, the Department, the Trustee and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership or interests in the Offered Revenue Bonds.

Principal, premium, interest payments and redemption proceeds on the Offered Revenue Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Department or the Trustee, on payment dates in accordance with their respective holdings shown on DTC's records. Payments by Direct Participants and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee or the Department or the Trustee, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal, premium, interest and redemption proceeds, if any, to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Department or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct Participants and Indirect Participants.

With respect to the Offered Revenue Bonds registered in the registration books of the Trustee in the name of the Nominee, the Department and the Trustee shall have no responsibility or obligation to any Participant or to any person on behalf of which a Participant holds an interest in the Offered Revenue Bonds. Without limiting the immediately preceding sentence, the Department and the Trustee shall have no responsibility or obligation (unless the Trustee is at such time the Securities Depository) with respect to (i) the accuracy of the records of the Securities Depository, the nominee or any Participant with respect to any ownership interest in the Offered Revenue Bonds, (ii) the delivery to any Participant or any other person, other than a Bondowner as shown in the registration books of the Trustee, of any notice with respect to the Offered Revenue Bonds, or (iii) the payment to any Participant or any other person, other than a Bondowner as shown in the registration books of the Trustee, of any amount with respect to principal of or interest on the Offered Revenue Bonds. The Department and the Trustee may treat and consider the person in whose name each Bond is registered in the registration books of the Trustee as the Bondowner and absolute owner of such Offered Revenue Bond for the purpose of payment of principal of, premium, if any, and interest on such Offered Revenue Bond, for the purpose of giving notices and other matters with respect to such Offered Revenue Bond, and for all other purposes whatsoever.

The Trustee shall pay all principal of and interest on the Offered Revenue Bonds only to or upon the order of the respective Bondowners, as shown in the registration books of the Trustee or their respective attorneys, duly authorized in writing, and all such payments shall be valid and effective to fully satisfy and discharge the obligations under Resolution RB-1 with respect to the payment of principal of, premium, if any, and interest on the Offered Revenue Bonds to the extent of the sum or sums so paid. No person other than a Bondowner, as shown in

the registration books of the Trustee, shall receive a Bond evidencing the obligation to make payments of principal, premium, if any, and interest pursuant to Resolution RB-1 and any Supplemental Resolution. Upon delivery by the Securities Depository to the Trustee and the Department of written notice to the effect that the Securities Depository has determined to substitute a new nominee in place of the Nominee, and subject to the provisions in Resolution RB-1 with respect to record dates, the term nominee in Resolution RB-1 shall mean such new nominee of the Securities Depository.

The Department, the Trustee and the Underwriters cannot and do not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments with respect to the Offered Revenue Bonds received by DTC or its nominee as the registered owner, or any redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis or that DTC will serve and act in the manner described in this Official Statement.

DTC may discontinue providing its services as depository with respect to the Offered Revenue Bonds at any time by giving reasonable notice to the Trustee and discharging its responsibilities with respect thereto under applicable law, or the Department may terminate its participation in the system of book-entry transfer through DTC at any time by giving notice to DTC. Under such circumstances, in the event that a successor depository is not obtained, Offered Revenue Bond certificates are required to be printed and delivered.

If the Department and the Trustee determine not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Offered Revenue Bonds and the Department and the Trustee do not select another qualified securities depository, the Trustee shall deliver physical Offered Revenue Bond certificates to the Beneficial Owners. The Offered Revenue Bonds may thereafter be transferred upon the books of the Trustee by the registered owners, in person or by authorized attorney, upon surrender of Offered Revenue Bonds at the Office of the Trustee in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form approved by the Trustee and upon payment of any charges provided for in the Resolutions. Certificated Offered Revenue Bonds may be exchanged for Offered Revenue Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the Trustee in Sacramento, California, upon payment of any charges provided for in the Resolutions.

THE DEPARTMENT AND THE TRUSTEE, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE OFFERED REVENUE BONDS, WILL SEND ANY NOTICE OF REDEMPTION OR OTHER NOTICES TO OWNERS TO DTC ONLY. ANY FAILURE OF DTC TO ADVISE ANY DTC PARTICIPANT, OR OF ANY DTC PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE REDEMPTION OF THE OFFERED REVENUE BONDS CALLED FOR REDEMPTION OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Offered Revenue Bonds, payment of principal of and interest and other payments with respect to the Offered Revenue Bonds to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Offered Revenue Bonds and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC.

Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

SO LONG AS CEDE & CO., AS NOMINEE OF DTC, IS THE REGISTERED OWNER OF ALL OF THE OFFERED REVENUE BONDS, REFERENCES HEREIN TO THE HOLDERS OF THE OFFERED REVENUE BONDS (OTHER THAN UNDER THE CAPTION “TAX MATTERS” HEREIN) SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE OFFERED REVENUE BONDS.

According to DTC, the foregoing information with respect to DTC has been provided for informational purposes only and is not intended to serve as a representation, warranty or contract modification of any kind.

APPENDIX E

THE AMENDED AND RESTATED MASTER CONTINUING DISCLOSURE UNDERTAKING

This Amended and Restated Master Continuing Disclosure Undertaking (the “Undertaking”) dated as of December 1, 2011 is by the Department of Veterans Affairs of the State of California (the “Department”), pursuant to the Home Purchase Revenue Bonds Resolution No. RB-1, adopted by the Department on March 19, 1980, as amended and supplemented (the “Resolution”), and amends and restates the Department’s Master Continuing Disclosure Undertaking, dated as of December 29, 1997. This Undertaking is executed and delivered in connection with the issuance, now or in the future, of Bonds pursuant to the Resolution, but only those Bonds which are expressly made subject to this Undertaking in any one of the Department documents authorizing the issuance or remarketing of such Bonds (collectively, the “Subject Bonds”).

The Department covenants and agrees as follows:

ARTICLE I DEFINITIONS

Section 1.1 **Definitions.** Any capitalized terms not otherwise defined in this Undertaking shall have the respective meanings set forth in the Resolution. The following terms used in this Undertaking shall have the following respective meanings:

(a) “**Annual Financial Information**” means, collectively, (1) with respect to the Prior Rule Bonds, the Prior Rule Bonds Annual Financial Information, (2) with respect to the New Bonds, the New Bonds Annual Financial Information, (3) any additional information with respect to a particular Series of Bonds which may be of the type set forth in a supplement to this Undertaking, and (4) the information regarding amendments to this Undertaking required pursuant to Sections 4.2(c) and (d) of this Undertaking. Annual Financial Information shall include Audited Financial Statements, if available, or Unaudited Financial Statements.

(b) “**Audited Financial Statements**” means annual financial statements, if any, of the 1943 Fund and of the Veterans Debenture Revenue Fund, audited by such auditor as shall then be required or permitted by State law or the Resolution. Audited Financial Statements shall be prepared in accordance with GAAP applied on a consistent basis; *provided, however*, that the Department may from time to time, in order to comply with federal or State legal requirements, modify the basis upon which such financial statements are prepared. Notice of any such modification shall be provided to (i) the Trustee and (ii) the MSRB, and shall include a reference to the specific federal or State law or regulation describing such accounting basis.

(c) “**Beneficial Owner**” means a beneficial owner of Subject Bonds, as determined pursuant to the Rule.

(d) “**Bonds Outstanding**” has the meaning set forth in the Resolution.

(e) “**Current Rule Required Event**” means any of the following events with respect to New Bonds:

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults, if material;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of any New Bonds, or other material events affecting the tax status of any New Bond;
- (vii) modifications to rights of Holders of New Bonds, if material;
- (viii) calls, if material, and tender offers, of New Bonds;
- (ix) defeasances;
- (x) release, substitution, or sale of property securing repayment of the New Bonds, if material;
- (xi) rating changes;
- (xii) bankruptcy, insolvency, receivership or similar event of the Department;
- (xiii) the consummation of a merger, consolidation, or acquisition involving the Department or the sale of all or substantially all of the assets of the Department, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; or
- (xiv) appointment of a successor or additional trustee or the change of name of a trustee, if material.

For the purposes of the event identified in clause (xii) above, the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for the Department in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed

jurisdiction over substantially all of the assets or business of the Department, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Department.

(f) “**Current Rule Required Event Notice**” means written or electronic notice of a Current Rule Required Event.

(g) “**Event**” means any Prior Rule Material Event or Current Rule Required Event.

(h) “**Event Notice**” means written or electronic notice of an Event.

(i) “**Fiscal Year**” means that period established by the Department with respect to which its, as applicable, Audited Financial Statements or Unaudited Financial Statements are prepared. As of the date of this Undertaking, the Department’s Fiscal Year begins on July 1 and ends on June 30 of the next calendar year.

(j) “**GAAP**” means generally accepted accounting principles as prescribed from time to time by the Financial Accounting Standards Board.

(k) “**Holders**” means the registered owners of the Subject Bonds.

(l) “**MSRB**” means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934, or any successor thereto or to the function of the MSRB contemplated by this Undertaking.

(m) “**New Bonds**” means the Department’s Home Purchase Revenue Bonds, 2011 Series A and B (the “2011 Bonds”) and any Subject Bonds with respect to which there occurs, after the issuance date of the 2011 Bonds, a “primary offering” (as defined in the Rule) (other than Subject Bonds with authorized denominations of \$100,000 or more that at the option of the holder thereof may be tendered to the Department or its designated agent for redemption or purchase at par value at least as frequently as every nine months until maturity, earlier redemption, or purchase by the Department or its designated agent and that were outstanding on November 30, 2010, for so long as such Subject Bonds continuously remain in authorized denominations of \$100,000 or more and may, at the option of the holder thereof, be tendered to the Department or its designated agent for redemption or purchase at par value at least as frequently as every nine months until maturity, earlier redemption, or purchase by the Department or its designated agent). Notwithstanding the foregoing, the Department, in a certificate signed by an Authorized Representative, may designate any Subject Bonds as New Bonds.

(n) “**New Bonds Annual Financial Information**” means the financial information or operating data applicable to the Department’s most recent Fiscal Year on and after the fiscal year ending on or after June 30, 2012 of the types included in Exhibit C to the New Bonds Official Statement.

(o) “**New Bonds Official Statement**” means the final offering document of the Department with respect to the Home Purchase Revenue Bonds, 2011 Series A and 2011 Series B dated December 1, 2011.

(p) “**1943 Fund**” means the Veterans’ Farm and Home Building Fund of 1943, established in the Treasury of the State.

(q) “**Notice**” means written notice, sent for overnight delivery via the United States Postal Service or a private delivery service which provides evidence of delivery.

(r) “**Notice Address**” means with respect to the Department:

Department of Veterans Affairs of the State of California
1227 O Street
Sacramento, CA 95814
Attention: Bond Finance Division

(s) “**Official Statement**” means, with respect to the Prior Rule Bonds, the Prior Rule Bonds Official Statement, and with respect to the New Bonds, the New Bonds Official Statement.

(t) “**Prior Rule Bonds**” means Subject Bonds that are not New Bonds.

(u) “**Prior Rule Bonds Annual Financial Information**” means the financial information or operating data applicable to the Department’s most recent Fiscal Year on and after the fiscal year ending on or after June 30, 1997 of the types included in Exhibit D to the Prior Rule Bonds Official Statement.

(v) “**Prior Rule Bonds Official Statement**” means the final offering document of the Department with respect to the Home Purchase Revenue Bonds, 1997 Series A, 1997 Series B, 1997 Series C and 1998 Series A dated December 10, 1997.

(w) “**Prior Rule Material Event**” means any of the following events with respect to the Prior Rule Bonds, if material:

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;

- (vi) adverse tax opinions or events affecting the tax-exempt status (if applicable);
- (vii) modifications to rights of Holders;
- (viii) Prior Rule Bond calls;
- (ix) defeasances;
- (x) release, substitution, or sale of property securing repayment of the Prior Rule Bonds; and
- (xi) rating changes.

(x) “**Prior Rule Material Event Notice**” means written or electronic notice of a Prior Rule Material Event.

(y) “**Required Event Notice**” means a Prior Rule Material Event Notice or a Current Rule Required Event Notice.

(z) “**Rule**” means the applicable provisions of Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, §240.15c2-12), as in effect on the date of this Undertaking, including any official interpretations thereof.

(aa) “**SEC**” means the United States Securities and Exchange Commission.

(bb) “**Securities Counsel**” means legal counsel expert in federal securities law.

(cc) “**Series of Bonds**” means one or more series of Bonds issued pursuant to the Resolution.

(dd) “**Trustee**” means the Treasurer of the State of California, as trustee pursuant to the Resolution.

(ee) “**Unaudited Financial Statements**” means the same as Audited Financial Statements, except that they shall not have been audited.

(ff) “**Underwriters**” means the respective underwriters in connection with the offering of a Series of Bonds which are Subject Bonds.

(gg) “**Veterans Debenture Revenue Fund**” means the Bond Reserve Account and Loan Loss Account established under the Resolution.

ARTICLE II THE UNDERTAKING

Section 2.1 **Purpose.** This Undertaking shall constitute a written undertaking for the benefit of the Holders and the Beneficial Owners, and is being executed and delivered solely to assist Underwriters in complying with subsection (b)(5) of the Rule.

Section 2.2 Annual Financial Information. (a) The Department shall provide Annual Financial Information with respect to each Fiscal Year to the Trustee and to the MSRB by no later than the first day of the tenth calendar month after the end of such Fiscal Year.

(b) The Department shall provide, in a timely manner, notice of any failure by it to provide Annual Financial Information to the MSRB on or before the date required by Section 2.2(a) hereof, to (i) the Trustee and (ii) the MSRB.

Section 2.3 Audited Financial Statements. If not provided as part of Annual Financial Information by the date required by Section 2.2(a) hereof, the Department shall provide Audited Financial Statements, when and if available, to the Trustee and to the MSRB. If Unaudited Financial Statements are provided, the Department shall deliver Audited Financial Statements, when and if available.

Section 2.4 Event Notice. (a) The Department shall provide, in a timely manner, a Prior Rule Material Event Notice to (i) the Trustee and (ii) the MSRB. Each Prior Rule Material Event Notice shall be so captioned and shall prominently state the title, date and CUSIP numbers of the applicable Subject Bonds. *Notwithstanding* the foregoing, unless the Rule were to require otherwise, Event Notice of the Prior Rule Material Events described in items (viii) and (ix) of the definition of Prior Rule Material Events need not be given under this Undertaking any earlier than, if applicable, the date notice is required to be given to Holders of applicable Subject Bonds pursuant to the Resolution or the Department documents authorizing the issuance of such Subject Bonds.

(b) **Current Rule Required Event Notice.** With respect to New Bonds, the Department shall provide, in a timely manner not in excess of ten business days after the occurrence of the respective Current Rule Required Event, a Current Rule Required Event Notice to the MSRB.

Section 2.5 Additional Disclosure Obligations. The Department acknowledges and understands that other state and federal laws, including but not limited to the Securities Act of 1933, as amended, and Rule 10b-5 promulgated under the Securities Exchange Act of 1934, as amended, may apply to the Department, and that under some circumstances compliance with this Undertaking, without additional disclosures or other action, may not fully discharge all duties and obligations of the Department under such laws.

Section 2.6 Additional Information. Nothing in this Undertaking shall be deemed to prevent the Department from disseminating any other information, using the means of dissemination set forth in this Undertaking or any other means of communication, or including any other information in any Annual Financial Information or notice of occurrence of an Event, in addition to that which is required by this Undertaking. If the Department chooses to include any information in any Annual Financial Information or notice of occurrence of an Event in addition to that which is specifically required by this Undertaking, the Department shall have no obligation under this Undertaking to update such information or include it in any future Annual Financial Information or notice of occurrence of an Event.

ARTICLE III OPERATING RULES

Section 3.1 **Fiscal Year.** Annual Financial Information shall be provided at least annually, *notwithstanding* any Fiscal Year longer than 12 calendar months. The Department shall promptly notify the Trustee and the MSRB, of each change in its Fiscal Year.

Section 3.2 **Incorporation by Reference.** It shall be sufficient for purposes of Section 2.2 hereof if the Department provides Annual Financial Information by specific reference to documents previously either (i) available to the public on the MSRB Internet Web site or (ii) filed with the SEC.

Section 3.3 **Submission of Information.** Annual Financial Information may be provided in one document or multiple documents, and at one time or in part from time to time.

Section 3.4 **Transmission of Information, Notices and Documents**

(1) Unless otherwise required by the MSRB, all notices, documents and information provided to the MSRB shall be provided to the MSRB's Electronic Municipal Markets Access (EMMA) system, the current Internet Web address of which is www.emma.msrb.org.

(2) All notices, documents and information provided to the MSRB shall be provided in an electronic format as prescribed by the MSRB (currently, portable document format (pdf) which must be word searchable except for non-textual elements) and shall be accompanied by identifying information as prescribed by the MSRB.

ARTICLE IV TERMINATION, AMENDMENT AND ENFORCEMENT

Section 4.1 **Termination.** (a) The Department's obligations under this Undertaking with respect to a Series of Bonds that are Subject Bonds shall terminate upon the legal defeasance pursuant to the Resolution, prior redemption, or payment in full of all of such Series of Bonds. The Department shall give notice of any such termination to the MSRB.

(b) This Undertaking, or any provision hereof, shall be null and void to the extent set forth in the opinion of Securities Counsel described in clause (1) in the event that the Department (1) delivers to the Trustee an opinion of Securities Counsel, addressed to the Department and the Trustee, to the effect that those portions of the Rule which require the provisions of this Undertaking, or any of such provisions, do not or no longer apply to any or all of the Subject Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as shall be specified in such opinion, and (2) delivers notice to such effect to the Trustee and to the MSRB.

Section 4.2 **Amendment.** (a) This Undertaking may be amended, and any provision of this Undertaking may be waived, without the consent of the Holders or Beneficial Owners of the Subject Bonds, except to the extent required pursuant to clause 4(ii) below, if all of the following conditions are satisfied: (1) such amendment or waiver is made in connection with a

change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules or regulations) or in interpretations thereof, or a change in the identity, nature or status of the Department or the type of business conducted thereby, (2) this Undertaking as so amended or waived would have complied with the requirements of the Rule as of the date of each primary offering of Subject Bonds affected by such amendment or waiver, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the Department shall have delivered to the Trustee an opinion of Securities Counsel, addressed to the Department and the Trustee, to the same effect as set forth in clause (2) above, (4) either (i) a party unaffiliated with the Department (such as the Trustee or bond counsel), acceptable to the Department and the Trustee, has determined that the amendment or waiver does not materially impair the interests of the Beneficial Owners of the Subject Bonds, or (ii) the Holders of the affected Subject Bonds consent to the amendment or waiver of this Undertaking pursuant to the same procedures as are required for amendments to the Resolution with consent of Holders, and (5) the Department shall have delivered copies of such amendment or waiver to the Trustee and to the MSRB.

(b) In addition to clause (a) above, the Department may amend this Undertaking, and any provision of this Undertaking may be waived, if the Trustee shall have received an opinion of Securities Counsel, addressed to the Department and the Trustee, to the effect that the adoption and the terms of such amendment or waiver would not, in and of themselves, cause the undertakings herein to violate the Rule, taking into account any subsequent change in or official interpretation of the Rule.

(c) To the extent any amendment to this Undertaking results in a change in the type of financial information or operating data provided pursuant to this Undertaking, the first Annual Financial Information provided thereafter shall include a narrative explanation of the reasons for the amendment and the impact of the change.

(d) If a change is made to the basis on which financial statements are prepared, the Annual Financial Information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. Such comparison shall include a qualitative and, to the extent reasonably feasible, quantitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information.

Section 4.3 Benefit; Enforcement. (a) The provisions of this Undertaking shall inure solely to the benefit of the Holders and the Beneficial Owners from time to time.

(b) *Except* as provided in this subsection (b), the provisions of this Undertaking shall create no rights in any other person or entity. Except as limited by the succeeding sentence, the obligation of the Department to comply with the provisions of this Undertaking shall be enforceable (i) in the case of enforcement of obligations to provide financial statements, financial information, operating data and notices, by any Beneficial Owner of Subject Bonds Outstanding, or by the Trustee on behalf of the Holders of Subject Bonds Outstanding, or (ii), in the case of challenges to the adequacy of the financial statements, financial information and operating data so provided, by the Trustee on behalf of the Holders of Subject Bonds Outstanding or by any

Beneficial Owner. A Beneficial Owner may not take any enforcement action pursuant to clause (ii) without the consent of the Holders of not less than 20% in aggregate principal amount of the Subject Bonds that at the time are Bonds Outstanding.

(c) The right to enforce the provisions of this Undertaking shall be limited to a right, by action in mandamus or for specific performance, to compel performance of the Department's obligations under this Undertaking. Any failure by the Department to perform in accordance with this Undertaking shall not constitute a default or any Event of Default under the Resolution, and the rights and remedies provided by the Resolution upon the occurrence of a default or an Event of Default shall not apply to any such failure.

ARTICLE V MISCELLANEOUS

Section 5.1 **Counterparts.** This Undertaking may be executed in several counterparts, each of which shall be an original and all of which shall constitute but one and the same instrument.

Section 5.2 **Governing Law.** This Undertaking shall be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of this Undertaking shall be instituted in a court of competent jurisdiction in the State, provided that, to the extent this Undertaking addresses matters of federal securities laws, including the Rule, this Undertaking shall be construed in accordance with such federal securities laws and official interpretations thereof.

[end of document]

IN WITNESS WHEREOF, the Department has executed this Undertaking by its duly authorized representative, as of the date first above written.

**DEPARTMENT OF VETERANS AFFAIRS OF
THE STATE OF CALIFORNIA**

By: _____
Authorized Officer

[Department of Veterans Affairs of the State of California Amended and Restated Master Continuing Disclosure Undertaking]

APPENDIX F

PROPOSED FORM OF OPINION OF BOND COUNSEL TO THE DEPARTMENT TO BE DELIVERED IN CONNECTION WITH THE ISSUANCE OF THE OFFERED REVENUE BONDS

Department of Veterans Affairs
of the State of California
1227 "O" Street, Room 200A
Sacramento, California 95814

Ladies and Gentlemen:

We have acted as bond counsel to the Department of Veterans Affairs of the State of California (the "Department") and in such capacity we have examined upon request copies of proceedings taken by the Department in connection with the issuance of the Department's \$220,435,000 aggregate principal amount of Home Purchase Revenue Bonds, 2012 Series A (the "Bonds") and the sale of the Bonds to the initial purchasers thereof. The Bonds are issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended, constituting Chapter 7 of Division 4 of the Military and Veterans Code of the State of California (the "Veterans Act"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Resolution of Issuance"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997 (the "Eighth Supplemental Resolution"), (4) the Tenth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted February 24, 1999 (the "Tenth Supplemental Resolution"), (5) the provisions of Section 2714 of the Eighteenth Supplemental Resolution Providing for the Issuance of an Amount Not to Exceed \$167,920,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted November 21, 2007 (the "Eighteenth Supplemental Resolution"), (6) the Nineteenth Supplemental Resolution Providing for the Issuance of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds in the Principal Amount Not to Exceed \$737,240,000 for the Purposes of Refunding Outstanding Home Purchase Revenue Bonds and to Finance New Contracts of Purchase, and Establish Certain Terms of Such Bonds Pursuant to the Veterans Revenue Debenture Act of 1970, as Amended, adopted March 18, 2009 (the "Nineteenth Supplemental Resolution"), (7) the Twentieth Supplemental Resolution Providing for Amendments and Supplements to Resolution No. RB-9, adopted June 16, 2010 (the "Twentieth Supplemental Resolution") and (8) the Series Certificate of the Department, dated as of February 14, 2012 (the "Series Certificate"). The Resolution of Issuance, the Eighth Supplemental Resolution, the Tenth Supplemental Resolution, the Eighteenth Supplemental Resolution, the Nineteenth Supplemental Resolution, the Twentieth Supplemental Resolution and the Series Certificate are collectively referred to herein as the "Resolution."

The Bonds are dated, mature on the dates in the principal amounts, bear interest, if any, and are payable as provided in the Resolution. The Bonds are subject to mandatory and optional redemption prior to maturity in whole or in part as set forth in the Resolution.

Applicable Federal tax law establishes certain requirements that must be met subsequent to the issuance of the Bonds in order that interest on the Bonds not be included in gross income for Federal income tax purposes under the Internal Revenue Code of 1986, as amended (the “Code”). The Department has adopted documents with respect to its program (the “Program Documents”) that establish procedures under which, if followed, such requirements can be met. The State and the Department have covenanted in the Resolution and in tax certificates and other documents applicable to the issuance of the Bonds (collectively with the Program Documents, the “Documents”), to at all times perform all acts and things permitted by law and necessary and desirable in order to assure that interest paid on the Bonds shall not be included in gross income for Federal income tax purposes under the Code. In rendering this opinion, we have relied upon such covenant and have assumed compliance by the State and the Department with and enforcement by the State and the Department of the provisions of such Documents.

In connection with the issuance of the Bonds, we have examined (a) a copy of the Resolution, and (b) such other opinions, documents, certificates and letters as we deem relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

1. Pursuant to the Veterans Act, the Department is empowered to issue the Bonds for the purposes specified in the Resolution, and to pledge the revenues and amounts in the funds and accounts established by the Resolution.
2. The Bonds have been validly authorized, executed and issued in accordance with the laws of the State of California and represent the legally valid and binding special obligations of the Department, enforceable in accordance with their terms and secured in the manner and to the extent set forth in the Resolution, and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein.
3. The Resolution has been duly and lawfully adopted, is a valid resolution of the Department and is binding upon the Department in accordance with its terms.
4. The Resolution creates a valid pledge to secure, on an equal and pro rata basis, the payment, subject to lawful appropriation, of the principal of and interest on the Bonds of (i) an undivided interest in the assets of the Veterans’ Farm and Home Building Fund of 1943 (the “1943 Fund”), except proceeds of State veterans general obligation bonds and amounts in the Rebate Account established under the Resolution, which undivided interest is secondary and subordinate to any interest or right of the people of the State of California and the holders of general obligation bonds in the 1943 Fund, created in accordance with any general obligation veterans bond act, (ii) any amounts held in the Bond Reserve Account established pursuant to the Resolution, and (iii) any amounts held in the Loan Loss Account established pursuant to the Resolution, which pledge is subject only to the provisions of the Resolution permitting the application of such assets and amounts for or to the purposes and on the terms and conditions set forth in the Resolution.

5. Under existing statutes and court decisions, and assuming compliance by the Department with certain tax covenants described herein, (i) interest on the Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Code and (ii) interest on the Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code; such interest, *however*, is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. No opinion as to exclusion from gross income of interest on any of the Bonds is expressed subsequent to any date on which action is taken pursuant to the Resolution for which action the Resolution requires a legal opinion to the effect that taking such action will not adversely affect such exclusion, should the undersigned not deliver an opinion as of such date to such effect.
6. Under existing law, interest on the Bonds is exempt from State personal income taxation.

With respect to the matters referenced in paragraphs 5 and 6 above, we express no opinion regarding any other Federal or state tax consequences with respect to the Bonds. We express no opinion on the effect of any action taken after the date of issuance of the Bonds, or not taken, in reliance upon an opinion of other counsel on the exclusion from gross income for Federal income tax purposes of interest on the Bonds, or under state and local tax law. We undertake no responsibility for the accuracy, completeness or fairness of any official statement or other offering materials relating to the Bonds and express herein no opinion relating thereto.

We render our opinion under existing statutes and court decisions as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any action hereafter taken or not taken, or any facts or circumstances that may hereafter come to our attention, or changes in law or in interpretations thereof that may hereafter occur, or for any other reason.

In rendering this opinion, we are advising you that the enforceability of the Bonds and the Resolution may be limited by bankruptcy, moratorium, insolvency, or other laws affecting creditors' rights or remedies and is subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

Very truly yours,

APPENDIX G

PROPOSED FORM OF OPINION OF THE ATTORNEY GENERAL TO BE DELIVERED IN CONNECTION WITH THE ISSUANCE OF THE OFFERED REVENUE BONDS

[Date]

Department of Veterans Affairs
of the State of California
1227 "O" Street, Room 200A
Sacramento, CA 95814

Ladies and Gentlemen:

We have acted as the Attorney General of the State of California in connection with the issuance by the Department of Veterans Affairs of the State of California (the "Department") of its Home Purchase Revenue Bonds 2012 Series A in the aggregate principal amount of \$220,435,000 (the "Bonds"). The Bonds are issued pursuant to (1) the Veterans' Revenue Debenture Act of 1970, as amended, constituting Chapter 7 of Division 4 of the Military and Veterans Code of the State of California (the "Veterans' Revenue Debenture Act"), (2) the Resolution of Issuance for Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted March 19, 1980 (the "Resolution of Issuance"), (3) the Eighth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted November 24, 1997 (the "Eighth Supplemental Resolution"), (4) the Tenth Supplemental Resolution Providing for Amendments and Supplements to the Resolution No. RB-1, adopted February 24, 1999 (the "Tenth Supplemental Resolution"), (5) the Eighteenth Supplemental Resolution Providing for the Issuance of an Amount Not to Exceed \$167,920,000 Principal Amount of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds, adopted November 21, 2007 (the "Eighteenth Supplemental Resolution"); (6) the Nineteenth Supplemental Resolution Providing for the Issuance of Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds in the Principal Amount Not to Exceed \$737,240,000 for the Purposes of Refunding Outstanding Home Purchase Revenue Bonds and to Finance New Contracts of Purchase and Establish Certain Terms of such Bonds Pursuant to the Veterans Revenue Debenture Act of 1970, as Amended, adopted March 18, 2009 (the "Nineteenth Supplemental Resolution"); and (7) the Twentieth Supplemental Resolution Providing for Amendments and Supplements to Resolution No. RB-9 adopted June 16, 2010 (the "Twentieth Supplemental Resolution"). The Resolution of Issuance, the Eighth Supplemental Resolution, the Tenth Supplemental Resolution, the Eighteenth Supplemental Resolution, the Nineteenth Supplemental Resolution and the Twentieth Supplemental Resolution are herein collectively referred to as the "Resolution."

In such connection, we have reviewed the Resolution, certifications of the Department, the Treasurer of the State of California and others, opinions of counsel to the Department, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein. We have assumed, without undertaking to verify, the genuineness of all documents, certificates and opinions presented to us (whether as originals or as copies) and of

the signatures thereon, the accuracy of the factual matters represented, warranted or certified in the documents, certificates and opinions, the correctness of the legal conclusions contained in the opinions, and the due and legal execution of the documents and certificates by, and validity thereof against, any parties other than the Department.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur or any other matters come to our attention after the date hereof. We disclaim any obligation to update this opinion. Furthermore, we have assumed compliance with all covenants and agreements contained in the Resolution.

In addition, we call attention to the fact that the rights and obligations under the Bonds, the Resolution and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against the State of California and its departments. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, severability or waiver provisions contained in the foregoing documents nor do we express any opinion with respect to the state or quality of title to or interest in any of the real or personal property described in or subject to the lien of the Resolution or the accuracy or sufficiency of the description of any such property contained therein of, or the remedies available to enforce liens on, any such property. We express no opinion as to whether interest on the Bonds is excluded or exempt from gross income for federal income tax purposes or is exempt from State of California personal income taxes, or as to any other tax consequence relating to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated February 2, 2012, pertaining to the Bonds, or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that:

1. The Bonds have been validly authorized, executed and issued in accordance with the laws of the State of California and constitute the valid and binding special obligations of the Department payable solely from and secured by the Pledged Property (as defined in the Resolution) under the Resolution. The Bonds are not a lien, charge or liability against the State of California, or against the Department, or against the property or funds of either, except only as to the Department and its property or funds as set forth in the Resolution. The owners of the Bonds cannot compel the exercise of the taxing power of the State of California or the forfeiture of its property to pay the Bonds or the interest thereon.

2. The Resolution has been duly and lawfully adopted, is a valid resolution of the Department and is binding upon the Department in accordance with the terms of the Resolution.

3. The Resolution creates a valid pledge to secure, on an equal and pro rata basis, the payment, subject to lawful appropriation, of the principal of and interest on the Bonds of (1) an undivided interest in the assets of the Veterans' Farm and Home Building Fund of 1943 (the "1943 Fund"), except proceeds of Veterans General Obligation Bonds (as defined in the

Resolution) and amounts in the Rebate Account established under the Resolution, which undivided interest is secondary and subordinate to any interest or right of the people of the State of California and the holders of Veterans General Obligation Bonds in the 1943 Fund under any general obligation veterans bond act; and (2) any amounts held in the Bond Reserve Account and the Loan Loss Account established pursuant to the Resolution within the Veterans Debenture Fund (as defined in the Resolution); which pledge is subject only to the provisions of the Resolution permitting the application of such assets and amounts for or to the purposes and on the terms and conditions set forth in the Resolution.

Sincerely,

Deputy Attorney General
For: KAMALA D. HARRIS
Attorney General of the State of California

APPENDIX H

CERTAIN FEDERAL TAX CODE REQUIREMENTS

The Federal Tax Code substantially restricts the use of proceeds of tax-exempt obligations used to finance mortgage loans for single family housing or to refund such obligations.

Those Federal Tax Code restrictions are not the same for all such tax-exempt bonds. There are three types of such tax-exempt bonds: (i) qualified mortgage bonds, which provide QMB Proceeds, (ii) qualified veterans' mortgage bonds, which provide QVMB Proceeds, and (iii) Pre-Ullman bonds, which provide Pre-Ullman Moneys. Revenue Bonds may be either qualified mortgage bonds or Pre-Ullman bonds. ("Pre-Ullman bonds" are bonds issued before 1981, or bonds issued to refund such bonds.) Veterans G.O. Bonds may be either qualified veterans' mortgage bonds or Pre-Ullman bonds. The principal Federal Tax Code restrictions relate to: (i) the use of proceeds of the bond issue, (ii) the yield on the financed mortgage loans and from certain non-mortgage investments related to the issue, (iii) for qualified mortgage bonds and qualified veterans' mortgage bonds, loan eligibility requirements, (iv) for qualified mortgage bonds, the availability of proceeds of the issue for financing housing located in "targeted areas," and (v) certain matters relating to the issue itself.

See "TAX MATTERS" for information regarding the requirements applicable to the Offered Revenue Bonds.

Failure to comply with the applicable provisions of the Federal Tax Code may result in interest on the applicable issue of bonds being included in gross income for federal income tax purposes retroactive to the date of issuance thereof.

Loan Eligibility Requirements Imposed by the Federal Tax Code on QMB Proceeds and QVMB Proceeds

QMB Proceeds

The Federal Tax Code contains the following loan eligibility requirements with respect to QMB Proceeds, except as described below under "Refinancing of Qualified Subprime Loans under the 2008 Housing Act," and except that the requirements described under "First-Time Homebuyer Requirement," "Purchase Price Limitation," and "Other Requirements Imposed by the Code – Recapture Provision Applicable to Qualified Mortgage Bonds" do not apply to home improvement loans, and the requirements described under "Qualified Home Improvement Loans" do not apply to loans for the acquisition of single family homes. None of these requirements applies to Pre-Ullman bonds or qualified veterans' mortgage bonds.

Residence Requirement. The Federal Tax Code requires that each of the premises financed with the lendable proceeds of qualified mortgage bonds be a one-to-four-family residence, one unit of which can reasonably be expected to become the principal residence of the veteran within a reasonable time after the financing is provided. Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase which finance the acquisition of single family homes in order to assure that interest paid on the qualified mortgage bonds not be included in gross income for Federal income tax purposes under the Federal Tax Code (the "Single Family Program Documents"). Certain documents adopted by the Department establish procedures to be followed in connection with Contracts of Purchase to

finance home improvement loans intended to assure that interest paid on the qualified mortgage bonds is not included in gross income for Federal income tax purposes under the Federal Tax Code (the “Home Improvement Program Documents,” together with the Single Family Program Documents, the “Program Documents”).

First-Time Homebuyer Requirement. The Federal Tax Code requires that, subject to certain exceptions, the lendable proceeds of qualified mortgage bonds be used to provide financing to borrowers who have not had a present ownership interest in their principal residence during the three-year period prior to execution of the mortgage loan. Veterans are excluded from the foregoing requirement but may only receive financing once pursuant to such exception. All financing with respect to targeted area residences and residences on land possessed under certain contract for deed agreements is treated as satisfying the first time homebuyer requirement.

New Mortgage Requirement. The Federal Tax Code requires that, with certain limited exceptions, the lendable proceeds of qualified mortgage bonds finance new mortgage loans only and that no proceeds may be used to acquire or replace an existing mortgage loan, which would include the refinancing of a pre-existing mortgage loan.

Purchase Price Limitation. The Federal Tax Code requires that the purchase price of the residence financed with the lendable proceeds of qualified mortgage bonds may not exceed 90 of the average area purchase price applicable to such residence or 110 of the applicable average area purchase price in the case of residences located in targeted areas.

Income Limitation. The Federal Tax Code requires that all mortgage loans made from the lendable proceeds of qualified mortgage bonds be made only to borrowers whose family income does not exceed 115 (for mortgage loans made to families with fewer than three members, 100) of the applicable median family income. An exception is provided for mortgage loans financed with the lendable proceeds of qualified mortgage bonds made with respect to targeted area residences that permits two-thirds in aggregate amount of such mortgage loans to be made with respect to borrowers whose family income does not exceed 140 (for mortgage loans made to families with fewer than three members, 120) of the applicable median family income and one-third in aggregate amount of such loans to be made without regard to any income limitation.

Federal tax law permits higher income limits for persons financing homes located in certain “high housing cost areas.” A high housing cost area is a statistical area for which the ratios of the area’s average purchase price for existing and new single family houses to the area’s median income exceed 120 of the same ratios determined on a national basis. These ratios are determined separately with respect to new and existing single family residences. An area is a high housing cost area only if the ratios for both new and existing houses meet the 120 test. In high housing cost areas, the veteran income limits are increased above 115 (or 100, as applicable) by one percent for each percentage point (1) by which the new or existing housing price ratio, whichever is smaller, exceeds 120. However, the new limit cannot exceed 140 (or 120, as applicable) of the income limits otherwise applicable. Certain areas of the State may qualify as high housing cost areas.

Family income includes income of all individuals executing both the note and mortgage and occupying the dwelling as their principal residence.

Requirements as to Assumptions. The Federal Tax Code provides that a mortgage loan may be assumed only if each of the then applicable residence requirements, first-time-homebuyer requirement, purchase price limitation, and income limitation is met with respect to such assumption.

Qualified Home Improvement Loans. The Federal Tax Code requires that a home improvement loan financed with the lendable proceeds of qualified mortgage bonds not exceed \$15,000, be made only with respect to an owner-occupied residence, and finance alterations, repairs, and improvements on or in connection with an existing one-to-four-family residence by the owner thereof, but only if such alterations, repairs and improvements substantially protect or improve the basic livability or energy efficiency of the property.

General. Qualified mortgage bonds treated under the Federal Tax Code as one bond issue for federal tax purposes (“qualified mortgage issue”) are deemed to meet the loan eligibility requirements of the Federal Tax Code if (i) the issuer in good faith attempted to meet all the loan eligibility requirements before the mortgage loans were executed, (ii) any failure to comply with the loan eligibility requirements is corrected within a reasonable period after such failure is first discovered, and (iii) 95 or more of the proceeds of the issue used to make mortgage loans was used to finance residences that met all such requirements at the time the mortgage loans were executed.

QVMB Proceeds

The Federal Tax Code requires that each mortgagor to whom financing is provided under a qualified veterans’ mortgage bond issue have served on active duty at some time before January 1, 1977 and apply for financing before the later of January 31, 1985 or the date which is 30 years after the last date on which the veteran left active service. The Department has established and has covenanted to comply with such requirements.

Generally, only the loan eligibility requirements stated above under “QMB Proceeds – Residence Requirement,” “– New Mortgage Requirement” and “– Qualified Home Improvement Loans” (*except* the \$15,000 maximum loan amount) apply to QVMB Proceeds.

Other Requirements Imposed by the Federal Tax Code

General. The Federal Tax Code provides that gross income for federal income tax purposes does not include interest on a mortgage revenue bond if it is a qualified mortgage bond or a qualified veterans’ mortgage bond. A qualified mortgage bond is a part of an issue of a state or political subdivision all the proceeds of which (net of amounts applied to any costs of issuance thereof and to fund a reasonably required reserve) are used to finance (or to refund bonds all of such net proceeds of which were used to finance) owner-occupied residences. A qualified veterans’ mortgage bond is part of an issue 95 percent or more of the net proceeds of which are used to provide residences to veterans. In addition, in order to be a qualified mortgage bond or a qualified veterans’ mortgage bond, a bond must be part of an issue that meets certain (i) general requirements, (ii) arbitrage restrictions on the use and investment of proceeds of the issue, and (iii) loan eligibility requirements set forth in the Federal Tax Code and as more fully described above under “Loan Eligibility Requirements Imposed by the Federal Tax Code.”

Volume Limitation, Targeted Area and Required Reports. The first general requirement of the Federal Tax Code, applicable to qualified mortgage bonds, is that the aggregate amount of private activity bonds (exclusive of qualified veterans’ mortgage bonds) that may be issued by

the Department in any calendar year (or previous years' carried forward amount) must not exceed the portion of the private activity bond volume limit for the State for such calendar year that is allocated by the State to the Department. With respect to qualified veterans' mortgage bonds, a separate limit is based on statutory formulae. The second general requirement of the Federal Tax Code applicable to qualified mortgage bonds is that at least 20 of the lendable proceeds of an issue of bonds which are not refunding bonds (if such set-aside was satisfied with respect to the bonds being refunded) must be made available (and applied with reasonable diligence) for owner-financing of residences in targeted areas (as defined by the Federal Tax Code) for at least one year after the date on which such funds are first available for such owner-financing (the "targeted area requirement"). The third general requirement of the Federal Tax Code requires the issuer of qualified mortgage bonds and qualified veterans' mortgage bonds to file with the Internal Revenue Service reports on the issuance of its qualified mortgage bonds or qualified veterans' mortgage bonds following such issuance, as well as an annual qualified mortgage loan information report.

Yield Limitations and Rebate. The Federal Tax Code requires that the effective interest rate on mortgage loans financed with the lendable proceeds of qualified mortgage bonds and qualified veterans' mortgage bonds may not exceed the yield on the issue by more than 1.125 (1.50 for Pre-Ullman bonds), and that certain investment earnings on non-mortgage investments, calculated based upon the extent such investment earnings exceed the amount that would have been earned on such investments if the investments were invested at a yield equal to the yield on the issue, be rebated to the United States or to veterans. These requirements apply to both Revenue Bonds and Veterans G.O. Bonds, except that for Revenue Bonds, rebate is paid to the United States and that for Veterans G.O. Bonds, rebate, absent an election to pay to the United States, is paid to veterans. See "THE DEPARTMENT OF VETERANS AFFAIRS OF THE STATE OF CALIFORNIA, THE PROGRAM AND THE 1943 FUND – THE PROGRAM – Contracts of Purchase" for discussions of provisions of the Veterans Code which affect the Department's ability to establish and to change interest rates on Contracts of Purchase.

Recapture Provision Applicable to Qualified Mortgage Bonds. For certain mortgage loans made after December 31, 1990 from the lendable proceeds of qualified mortgage bonds issued after August 15, 1986, and for assumptions of such mortgage loans, the Federal Tax Code requires a payment to the United States from certain borrowers upon sale or other disposition of their homes (the "Recapture Provision"). The Recapture Provision requires that an amount determined to be the subsidy provided by a qualified mortgage bond financing to a borrower be paid to the United States on disposition of the residence (but not in excess of 50 of the gain realized by the borrower). The recapture amount would (i) increase over the period of ownership, with full recapture occurring if the residence were sold between four and five full years after the closing of the mortgage loan and (ii) decline ratably to zero with respect to sales occurring between five and nine full years after the closing of the mortgage loan. An exception excludes from recapture part or all of the subsidy in the case of certain assisted individuals whose incomes are less than prescribed amounts at the time of the disposition. The Federal Tax Code requires an issuer to inform borrowers of certain information with respect to the Recapture Provision.

Required Redemptions. For qualified mortgage bonds issued after 1988, the Federal Tax Code requires redemption of certain qualified mortgage bonds issued after 1988 from unexpended proceeds required to be used to make mortgage loans that have not been used within

42 months from the date of issuance (or the date of issuance of the original bonds in the case of refundings of unexpended proceeds), except for a \$250,000 *de minimis* amount. As a result, the redemption of Revenue Bonds that are qualified mortgage bonds from proceeds attributable to such Revenue Bonds not used to make Mortgage Loans may be required. Additionally, for bonds issued after 1988, the Federal Tax Code permits repayments (including prepayments) of principal of mortgage loans financed with the proceeds of an issue of such bonds to be used to make additional mortgage loans for only 10 years from the date of issuance of the bonds (or the date of issuance of the original bonds in the case of refundings), after which date such amounts must be used to redeem bonds, except for a \$250,000 *de minimis* amount. As a result, the Department is required by the Federal Tax Code to redeem Revenue Bonds which are qualified mortgage bonds from repayments (including prepayments) of principal of certain Contracts of Purchase not later than the close of the semi-annual period after the payment is received.

Compliance. The Federal Tax Code states that an issuer will be treated as meeting the targeted area requirement, the arbitrage restrictions on mortgage loans, and the recapture information requirements if it in good faith attempted to meet all such requirements and any failure to meet such requirements was due to inadvertent error after taking all reasonable steps to comply with such requirements.

APPENDIX I

SUMMARY OF CERTAIN PROVISIONS OF RESOLUTION RB-1

This Appendix I contains a summary of certain provisions of Resolution RB-1 and should be read in conjunction with the information set forth in the forepart of this Official Statement contained under the captions “INTRODUCTION – Home Purchase Revenue Bonds,” “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – The 1943 Fund,” “—Bond Reserve Account,” “—Cash Flow Statements and Program Operating Procedures,” “—Loan Loss Account,” “—Cash Flow Statements to be Delivered in Connection with the Offered Revenue Bonds,” “—Maintenance of Fund Parity,” “—Additional Revenue Bonds,” “THE OFFERED REVENUE BONDS – Redemption” and “THE PROGRAM – Contracts of Purchase – Interest Rates – Interest Rate Setting.”

This summary is only a brief description of limited provisions of Resolution RB-1, does not purport to be comprehensive and is qualified in its entirety by reference to the full text of Resolution RB-1. Reference should be made to Resolution RB-1 for a full and complete statement of its provisions.

Resolution to Constitute Contract (Section 101)

In consideration of the purchase and acceptance of any and all of the Bonds issued under Resolution RB-1 by those who shall own the same from time to time, Resolution RB-1 shall be deemed to be and shall constitute a contract between the Department, the Trustee and the owners of the Bonds, and the pledges made in Resolution RB-1 and the covenants and agreements in Resolution RB-1 set forth to be performed by the Department or the Trustee shall be for the equal benefit, protection and security of the owners of any and all of the Bonds, all of which, without regard to the time or times of their issue or maturity, shall be of equal rank without preference, priority or distinction of any of the Bonds over any other of Resolution RB-1, except as expressly provided in or permitted by Resolution RB-1 or by the applicable Series Resolution.

Pledge Effected by Resolution RB-1 (Section 102)

For the purpose of fixing and declaring the terms and conditions upon which the Bonds are to be issued, executed, delivered, secured and accepted by the owners of the Bonds, and in order to secure the payment of all Bonds at any time issued and Outstanding under Resolution RB-1 and the interest thereon according to their tenor, purport and effect, and in order to secure the performance and observance of all the covenants, agreements and conditions therein and in Resolution RB-1 contained, the Department has adopted Resolution RB-1, has pledged, conveyed and assigned, and, subject to the subordination provisions in favor of other debt holders of the Department contained in the definition in Resolution RB-1 of Pledged Property, does by Resolution RB-1 pledge, convey and assign the Pledged Property to the Trustee as security for the payment of the principal of, including redemption premium, if any, on the Bonds and the interest thereon for the equal and proportionate benefit and security, from time to time, of the owners of the Bonds, without preference, priority or distinction as to lien or otherwise, *except* as otherwise provided in Resolution RB-1 or as provided in an applicable Series Resolution, of any one Bond over any other Bond, by reason of priority in the issue, sale or negotiation thereof or otherwise, all in accordance with the terms of Resolution RB-1.

The Bonds are special obligations of the Department payable solely from and secured by the Pledged Property under Resolution RB-1 and are not a lien, charge or liability against the

State of California, or against the Department, or against the property or funds of either, except only to the extent of the aforesaid pledge as provided in Resolution RB-1.

Definitions (Section 103)

In Resolution RB-1 and any resolution supplemental to Resolution RB-1 the following terms shall have the following meanings:

“Account” means an Account (and any subaccounts therein) created by or pursuant to Resolution RB-1 or a Series Resolution.

“Accountant” means an independent certified public accountant or firm of independent certified public accountants of national reputation selected by the Department, who may be the accountant or firm of accountants who regularly audit the books of the Department.

“Accrued Debt Service” means, as of any date of determination and, as the context of Resolution RB-1 requires, with respect to all Bonds and/or all Veterans G.O. Bonds, the sum of:

(a) the aggregate amount of scheduled interest and principal (except to the extent principal is otherwise to be redeemed pursuant to clause (b) or (c) hereof) to become due after such date but on or before the end of the current Debt Service Year, less the product of (i) the number of whole months remaining in the current Debt Service Year and (ii) the Monthly Debt Service Requirement;

(b) the redemption price of bonds for which notice of redemption has been issued, provided such redemption price is to be paid from amounts on deposit in the Revenue Account; and

(c) the redemption price of bonds that the Department will be obligated to redeem prior to the end of the next succeeding Debt Service Year under the terms of any Series Resolution or Supplemental Resolution or resolution of issuance governing Veterans G.O. Bonds, to the extent that such obligation arises on account of amounts on deposit in the Revenue Account.

“Additional Bonds” means any additional Bonds issued pursuant to Section 209 of Resolution RB-1.

“Amortized Value” means the purchase price of securities, excluding accrued interest, plus an amortization of any discount or less an amortization of any premium included in the purchase price. The premium or discount shall be amortized on an actuarial basis, such that the Amortized Value at any time equals the price at which the yield on a security equals the yield of such security as of its original purchase. In the case of an Investment Obligation callable at the option of the issuer thereof, the original yield and Amortized Value shall be computed on the assumption that, (i) for securities purchased at a premium, such security is redeemed as of the first possible redemption date, provided, that after such redemption date, such value of the Investment Security shall be computed at par; or (ii) for securities purchased at a discount, such security is held to maturity.

“Applicable Fund Parity Percentage” means 50% or such other percentage set forth in the Program Operating Procedures. But see “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS – Maintenance of Fund Parity” in this Official Statement for current percentage.

“Appreciated Amount” means, with respect to a Deferred Interest Bond, (i) as of any date of computation with respect to any Deferred Interest Bond up to the date, if any, set forth in the Series Resolution authorizing such Deferred Interest Bond as the date on which such Deferred Interest Bond shall commence to bear interest payable thereafter on applicable interest payment dates, an amount equal to the initial principal amount of such Deferred Interest Bond plus the interest accrued on such Deferred Interest Bond from the date of original issuance of such Deferred Interest Bond to the applicable interest payment date next preceding the date of computation or the date of computation if an applicable interest payment date, such increased amount to accrue at the rate per annum set forth in the Series Resolution authorizing such Deferred Interest Bond, compounded on each applicable interest payment date, plus, if such date of computation shall not be an applicable interest payment date, a portion of the difference between the Appreciated Amount as of the immediately preceding applicable interest payment date (or the date of original issuance if the date of computation is prior to the first applicable interest payment date succeeding the date of original issuance) and the Appreciated Amount as of the immediately succeeding applicable interest payment date, calculated based upon an assumption that the Appreciated Amount accrues in equal daily amounts on the basis set forth in the Series Resolution authorizing such Deferred Interest Bonds; and (ii) as of any date of computation on and after the date, if any, set forth in the Series Resolution authorizing such Deferred Interest Bond as the date on which such Deferred Interest Bond shall commence to bear interest payable thereafter on applicable interest payment dates, the Appreciated Amount as of such current interest payment commencement date. For the purposes of actions, requests, notifications, consents or directions of Bondowners under Resolution RB-1, the calculation of the Appreciated Amount shall be as of the applicable interest payment dates preceding such date of calculation (unless such date of calculation shall be an applicable interest payment date, in which case, as of the date of calculation).

“Authorized Representative” or “Authorized Officer” means the Secretary of Veterans Affairs, Undersecretary of Veterans Affairs, Deputy Secretary of Operations, Deputy Secretary of Administration or any other authorized representative as from time to time may be designated by the Secretary in writing to the Trustee as authorized to act under Resolution RB-1 on behalf of the Department.

“Bond Act” means the Veterans’ Revenue Debenture Act of 1970 (constituting Chapter 7 of Division 4 of the Veterans Code), as now in effect and as it may from time to time hereafter be amended or supplemented.

“Bond Registrar” means the Trustee as the party responsible for maintenance of the Bond registration books of the Department pursuant to Section 208 of Resolution RB-1.

“Bond Reserve Account” means the Bond Reserve Account established pursuant to Section 401 of Resolution RB-1.

“Bond Reserve Requirement” means, as of any particular date of calculation, an amount equal to the aggregate of all amounts established for all Series of Bonds Outstanding in the Series Resolutions authorizing the issuance of such Bonds, at least equal in the aggregate to three per centum (3%) of the aggregate Outstanding principal amount of the Bonds with interest rates fixed to the maturity thereof.

“Bondowner” or “owner of Bonds” or “Holder” or “Bondholder” means the registered owner of any registered Bond.

“Bonds” means Revenue Bonds.

“Cash Equivalent” means a Letter of Credit, Insurance Policy, Surety, Guarantee or other Security Arrangement (as defined and provided for in a Series Resolution providing for the issuance of Bonds or in a Supplemental Resolution), provided by an institution which has received a rating of its claims paying ability from each of the Rating Agencies at least equal to the then-existing respective rating on the Bonds or whose unsecured debt securities are rated at least the then-existing respective rating on the Bonds (or the highest rating of short-term obligations if the Cash Equivalent is a short-term instrument) by the Rating Agencies.

“Cash Flow Statement” means a Cash Flow Statement conforming to the requirements of Section 607 of Resolution RB-1.

“Certificate of the Department” means an instrument in writing signed by an Authorized Representative.

“Committee” means the Veterans’ Debenture Finance Committee created by the Bond Act.

“Contract of Purchase” means any contract of purchase entered into by the Department and a veteran or other eligible person covering any property (whether residential or otherwise) purchased or acquired by the Department with moneys in the 1943 Fund or any other obligation representing a program investment of such moneys irrespective of the form of such obligation.

“Costs of Issuance” means all items of expense payable or reimbursable directly or indirectly by the Department and related to the authorization, sale, issuance and remarketing of the Bonds, as certified by an Authorized Representative.

“Counsel’s Opinion” means an opinion signed by an attorney or firm of attorneys selected by the Department; any such attorney may be a lawyer in the regular employment of the Department.

“Credit and Liquidity Support Expenses” means, with respect to a Series of Bonds or a series of Veterans G.O. Bonds (as the context requires), as set forth in a Series Resolution or Supplemental Resolution, or resolution of issuance governing such series of Veterans G.O. Bonds, respectively, the amounts necessary to pay any fees and reimbursement in connection with tender option features, letters of credit, standby bond purchase agreements, bond insurance and other forms of credit and liquidity support related thereto.

“Debt Service Year” means the year beginning on the second day of October and ending on the first day of October in the next succeeding year, or any other twelve-month period hereafter selected and designated as such in the Program Operating Procedures.

“Deferred Interest Bond” means any Bond designated as such by the Series Resolution authorizing the issuance of such Bond.

“Department Request” means a written request or direction of the Department signed by an Authorized Representative.

“Event of Default” means any of the events of default described in Section 702 of Resolution RB-1.

“Excess Revenues” means, as of any date of calculation, the amount of all Revenues held in the Revenue Account in excess of Accrued Debt Service (as adjusted for any use of Revenues contemplated at the time of such calculation).

“Expenses” means any moneys required by the Department to pay, or to be set aside to pay, the expenses of the Trustee and any expenses which the Department may lawfully pay from the 1943 Fund (whether or not related to the Bonds), except (i) as limited with respect to any Series of Bonds by the applicable Series Resolution and (ii) that Credit and Liquidity Support Expenses shall not be included in the definition of “Expenses”; *provided, however*, that such expenses related to Cash Equivalents shall not be excluded.

“Fiscal Year” means the year beginning on the first day of July and ending on the last day of June in the next succeeding year, or any other twelve-month period selected and designated as the official fiscal year period of the Department.

“Fitch” means Fitch IBCA, Inc., and includes any successor thereto.

“Fund Parity” means, on any determination date: (a) an amount equal to the difference between (i) all assets in the 1943 Fund and in the Accounts established under Resolution RB-1 and any Series Resolution or Supplemental Resolution and (ii) the aggregate principal amount of all Revenue Bonds Outstanding and all Veterans G.O. Bonds outstanding (plus accrued interest), reduced by (b) allowances and reserves for loss coverage on Contracts of Purchase, loss coverage on properties subject to Contracts of Purchase, and life and disability coverage on persons obligated under Contracts of Purchase, as specified in the Program Operating Procedures.

“Government Obligations” means bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest.

“Investment Obligations” means, any of the following which at the time of purchase are legal investments under the laws of the State of California for moneys held under Resolution RB-1 and then proposed to be invested therein:

- (1) Government Obligations;
- (2) Bonds, consolidated bonds, collateral trust debentures, consolidated debentures, or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended, debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended, bonds or debentures of the Federal Home Loan Banks, stock, bonds, debentures and other obligations of the Government National Mortgage Association or the Federal National Mortgage Association established under the National Housing Act as amended, obligations of the Federal Home Loan Mortgage Corporation, and bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act as amended;
- (3) interest-bearing demand or time deposits in banks or savings and loan associations, which, to the extent they are not insured by federal deposit insurance, are collateralized by securities eligible to secure public deposits in the State, or which are

issued by an institution, the senior unsecured debt of which is rated in one of the top two rating categories of a Rating Agency;

(4) negotiable certificates of deposit issued by a nationally or state-chartered bank or savings and loan association or by a state-licensed branch of a foreign bank which, to the extent they are not insured by federal deposit insurance, are collateralized by securities eligible to secure public deposits in the State, or which are issued by an institution the senior unsecured debt of which is rated in one of the top two rating categories by a Rating Agency;

(5) repurchase agreements backed by or related to obligations described in (1) or (2) above with any institution whose unsecured debt securities are rated, or which agreements are rated, at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency;

(6) (1) investment agreements, secured (by collateralization, guaranty or otherwise) or unsecured, with any institution, or fully guaranteed by any institution, whose unsecured debt securities are rated at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency; or (2) any investment agreement that is secured (by collateralization, guaranty or otherwise), to such extent that the investment agreement itself is the subject of such a rating or the Bonds are the subject of written confirmation from a Rating Agency that investment of amounts in such an investment agreement will not cause the outstanding rating of the Bonds by such Rating Agency to be withdrawn, downgraded or suspended;

(7) commercial paper (having original maturities of not more than 180 days) rated in the highest rating category by a Rating Agency;

(8) direct and general obligations of or obligations unconditionally guaranteed by any state or political subdivision thereof, the payment of the principal of and interest on which the full faith and credit of the state or such political subdivision is pledged, and certificates of participation in any such obligations (which obligations may be subject to annual appropriations), which obligations or certificates of participation, respectively, are rated at least equal to the then existing rating of the Bonds by a Rating Agency;

(9) investments in any mutual fund the portfolio of which is limited to Investment Obligations, including any proprietary mutual fund of the Trustee or co-Trustee for which the Trustee or co-Trustee or an affiliate is investment advisor or provided other services to such mutual fund and receives reasonable compensation for such services (and if such mutual fund consists solely of Government Obligations, then such fund will constitute "Government Obligations" for the purposes of Resolution RB-1);

(10) obligations of any state, political subdivision, political corporation or agency, the payment of principal, redemption price, if any, and interest on which is irrevocably secured by Government Obligations;

(11) deposits in the Surplus Money Investment Fund in the Treasury of the State;

(12) interest-bearing demand or time deposits in banks or savings and loan associations, that, to the extent they are not insured by federal deposit insurance, are collateralized by securities eligible to secure public deposits in the State, or that are issued by an institution, that has a rating for its source of payment of such investment that is rated in one of the top two rating categories by a Rating Agency;

(13) negotiable certificates of deposit issued by a nationally or state-chartered bank or savings and loan association or by a state-licensed branch of a foreign bank that, to the extent they are not insured by federal deposit insurance, are collateralized by securities eligible to secure public deposits in the State, or that are issued by an institution that has a rating for its source of payment of such investment that is rated in one of the top two rating categories by a Rating Agency;

(14) repurchase agreements backed by or related to obligations described in (1) or (2) above with any institution that has a rating for its source of payment of such investment, or that agreements are rated, at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency; and

(15) (1) investment agreements, secured (by collateralization, guaranty or otherwise) or unsecured, with any institution, or fully guaranteed by any institution, that has a rating for its source of payment of such investment at least equal to the then existing rating on the Bonds (or the highest rating of short-term obligations if the investment is a short-term obligation) by a Rating Agency, or (2) any investment agreement that is secured (by collateralization, guaranty or otherwise), to such extent that the investment agreement itself is the subject of such a rating or the Bonds are the subject of written confirmation from a Rating Agency that investment of amounts in such an investment agreement will not cause the outstanding rating of the Bonds by such Rating Agency to be withdrawn, downgraded or suspended.

Provided, that it is expressly understood that the definition of Investment Obligations shall be, and be deemed to be, expanded, or new definitions and related provisions shall be added to Resolution RB-1 by a Supplemental Resolution adopted and filed in accordance with Section 1001(j) of Resolution RB-1 thus permitting investments with different characteristics from those permitted which the Department deems from time to time to be in the interests of the Department to include as Investment Obligations;

For purposes of the definition, "institution" means an individual, partnership, corporation, trust or unincorporated organization, or a government or agency, instrumentality, program, account, fund, political subdivision or corporation thereof.

If the rating of any Investment Obligation purchased pursuant to Resolution RB-1 is downgraded, suspended or withdrawn by any Rating Agency, the Trustee is not required to sell such Investment Obligation but may retain the same under Resolution RB-1.

"Liquidation/Insurance Proceeds" means amounts representing proceeds of (1) the sale or other disposition of any property subject to any Contract of Purchase, whether upon cancellation of said Contract of Purchase (on account of default or any other cause) or for any other cause, exclusive of amounts so recovered and required by law, contract or resolution of the Department to be otherwise applied; and (2) compensation for losses incurred with respect to the property

subject to any Contract of Purchase from the proceeds of condemnation, title insurance, hazard insurance, or primary or pool insurance of the Contracts of Purchase (including Veterans Administration guarantees), exclusive of amounts recovered in respect of such losses to the extent required to be otherwise applied pursuant to applicable law, contract or resolution of the Department.

“Loan Loss Account” means the Loan Loss Account established pursuant to Section 401 of Resolution RB-1.

“Loan Loss Requirement” means, as of any particular date of calculation, an amount established in the current Cash Flow Statement which, when added to the Bond Reserve Requirement, shall not exceed ten percent (10%) of the initial principal amount of all Series of which any Bonds are Outstanding or such larger amount as may be provided in a Supplemental Resolution adopted pursuant to Section 1001(m) of Resolution RB-1.

“Mandatory Sinking Account Payments” means, as of any particular date of calculation, with respect to the Term Bonds of any Series and maturity, the amount of money required to be applied on any applicable date to the redemption prior to maturity or the purchase of the Term Bonds, except as such requirement shall have been previously reduced by the principal amount of any Term Bonds of such Series and maturity with respect to which such Mandatory Sinking Account Payments are payable which are to be purchased or redeemed (except out of Mandatory Sinking Account Payments). Mandatory Sinking Account Payments may be established as fixed dollar amounts or as method(s) of calculation thereof.

“Monthly Debt Service Requirement” means, as of any date of determination, one-twelfth (1/12) of the aggregate amount of scheduled interest and principal to become due during the Debt Service Year in which such date falls, as computed on the first day of such Debt Service Year.

“Moody’s” means Moody’s Investors Service, Inc., and includes any successor thereto.

“1943 Fund” means the Veterans’ Farm and Home Building Fund of 1943, established in the Treasury of the State by Section 988 of the Veterans Code.

“Outstanding” as used in relation to Bonds means, as of any date, all Bonds theretofore authenticated and delivered by the Trustee under Resolution RB-1, except:

- (a) any Bond deemed paid in accordance with Section 411(b) of Resolution RB-1;
- (b) any Bond cancelled by, or delivered for cancellation to, the Trustee because of payment at maturity or redemption or purchase prior to maturity;
- (c) any Bond deemed paid in accordance with the provisions of Section 303 of Resolution RB-1;
- (d) any Bond deemed paid in accordance with the provisions of Section 1101 of Resolution RB-1; and
- (e) any Bond in lieu of or in substitution for which another Bond shall have been authenticated and delivered pursuant to Section 211 of Resolution RB-1, unless proof satisfactory to the Trustee is presented that any Bond for which a Bond in lieu thereof or in substitution therefor shall have been authenticated and delivered is held by a bona fide purchaser, as that term is defined in Article Eight of the Uniform Commercial Code of the State, as

amended, in which case both the Bond so substituted and replaced and the Bond or Bonds authenticated and delivered in lieu thereof or in substitution therefor shall be deemed Outstanding.

“Pledged Property” means (a) an undivided interest in the assets of the 1943 Fund, other than any GO Bond Series Bond Proceeds Subaccount, which undivided interest shall be secondary and subordinate to the rights of the holders of Veterans G.O. Bonds to receive payment of debt service thereon, directly or indirectly, from amounts in the 1943 Fund under any general obligation veterans bond act, (b) any amounts held in the Bond Reserve Account, and (c) any amounts in the Loan Loss Account, *except* amounts in any Rebate Account and *except* that the pledge established in a Series Resolution may be limited in purpose and time, as set forth in the Series Resolution.

“Primary Contract of Purchase Coverage” means coverage in the form of primary mortgage insurance, guaranty (including by United States Department of Veterans Affairs guaranty) or otherwise of loss from Contract of Purchase defaults as provided in the Program Operating Procedures.

“Principal” means (a) as such term references the principal amount of a Deferred Interest Bond or Deferred Interest Bonds, the Appreciated Amount thereof; and (b) as such term references the principal amount of any other Bond or Bonds, the principal amount at maturity of such Bond or Bonds.

“Proceeds Account” means the Proceeds Account established pursuant to Section 401 of Resolution RB-1.

“Program” means the finance program of the Department pursuant to which the Department will issue the Bonds and Veterans G.O. Bonds and apply the proceeds thereof to finance Contracts of Purchase.

“Program Acts” means the Veterans’ Farm and Home Purchase Act of 1943 (constituting Article 3 of Chapter 6 of Division 4 of the Veterans Code) and the Veterans’ Farm and Home Purchase Act of 1974 (constituting Article 3.1 of Chapter 6 of Division 4 of the Veterans Code), as now in effect and as they may from time to time hereafter be amended or supplemented.

“Program Operating Procedures” means, at any time, the Department’s program operating procedures governing the discretionary activities of the Department, in the then current form, as described in Section 606 of Resolution RB-1.

“Rating Agency” means, at any time, any bond rating agency, including Fitch, Moody’s and S&P, that shall have rated any of the Bonds at the request of the Department and shall be maintaining ratings on such Bonds at such time.

“Rating Confirmation” means, with respect to any action or financial condition described in Resolution RB-1, written confirmation from each of the Rating Agencies that the taking of such action or the existence of such financial condition shall not cause the outstanding ratings by such respective Rating Agencies of all Bonds which are not rated based solely on the credit of a bond insurer or other guarantor to be withdrawn, downgraded or suspended.

“Rebate Account” means any Account of that name established by the Department pursuant to Section 401(c) of Resolution RB-1.

“Redemption Price” means, with respect to a Bond or portion thereof, the portion of the principal amount of such Bond or portion plus the applicable premium, if any, payable upon redemption thereof in the manner contemplated in accordance with its terms pursuant to the provisions of Resolution RB-1 and any Series Resolution.

“Restricted Recoveries” means, as set forth or referenced in the Series Resolution authorizing a Series of Bonds or in a resolution of issuance authorizing a series of Veterans G.O. Bonds, or as otherwise designated in the Program Operating Procedures, that portion of prepayments and scheduled repayments of principal on Contracts of Purchase financed (directly or indirectly) by or credited to such Series of Bonds or series of Veterans G.O. Bonds, respectively, to the extent such amounts are required by the Federal Tax Code or by the terms of such Series Resolution or resolution of issuance, respectively, to be applied to a redemption of Bonds or Veterans G.O. Bonds.

“Revenue Account” means the Revenue Account established pursuant to Section 401 of Resolution RB-1.

“Revenues” means all moneys received by or on behalf of the Department representing (i) principal and interest payments on the Contracts of Purchase including all prepayments representing the same and all prepayment premiums or penalties received by or on behalf of the Department in respect to the Contracts of Purchase, (ii) interest earnings received on the investment of amounts to the extent deposited in the Revenue Account pursuant to Section 502 of Resolution RB-1, (iii) amounts transferred to the Revenue Account from the Bond Reserve Account or the Loan Loss Account and (iv) any other amounts payable by parties executing Contracts of Purchase or private participants in the Program or related to recoveries on defaulted Contracts of Purchase, including origination and commitment fees, servicing acquisition fees, and Liquidation/Insurance Proceeds, except to the extent not included as “Revenues” pursuant to the provisions of any Series Resolution.

“S&P” means Standard & Poor’s Ratings Services, a division of The McGraw Hill Companies, Inc. and includes any successor thereto.

“Securities Depository” means DTC, unless a successor has been appointed to act as the Securities Depository under Resolution RB-1.

“Series Certificate” means a Certificate of the Department which shall be dated as of the date of sale and shall be executed (or re-executed in final form) and delivered on the date of issuance of the applicable Series of Bonds.

“Series Proceeds Subaccounts” means, collectively, the Revenue Bond Series Proceeds Subaccounts and the GO Bond Series Proceeds Subaccounts.

“Series Recycling Subaccounts” means, collectively, the Revenue Bond Series Recycling Subaccounts and the GO Bond Series Recycling Subaccounts.

“Series Resolution” means a Supplemental Resolution of the Committee authorizing the issuance of a Series of Bonds and including any Series Certificate delivered pursuant thereto.

“Series Restricted Recoveries Subaccounts” means, collectively, the Revenue Bond Series Restricted Recoveries Subaccounts and the GO Bond Series Restricted Recoveries Subaccounts.

“Series Revenue Subaccounts” means, collectively, the Revenue Bond Series Revenue Subaccounts and GO Bond Series Revenue Subaccounts.

“State” means the State of California.

“Supplemental Contract of Purchase Coverage” means the coverage, if any, of loss from Contract of Purchase defaults provided in the Program Operating Procedures which supplements any Primary Contract of Purchase Coverage.

“Supplemental Resolution” means any resolution of the Committee supplementing or amending Resolution RB-1.

“Federal Tax Code” or “Tax Code” means applicable provisions of the Internal Revenue Code of 1954, as amended, and the Internal Revenue Code of 1986, as amended, and the applicable regulations thereunder.

“Term Bonds” means the Bonds with respect to which Sinking Account Requirements have been established.

“Trustee,” as used under “Summary of Certain Provisions of Resolution RB-1,” means the Treasurer of the State, whenever acting as Trustee in accordance with Resolution RB-1 and the Bond Act, and, except as set forth in Section 801 of Resolution RB-1, any corporation or association which may be co-Trustee with the Treasurer under Resolution RB-1 pursuant to Article VIII of Resolution RB-1, or the successor to the co-Trustee under Resolution RB-1 as provided in Article VIII of Resolution RB-1.

“Veterans’ Bond Payment Fund” means the revolving special fund established in the State Treasury by Section 988.6(a) of the Veterans Code.

“Veterans Code” means the Military and Veterans Code of the State of California.

“Veterans Debenture Fund” means the Veterans Debenture Revenue Fund established in the Treasury of the State by Section 1003.11 of the Veterans Code.

“Veterans General Obligation Bonds” means, as of any given time, general obligation bonds of the State the proceeds of which were required to be deposited in the 1943 Fund (or returned to the General Fund or the Pooled Money Investment Account in the State Treasury in repayment of amounts withdrawn from said General Fund or the Pooled Money Investment Account and deposited in the 1943 Fund) and which are at such given time outstanding. Veterans General Obligation Bonds are referred to in this Official Statement as “Veterans G.O. Bonds.”

Miscellaneous Definitions (Section 104)

Unless the context shall otherwise indicate, words which import the singular shall include the plural, and words which import the plural shall include the singular. The word “person” shall mean any individual, corporation, partnership, joint venture, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof. The words “of Resolution RB-1,” “in Resolution RB-1,” “to Resolution RB-1,” “by Resolution RB-1” and “under Resolution RB-1” refer to the entire Resolution RB-1. The words “interest payment date” mean with respect to any Series of Bonds, the interest payment date(s) established in the applicable Series Resolution, regardless of whether the referenced Bonds are

interest-bearing or not. Any reference to a rating category shall mean the category published by a Rating Agency without reference to numbered or lettered annotations or pluses and minuses.

Authentication of Bonds (Section 205)

Only such of the definitive Bonds as shall have endorsed thereon a certificate of authentication substantially in the form set forth in the applicable Series Resolution, duly executed by the Trustee, shall be entitled to any benefit or security under Resolution RB-1. No definitive Bond shall be valid or obligatory for any purpose unless and until such certificate of authentication shall have been duly executed by the Trustee, and such certificate of the Trustee upon any such Bond shall be conclusive evidence that such Bond has been duly authenticated and delivered under Resolution RB-1. The Trustee's certificate of authentication on any definitive Bond shall be deemed to have been duly executed if signed by an authorized officer of the Trustee, but it shall not be necessary that the same officer sign the certificate of authentication on all of the Bonds that may be issued under Resolution RB-1 at any one time.

Exchange of Bonds (Section 206)

Subject to, and in accordance with, Section 207 of Resolution RB-1, Bonds, upon surrender thereof at the principal office of the Trustee in Sacramento California, together with an assignment duly executed by the registered owner or his attorney or legal representative in such form as shall be satisfactory to the Trustee, may, at the option of the registered owner thereof, be exchanged for an equal aggregate principal amount of Bonds of like tenor and of the same Series (and subseries, if applicable) and maturity, bearing interest at the same rate, of any denomination or denominations authorized by Resolution RB-1.

Negotiability, Registration and Registration of Transfer of Bonds (Section 207)

The transfer of any Bond may be registered only upon the books kept for the registration of, and registration of transfers of, Bonds upon surrender thereof to the Trustee together with an assignment duly executed by the registered owner or his attorney or legal representative in such form as shall be satisfactory to the Trustee. Upon any such registration of transfer of a Bond, the Department shall execute and the Trustee shall authenticate and deliver in exchange for such Bond a new Bond or Bonds, registered in the name of the transferee, in any denomination or denominations authorized by Resolution RB-1, in an aggregate principal amount equal to the principal amount of such Bond of like tenor and of the same Series (and subseries, if applicable) and maturity and bearing interest at the same rate.

Issuance of the Bonds (Section 209)

Each Series Resolution authorizing the issuance of a Series of Bonds shall specify and determine:

- (a) The authorized principal amount of such Series of Bonds;
- (b) The purposes for which such Series of Bonds are being issued which shall be one or more of the following purposes: (i) the financing of Contracts of Purchase; (ii) the making of such deposits in amounts, if any, required by Resolution RB-1 or the Series Resolution to be paid into various Accounts or the direct payment of Costs of Issuance; or (iii) the refunding of all or any part of the Bonds of any Series (including any Bonds not deemed Outstanding under Resolution RB-1 pursuant to Section 411(b)) or, to the extent permitted by law, Veterans G.O.

Bonds, including the payment of any redemption premium thereon (or premium, to the extent permitted by law, included in the purchase price if purchased in lieu of redemption);

(c) The maturity date or dates, the amounts of each maturity, and the interest payment dates of the Bonds of such Series;

(d) The interest payment dates, and rate or rates, of the Bonds of such Series or method of determining the same;

(e) The denomination or denominations of, and the manner of dating, numbering and lettering the Bonds of each Series;

(f) In the case of Term Bonds, if any, provision for Mandatory Sinking Account Payments;

(g) The Redemption Price or Redemption Prices, if any, the time or times and the terms and conditions upon which the Bonds of such Series may be redeemed prior to their maturities, including without limitation the method of selection for redemption as among maturities;

(h) The amounts to be deposited from the proceeds of such Series of Bonds in the Accounts created and established by Resolution RB-1 and the Series Resolution;

(i) That *notwithstanding* any other provision of the Series Resolution, upon issuance, sale and delivery of such Series of Bonds, so much of such proceeds of the Bonds of such Series shall be credited to the Bond Reserve Account so that the amount in such fund shall be at least equal to the Bond Reserve Requirement calculated immediately after the delivery of such Series of Bonds;

(j) That *notwithstanding* any other provision of the Series Resolution, upon sale and delivery of such Series of Bonds, so much of such proceeds of the Bonds of such Series shall be credited to the Loan Loss Account so that the amount in such fund shall be at least equal to the Loan Loss Requirement calculated immediately after the delivery of such Series of Bonds;

(k) The manner in which Bonds of such Series are to be sold and provisions for the sale thereof;

(l) The form of any credit enhancement or liquidity support for such Series of Bonds; and

(m) Any other provisions deemed advisable by the Department not in conflict with the provisions of Resolution RB-1.

Said Bonds shall be executed substantially in the form and manner set forth in Resolution RB-1 and shall be deposited with the Trustee for authentication, but before said Bonds shall be authenticated and delivered by the Trustee, there shall be on file with the Trustee the following:

(a) A copy, duly certified by an Authorized Representative, of Resolution RB-1 and the Series Resolution for such Series of Bonds;

(b) A Certificate of the Department to the effect that no Event of Default shall have occurred and then be continuing;

(c) An opinion of nationally recognized bond counsel stating in the opinion of such counsel that (i) Resolution RB-1 and the applicable Series Resolution have been duly adopted

and are valid and binding upon the Department and (ii) said Bonds are valid and legally binding special obligations of the Department secured in the manner and to the extent set forth in Resolution RB-1 and the applicable Series Resolution and are entitled to the benefit, protection and security of the provisions, covenants and agreements contained therein;

(d) A Cash Flow Statement conforming to the requirements of Section 607 of Resolution RB-1;

(e) With respect to refunding Bonds, a certificate of an Authorized Representative stating that the proceeds (excluding accrued interest but including any premium) of such refunding Bonds, together with any moneys to be withdrawn from the Bond Reserve Account by the Trustee, and any other moneys which have been made available to the Trustee for such purposes, and the principal of and the interest on the investment of such proceeds or any such moneys, will be not less than an amount sufficient to pay the principal of and the redemption premium, if any, on the Bonds to be refunded and the interest which will become due and payable on or prior to the date of their payment or redemption, the expenses in connection with such refunding and to make any required deposits to the Bond Reserve Account and the Loan Loss Account and specifying transfers, if any, from the Series Proceeds Subaccount applicable to the Series of Bonds to be refunded and the refunding Bonds;

(f) With respect to refunding Bonds, if all or part of the refunded Bonds are to be redeemed prior to maturity, irrevocable instructions from an Authorized Representative of the Department to the Trustee to redeem the applicable Bonds;

(g) A Rating Confirmation; and

(h) A request and authorization to the Trustee on behalf of the Department, signed by an Authorized Representative, to authenticate and deliver the Bonds to the purchaser or purchasers therein identified upon payment to the Trustee for the account of the Department of the purchase price therefor.

When the documents mentioned in clauses (a) to (h), inclusive, of Section 209 shall have been filed with the Trustee and when the Bonds described in the Series Resolution mentioned in clause (a) above shall have been executed and authenticated as required by Resolution RB-1, the Trustee shall deliver such Bonds at one time to or upon the order of the purchaser or purchasers named in the request and authorization mentioned in clause (h) of Section 209, but only upon payment to the Trustee of the purchase price of said Bonds. The Trustee shall be entitled to rely upon such request and authorization as to the amount of such purchase price.

Simultaneously with the delivery of such Bonds the Trustee shall deposit or credit the proceeds of said Bonds into the applicable Revenue Bond Series Proceeds Subaccount of the Proceeds Account. Unless otherwise provided in the applicable Series Resolution, the Trustee shall apply such proceeds together with any other available funds, as follows:

(i) an amount shall be transferred to and deposited to the credit of the Bond Reserve Account such that the amount on deposit in such Account will at least equal the Bond Reserve Requirement (with respect to refunding Bonds, after giving effect to the refunding);

(ii) an amount shall be transferred to and deposited to the credit of the Loan Loss Account such that the amount on deposit in such Account will at least equal the

Loan Loss Requirement (with respect to refunding Bonds, after giving effect to the refunding); and

(iii) an amount to be transferred to and deposited into any Account or for any purpose not referred to in clauses (i) or (ii) above as provided in the applicable Series Resolution.

Transfers Outside Book-Entry System (Section 214)

In the event (i) the Securities Depository (*i.e.*, initially, DTC) determines not to continue to act as Securities Depository for any Series of the Bonds or (ii) the Department and the Trustee determine that the Securities Depository shall no longer so act and the Department delivers a written certificate to the Trustee to that effect, then the Department will discontinue the book-entry system with the Securities Depository with respect to such Series. If the Department and the Trustee determine to replace the Securities Depository with another qualified securities depository, the Department shall prepare or direct the preparation of a new, single, separate, fully registered bond for each of the maturities of the Bonds of such Series, registered in the name of such successor or substitute qualified securities depository or its nominee, or make such other arrangements acceptable to the Department and the Securities Depository as are not inconsistent with the terms of Resolution RB-1 or any Supplemental Resolution. If the Department and the Trustee fail to identify another qualified securities depository to replace the Securities Depository, then the Bonds of such Series shall no longer be restricted to being registered in the registration books of the Trustee in the name of the Nominee, but shall be registered in whatever name or names the Bondowner of Bonds transferring or exchanging Bonds shall designate in accordance with Resolution RB-1. Notwithstanding anything in Section 214 of Resolution RB-1 to the contrary, the book-entry system may not be discontinued within the period commencing 15 days prior to the date of mailing a notice of redemption and ending on the redemption date specified in such notice.

Payments and Notices to the Nominee (Section 215)

Notwithstanding any other provision of Resolution RB-1 or any Supplemental Resolution to the contrary, so long as any Bond is registered in the name of the Nominee, all payments with respect to principal of, premium, if any, and interest on such Bond and all notices with respect to such Bond shall be made and given, respectively, as provided in the applicable Representation Letter or as otherwise instructed by the Securities Depository.

Redemption of Bonds (Section 301)

The Trustee shall select the Bonds or portions of Bonds to be redeemed or purchased in accordance with Resolution RB-1 and the applicable Series Resolution. Except as otherwise stated in the Series Resolution authorizing a Series of Bonds under Resolution RB-1 with respect to all or any part of the Series of Bonds authorized thereunder, moneys shall upon direction by Department Request to the Trustee be applied by the Trustee to the purchase or the redemption of Bonds selected from among the Series (and subseries, if applicable), maturities and interest rates on the basis specified by the Department in such Department Request. Except as otherwise provided in a Series Resolution, the Department Request relating to each redemption of Bonds shall be filed with the Trustee at least thirty (30) days prior to the date fixed for redemption or such lesser number of days as shall be acceptable to the Trustee.

Except as otherwise provided in a Series Resolution, if less than all of the Bonds of one Series (and subseries, if applicable) and one maturity bearing the same interest rate (and otherwise of like tenor) shall be called for redemption, the particular Bonds of such Series (and subseries if applicable) and maturity bearing the same rate of interest (and otherwise of like tenor) to be redeemed shall be selected in such manner based upon Series, maturity, principal amount and interest rate as directed by the Department or, if no such direction is received by the Trustee, by lot or in such manner as the Trustee in its discretion may determine; provided, however, that the portion of Bonds of any Series (and subseries, if applicable) to be redeemed shall be in the minimum principal amount or some integral multiple thereof established for such Bonds in the applicable Series Resolution, and that in selecting Bonds for redemption, the Trustee shall treat each Bond as representing that number of Bonds which is obtained by dividing the principal amount of such Bond by said minimum principal amount. If less than all of the Term Bonds Outstanding of any one maturity of a Series (or subseries, if applicable) shall be purchased or called for redemption (other than in satisfaction of Mandatory Sinking Account Payments), the principal amount of such Term Bonds that are so purchased or redeemed shall be credited, to the extent practicable, except as otherwise provided in a Department Request, against all remaining Mandatory Sinking Account Payments for the Term Bonds of such Series (and subseries, if applicable) and maturity in the proportion which the then remaining balance of each such Mandatory Sinking Account Payments bears to the total of all Bonds of such Series (and subseries, if applicable) and maturity then Outstanding.

Effect of Calling for Redemption (Section 303)

On the date so designated for redemption if the conditions precedent, if any, to such redemption have been satisfied, any required notice which has not been waived having been given in the manner and under the conditions in Resolution RB-1 above provided, the Bonds or portions of Bonds so called for redemption shall become and be due and payable at the Redemption Price provided for redemption of such Bonds or portions thereof on such date, and, if sufficient money or Government Obligations (the principal of and interest on which will provide sufficient money for payment of the Redemption Price and the accrued interest) are held by the Trustee in trust for the owners of the Bonds or portions thereof to be redeemed, as provided in Resolution RB-1, such Bonds or portions thereof shall cease to be Outstanding under the provisions of Resolution RB-1, interest on the Bonds or portions of Bonds so called for redemption shall cease to accrue, such Bonds or portions of Bonds shall cease to be entitled to any benefit or security under Resolution RB-1 and the owners of such Bonds or portions of Bonds shall have no rights in respect of Resolution RB-1, except to receive payment of the Redemption Price thereof and the accrued interest thereon to the date of redemption and, to the extent provided in Section 304 of Resolution RB-1, to receive Bonds for any unredeemed portion of Bonds.

Establishment of Accounts (Section 401)

- (a) Resolution RB-1 creates the following Accounts within the 1943 Fund:

Proceeds Account

Revenue Bond Series Proceeds Subaccounts

Revenue Bond Series Recycling Subaccounts

GO Bond Series Proceeds Subaccounts

GO Bond Series Recycling Subaccounts

Revenue Account

Revenue Bond Series Restricted Recoveries Subaccounts

Revenue Bond Series Revenue Subaccounts

GO Bond Series Restricted Recoveries Subaccounts

GO Bond Series Revenue Subaccounts

(b) Resolution RB-1 creates the following Accounts within the Veterans Debenture Fund and designated as set forth below:

Bond Reserve Account

Series Bond Reserve Subaccounts

Loan Loss Account

Series Loan Loss Subaccounts

(c) Additional Accounts (including for the purpose of depositing amounts required to be rebated to mortgagors or the United States, *i.e.*, a Rebate Account) may be created and designated in Series Resolutions. Any Series Proceeds Subaccount, Series Recycling Subaccount, Series Restricted Recoveries Subaccount and Series Revenue Subaccount may be established with respect to more than one Series of the Bonds, or more than one series of Veterans G.O. Bonds, as set forth in the Series Resolution or Supplemental Resolution or any resolution of issuance governing a series of Veterans G.O. Bonds. Each such Account established with respect to Bonds shall be held by the Trustee, in trust, separate and apart from all other funds of the Department, for the purposes provided in this Resolution, provided that in Series Resolutions, the Department may provide for the deposit of amounts in Accounts, which amounts shall be subject to the lien of this Resolution only for the purposes and period of time set forth in the applicable Series Resolution.

Proceeds Account (Section 402)

(a) Upon the issuance of a Series of Bonds or a series of Veterans G.O. Bonds, unless otherwise provided in the applicable Series Resolution or resolution of issuance governing such Veterans G.O. Bonds, respectively, the Trustee shall establish a Series Proceeds Subaccount and a Series Recycling Subaccount within the Proceeds Account applicable to such Series of Bonds or series of Veterans G.O. Bonds. The Trustee shall deposit amounts received in connection with the issuance of Bonds or Veterans G.O. Bonds into the Proceeds Account or any such Subaccount in the amount(s) and at the time(s) set forth in the Series Resolution or resolution of issuance, respectively, authorizing the issuance thereof. Amounts shall also be deposited in the Proceeds Account from a transfer of funds from the Revenue Account pursuant to the provisions of Section 403(c)(11) of Resolution RB-1. Amounts on deposit in the Proceeds Account may be transferred between various Series Proceeds Subaccounts and Series Recycling Subaccounts, as set forth in the Program Operating Procedures.

(b) Moneys in the Proceeds Account shall be withdrawn or transferred therefrom in accordance with law upon requisition of the Department for the purpose of carrying out the provisions of the Bond Act and the Program Acts, including by entering into Contracts of Purchase, and by paying administrative expenses of the Department, including Costs of Issuance.

(c) The Trustee shall transfer from the Proceeds Account any amount specified by the Department from time to time in a Department Request for the purpose of redeeming or purchasing Bonds or Veterans G.O. Bonds or for the purpose of funding the Bond Reserve Account as provided in the applicable Series Resolution, or resolution of issuance, and Program Operating Procedures.

(d) The Trustee shall transfer any amount deposited in a Series Recycling Subaccount to the related Series Restricted Recoveries Subaccount or to the related Series Revenue Subaccount, upon a Department Request in the amount and at the time(s) stated in such Department Request.

(e) Moneys held for the credit of the Proceeds Account shall be transferred to be applied for payment of Bonds or Veterans G.O. Bonds pursuant to Section 410 of Resolution RB-1.

Revenue Account; Application of Revenues (Section 403)

(a) The Department shall transfer all Revenues to the Trustee for deposit in the Revenue Account upon the Department's identification and receipt thereof. Upon transfer, the Department shall identify the amount of Restricted Recoveries included in such Revenues and deposit the same, unless otherwise provided in the applicable Series Resolution or any resolution of issuance governing a series of Veterans G.O. Bonds, in the related Series Restricted Recoveries Subaccount. The balance shall be deposited in the related Series Revenue Subaccount.

(b) Pursuant to a Department Request, based on the Department's determination that certain Revenues previously deposited in a Series Revenue Subaccount constitute Restricted Recoveries, the Trustee shall transfer Revenues in an amount equal to and representing such Restricted Recoveries from the Series Revenue Subaccount to the related Series Restricted Recoveries Subaccount (if any).

(c) From time to time as required or as otherwise directed by Department Request, the Department shall cause to be transferred, applied, or retained all Revenues in the Revenue Account (not including Series Restricted Recoveries Subaccounts, which shall be governed by Section 409 of Resolution RB-1) for the following purposes (subject, in the case of any deficiency in available Revenues to meet the requirements of one or more of clauses (1) through (6), to the provisions as to deficiency contained in Section 410):

(1) In accordance with the applicable Series Resolution, to transfer to any Rebate Account, or otherwise to the U.S. Treasury, the amount(s) if any, specified by Department Request;

(2) From the GO Bond Series Revenue Subaccounts, to reimburse the General Fund for amounts previously paid out of the General Fund (and not previously reimbursed pursuant to this provision) for principal of and interest on the Veterans G.O. Bonds of the related series (together with interest at the same rate as borne by said bonds, compounded semiannually, from the due date of such principal and interest to the date of such reimbursement);

(3) From the GO Bond Series Revenue Subaccounts, to transfer to the Veterans' Bond Payment Fund the amount of the principal of and interest then due on the Veterans G.O. Bonds of the related series and to transfer to the General Fund or

Veterans' Bond Payment Fund, as applicable, the amount of Credit and Liquidity Support Expenses then due and related thereto;

(4) From the Revenue Bond Series Revenue Subaccounts, to pay interest due on the Bonds of the related Series;

(5) From the Revenue Bond Series Revenue Subaccounts, to pay principal (including by operation of Mandatory Sinking Account Payments) due on the Bonds of the related Series;

(6) From the Revenue Bond Series Revenue Subaccounts, to pay any Credit and Liquidity Support Expenses then due and related to the Bonds of the related Series;

(7) From the Revenue Bond Series Revenue Subaccounts, upon Department Request and (without Department Request) at least once every month, to deposit to the credit of the Bond Reserve Account an amount sufficient to cause the amount on deposit in said Account to equal the Bond Reserve Requirement (to be allocated among any Revenue Bond Series Bond Reserve Subaccounts in accordance with the Program Operating Procedures);

(8) From the Revenue Bond Series Revenue Subaccounts, pursuant to the terms of a Series Resolution upon the issuance of a Series of Bonds, to transfer such amount as is required to cause the amount in the Loan Loss Account to equal the Loan Loss Requirement;

(9) From all Series Revenue Subaccounts pursuant to Program Operating Procedures to transfer an amount to the Department for deposit to any operating or other account, free and clear of the lien of Resolution RB-1, equal to Expenses specified in a Department Request as contemplated by the Program Operating Procedures;

(10) From the GO Bond Series Revenue Subaccounts, on the first day of each month, to accumulate in the GO Bond Series Revenue Subaccounts collectively (in such respective allocations made at such times as are required by the Program Operating Procedures), an amount equal to Accrued Debt Service on the Veterans G.O. Bonds of all series;

(11) From any Series Revenue Subaccount, upon Department Request, to transfer amounts for credit to the related Series Recycling Subaccount; and

(12) With respect to amounts constituting Excess Revenues or Restricted Recoveries, to redeem any Series of Bonds or series of Veterans G.O. Bonds upon Department Request and in accordance with the provisions of a Series Resolution or Supplemental Resolution, or resolution of issuance governing such Veterans G.O. Bonds, respectively.

(d) Revenues in the Revenue Account shall be applied to the purchase of Bonds at the times, in the manner and for the purposes set forth in Section 406 of Resolution RB-1.

(e) Amounts on deposit in the Revenue Account upon Department Request may be transferred between any Series Restricted Recoveries Subaccount or Series Revenue Subaccount and any other Series Restricted Recoveries Subaccount or Series Revenue Subaccount, as set forth in the Program Operating Procedures.

Interest (Section 404)

In payment of interest on Bonds, the Trustee shall remit (or other method of transfer acceptable to the Department and to any Securities Depository) (i) by mail to each owner of Bonds the amounts required for paying the interest on such Bonds as such interest becomes due and payable and (ii) payment for any Credit and Liquidity Support Expenses relating to such Bonds as described in Section 403(c)(6) of Resolution RB-1. An Authorized Representative of the Department shall advise the Trustee regarding the amount of any such Credit and Liquidity Support Expenses and when payment is due.

Principal (Section 405)

(a) **Principal Payments.** The Trustee shall set aside in the Revenue Account for remittance to Bondowners the amounts required for paying the principal of all Bonds as such principal becomes due and payable.

(b) **Mandatory Sinking Account Payments Redemption.** Amounts on deposit in any Revenue Bond Series Revenue Subaccount prior to being applied in satisfaction of Mandatory Sinking Account Payments shall be applied as applicable to the purchase of Term Bonds of the related Series then Outstanding subject to Mandatory Sinking Account Payments on the next date such payments are scheduled as provided in this paragraph. The Trustee, upon direction of an Authorized Representative, shall endeavor to purchase the Term Bonds or portions of Term Bonds of each Series stated to mature on the next maturity date or to be redeemed pursuant to Mandatory Sinking Account Payments for Term Bonds of such Series then Outstanding at a price not to exceed the Redemption Price (plus accrued interest to the date of redemption) which would be payable on the next redemption date to the Owners of such Term Bonds under the provisions of the applicable Series Resolution if such Term Bonds or portions of Term Bonds should be called for redemption on such date. *Provided, however,* that, subject to applicable law, *notwithstanding* the maximum purchase price set forth in the preceding sentence, if at any time the investment earnings on the moneys in the Revenue Account equal to the Mandatory Sinking Account Payments for the next date such payments are scheduled shall be less than the interest accruing on the Bonds to be redeemed on such date from such Mandatory Sinking Account Payments, then the Trustee may pay a purchase price for any such Bond in excess of the Redemption Price which would be payable on the next redemption date to the owner of such Bond under the provisions of the applicable Series Resolution, if an Authorized Representative certifies to the Trustee that the amount paid in excess of said Redemption Price is expected to be less than the interest which is expected to accrue on said Bond less any investment earnings on such available moneys during the period from the settlement date of the proposed purchase to the redemption date. The Trustee shall pay the interest accrued on such Term Bonds or portions of Term Bonds to the date of settlement therefor from the Revenue Account. *Notwithstanding* the foregoing, no such purchase shall be made by the Trustee after the giving of notice of redemption by the Trustee.

(c) Any purchase or redemption of Bonds shall be made pursuant to the provisions of Article III of Resolution RB-1. Upon retirement of any Term Bonds by purchase or redemption pursuant to the provisions of Section 405 of Resolution RB-1, the Trustee shall file with the Department a statement identifying such Bonds and setting forth the date of their purchase or redemption, the amount of the purchase price or the Redemption Price of such Bonds and the amount paid as interest thereon. The expenses in connection with the purchase or redemption of

any such Bonds shall be paid by the Trustee from any moneys available therefor in the Revenue Account.

Redemption (Section 406)

(a) The Trustee shall apply all amounts in Revenue Bond Series Restricted Recoveries Subaccounts, and all moneys otherwise set aside in the Revenue Account for the redemption of Bonds pursuant to Section 403(c)(12) of Resolution RB-1, to the purchase or redemption of Bonds issued under the provisions of Resolution RB-1, as follows:

(1) The Trustee, upon direction of an Authorized Representative, shall endeavor to purchase Bonds or portions of Bonds then Outstanding, whether or not such Bonds or portions of Bonds shall then be subject to redemption, at a price not to exceed the Redemption Price (plus accrued interest, if any, to the date of redemption) which would be payable on the next redemption date to the owners of such Bonds if such Bonds or portions of Bonds should be called for redemption on such date from the moneys in the respective Account. Such maximum purchase price may be exceeded in accordance with the proviso in Section 405(b) of Resolution RB-1. The Trustee shall pay the interest accrued on such Bonds to the date of settlement therefor from the Revenue Account, but no such purchase shall be contracted for by the Trustee after the giving of notice by the Trustee that such Bonds have been called for redemption except from moneys other than the moneys set aside for the redemption of such Bonds.

(2) The Trustee, having endeavored to purchase Bonds pursuant to subsection (1) of this subsection (a), shall call for redemption, on the earliest practicable date on which Bonds are subject to redemption from such moneys, such amount (computed on the basis of Redemption Prices) of Bonds as will exhaust the moneys set aside for such redemption, as nearly as may be practicable.

(b) Any purchase or redemption of Bonds shall be made pursuant to the provisions of Article III of Resolution RB-1. Prior to calling Bonds or portions of Bonds for redemption, the Trustee shall set aside the respective amounts required for paying the interest on and the Redemption Price of the Bonds or portions of Bonds so called for redemption. Upon the retirement of any Bonds under Section 406 of Resolution RB-1 by purchase or redemption, the Trustee shall file with the Department a statement briefly describing such Bonds and setting forth the date of their purchase or redemption, the amount of the purchase price or the Redemption Price of such Bonds and the amount paid as interest thereon. The expenses in connection with the purchase or redemption of any such Bonds shall be paid by the Trustee from any moneys available therefor in the Revenue Account.

Bond Reserve Account (Section 407)

(a) Moneys held for the credit of the Bond Reserve Account shall be transferred by the Trustee to be applied for payment of Bonds pursuant to Section 410 of Resolution RB-1.

(b) Moneys held for the credit of the Bond Reserve Account as of any date in excess of the Bond Reserve Requirement upon Department Request shall be transferred to the Loan Loss Account, the Revenue Account or the Proceeds Account.

(c) A Series Resolution may provide that the Bond Reserve Requirement with respect to the applicable Series of Bonds may be funded through Cash Equivalents. In connection with

any discussion in Resolution RB-1 of “moneys” on deposit in or held for the credit of the Bond Reserve Account, “moneys” shall be deemed to include said Cash Equivalents.

(d) Upon Department Request, the Trustee shall transfer an amount required to cause the Bond Reserve Account to equal the Bond Reserve Requirement from available amounts in the 1943 Fund.

Loan Loss Account (Section 408)

(a) Pursuant to the Program Operating Procedures, moneys held for the credit of the Loan Loss Account as of any date upon Department Request shall be transferred to the Revenue Account, the Bond Reserve Account, the Proceeds Account or any GO Bond Series Revenue Subaccount.

(b) A Series Resolution may provide that the Loan Loss Requirement with respect to the applicable Series of Bonds may be funded through Cash Equivalents. In connection with any discussion in Resolution RB-1 of “moneys” on deposit in or held for the credit of the Loan Loss Account, “moneys” shall be deemed to include said Cash Equivalents.

(c) Moneys held for the credit of the Loan Loss Account shall be transferred by the Trustee to be applied for payment of Bonds, pursuant to Section 410 of Resolution RB-1.

(d) Upon Department Request, the Trustee shall transfer an amount required to cause the Loan Loss Account to equal the Loan Loss Requirement from available amounts in the 1943 Fund.

(e) To the extent set forth in a Department Request, the Trustee shall apply amounts in the Loan Loss Account to remedy shortfalls in recoveries on Contracts of Purchase financed by or otherwise allocable to the Veterans G.O. Bonds of any series.

Restricted Recoveries (Section 409)

Upon the issuance of a Series of Bonds or series of Veterans G.O. Bonds, if so required by the terms of the Series Resolution or resolution of issuance governing the Veterans G.O. Bonds, the Trustee shall establish a Series Restricted Recoveries Subaccount within the Revenue Account applicable to such Series of Bonds or series of Veterans G.O. Bonds. If the Trustee does not receive a Department Request with respect to a mandatory redemption from Restricted Recoveries set forth in a Series Resolution, the Trustee shall apply Restricted Recoveries in an amount sufficient to accomplish such mandatory redemption to a redemption of Bonds (subject to any other priority set forth in the applicable Series Resolution) on a *pro rata* basis, as nearly as practicable, from among each maturity of the Series (and subseries, if applicable) of Bonds which financed the related Contracts of Purchase. Upon Department Request, the Trustee shall transfer amounts in any Series Restricted Recoveries Subaccount to the related Series Revenue Subaccount.

Deficiencies in Debt Service (Section 410)

In the event that amounts in the Revenue Account shall be insufficient on any interest payment date or principal payment date for the Bonds or the Veterans G.O. Bonds to pay the principal of and interest on such Bonds, or provide for payment with respect to Veterans G.O. Bonds pursuant to the provisions of Section 403(c)(2) or (3) of Resolution RB-1 in each case if payment is due and unpaid on such date, whether at the stated payment or maturity date or by the retirement thereof by Mandatory Sinking Account Payments (or sinking account retirement with

respect to the Veterans G.O. Bonds) therefor, the Trustee shall withdraw amounts from the following Accounts in the following order of priority to the extent necessary to eliminate such deficiency; *provided, however*, that no amounts shall be used for such purpose to the extent that such amounts have been set aside for the payment of Bonds or Veterans G.O. Bonds which have been identified for purchase pursuant to Section 403 or 406 of Resolution RB-1 or called for redemption, and no amounts on deposit in the Proceeds Account shall be used for such purpose to the extent that the Department is contractually obligated to enter into Contracts of Purchase acceptable for financing with such amounts:

(a) With respect to deficiencies in payments related to Veterans G.O. Bonds, in the following order of priority:

- (i) GO Bond Series Recycling Subaccounts;
- (ii) GO Bond Series Proceeds Subaccounts;
- (iii) GO Bond Series Restricted Recoveries Subaccounts;
- (iv) Revenue Bond Series Revenue Subaccounts;
- (v) Revenue Bond Series Recycling Subaccounts;
- (vi) Revenue Bond Series Proceeds Subaccounts; and
- (vii) Revenue Bond Series Restricted Recoveries Subaccounts.

(b) With respect to deficiencies in debt service related to Bonds, in the following order of priority:

- (i) Revenue Bond Series Recycling Subaccounts;
- (ii) Revenue Bond Series Proceeds Subaccounts;
- (iii) Revenue Bond Series Restricted Recoveries Subaccounts;
- (iv) GO Bond Series Revenue Subaccounts;
- (v) GO Bond Series Recycling Subaccounts;
- (vi) GO Bond Series Proceeds Subaccounts;
- (vii) GO Bond Series Restricted Recoveries Subaccounts;
- (viii) Loan Loss Account; and
- (ix) Bond Reserve Account.

Moneys Held in Trust (Section 411)

(a) All moneys which the Trustee shall have withdrawn or set aside for the purpose of payment of any of the Bonds secured by Resolution RB-1, either at the maturity thereof or upon call for redemption, shall be held in trust for the respective owners of such Bonds and such moneys shall not be subject to lien or attachment by any creditor of the Department or the Trustee. Any moneys which shall be so set aside by the Trustee and which shall remain unclaimed by the owners of such Bonds for the period of two (2) years after the date on which such Bonds or the interest thereon shall have become due and payable shall be paid to the Department or to such officer, board or body as may then be entitled by law to receive the same, and thereafter the owners of such Bonds shall look only to the Department or to such officer,

board or body, as the case may be, for payment and then only to the extent of the amounts so received without any interest thereon, and the Trustee shall have no responsibility with respect to such moneys.

(b) If sufficient money or Government Obligations (the principal of or interest on which will provide sufficient money for payment of the principal amount or accrued interest on the Bonds on their maturity date or each date thereafter that they become due by redemption or otherwise) are held by the Trustee in trust for the Owners of Bonds, such Bonds shall cease to be Outstanding under the provisions of Resolution RB-1, interest on the Bonds which have matured shall cease to accrue, such Bonds shall cease to be entitled to any benefit or security under Resolution RB-1, and the owners of such Bonds shall have no rights in respect thereof, except to receive payment of the principal amount thereof and accrued interest thereon to the maturity date. Notwithstanding any provision of Resolution RB-1 to the contrary, the Department may issue refunding Bonds to refund the liabilities remaining on any such Bonds, despite their characterization for other purposes as not Outstanding under Resolution RB-1.

Security for Deposits (Section 501)

All money deposited with a co-Trustee in any Account created under Resolution RB-1 shall, unless invested in Investment Obligations in accordance with Section 502 (except, to the extent applicable, the last paragraph of Section 502) of Resolution RB-1, to the extent such deposits are in excess of the amount guaranteed by the Federal Deposit Insurance Corporation or other Federal agency, be continuously secured (if permitted by law), for the benefit of the Department and the owners of the Bonds either (a) by lodging with a bank or trust company selected by the Department as custodian, or, if then permitted by law, by setting aside under control of the trust department of the bank holding such deposit as collateral security, Government Obligations or, with the approval of the Department, other marketable securities eligible as security for the deposit of trust funds under regulations of the Comptroller of the Currency of the United States of America, having a market value at all times (exclusive of accrued interest) not less than the amount of such deposit; or (b) if the furnishing of security as provided in clause (a) of Section 501 of Resolution RB-1 is not permitted by applicable law, then in such other manner as may then be required or permitted by applicable State or Federal laws and regulations regarding the security for, or granting a preference in the case of, the deposit of trust funds; *provided, however*, that it shall not be necessary, *except* as otherwise expressly provided, for the Trustee to give security for any money which shall be represented by obligations purchased under the provisions of Article V of Resolution RB-1 as an investment of such money.

Investment of Moneys (Section 502)

The Revenue Bond Series Proceeds Subaccounts, Series Recycling Subaccounts, Series Restricted Recoveries Subaccounts, Series Revenue Subaccounts, Loan Loss Account and Bond Reserve Account shall, as nearly as is practicable, be fully and continuously invested or reinvested in Investment Obligations.

Any Investment Obligations so purchased in any Account shall be deemed at all times to be part of such Account. Any interest paid on the investment in any Account (*except* any Rebate Account) shall be credited to the Revenue Account and thereafter treated as Revenues. Any interest paid on the investment of any Rebate Account shall be credited to such Rebate Account. Any profit or loss resulting from such investment shall be credited to or charged against the

Account. The Trustee shall sell or present for redemption any obligations so purchased whenever it shall be necessary so to do in order to provide money to meet any payment or transfer from any such Account. Neither the Trustee nor the Department shall be liable or responsible for any loss resulting from any such investment.

In computing the amount on deposit to the credit of any Account, obligations in which money in such Account shall have been invested shall be valued at Amortized Value plus accrued interest.

No Extension of Maturities or Claims for Interest (Section 603)

The Department will not directly or indirectly extend or assent to the extension of the time for the payment of any principal of or claim for interest on any Bond and will not directly or indirectly be a party to any arrangement therefor without the consent of any Bondowner materially adversely affected thereby.

Covenant Against Encumbrances (Section 605)

The Department covenants that, except as expressly permitted in Resolution RB-1, it will not sell, convey, mortgage, encumber or otherwise dispose of the money held for the credit of any Account created under Resolution RB-1 except the pledge created by Resolution RB-1 and any interest or right to which such pledge is by its terms secondary and subordinate or take any other action which would adversely affect the security of the Bondowners stated in Resolution RB-1.

Program Operating Procedures (Section 606)

(a) The Department shall have on file with the Trustee at all times during which Bonds are Outstanding current Program Operating Procedures accompanied by a Counsel's Opinion that the same are consistent with the provisions of Resolution RB-1.

(b) Upon adoption of Program Operating Procedures, the Department shall thereafter administer the Program and perform its obligations under Resolution RB-1 in accordance in all material respects with the Program Operating Procedures. Any action taken by the Department with respect to Contracts of Purchase, Bonds and Pledged Property shall be deemed a representation and warranty by the Department under Resolution RB-1 that such action is in conformance with any provision of the current Program Operating Procedures applicable thereto.

(c) The Program Operating Procedures may be amended only if (1) a Cash Flow Statement is delivered to the Trustee and (2) an opinion of nationally recognized bond counsel is delivered to the Trustee to the effect that such amendment or action taken pursuant to such amendment will not affect the exemption of interest on the Bonds from the gross income of the holders thereof for federal income tax purposes.

Cash Flow Statements (Section 607)

(a) The Department shall file with the Trustee a current Cash Flow Statement (i) upon adoption of each Series Resolution and each Supplemental Resolution, (ii) upon issuance of any series of Veterans G.O. Bonds, (iii) when required pursuant to any Series Resolution or Supplemental Resolution, (iv) upon any change in the Program Operating Procedures and (v) whenever required pursuant to the provisions of Section 608 of Resolution RB-1. The Department may file a new or amended Cash Flow Statement conforming to the requirements of Section 607 of Resolution RB-1 at any time. Any Cash Flow Statement shall be the subject of a Rating Confirmation if it does not include all the scenarios included in the Cash Flow Statement previously on file with the Trustee.

(b) A Cash Flow Statement shall consist of a Certificate of the Department containing the conclusion of an Authorized Representative of the Department that projected Revenues will be sufficient to provide for timely payments of interest and principal on the Bonds and Expenses, under each of the scenarios included in the cash flow projections attached to Resolution RB-1. The Cash Flow Statement shall include each scenario included in the immediately prior Cash Flow Statement except as may be required by any Rating Agency in connection with a Rating Confirmation. A Cash Flow Statement shall (i) take into account the financial position of the 1943 Fund, the Bond Reserve Account and the Loan Loss Account as of the stated starting date of the projection; (ii) reflect all the significant transactions that have occurred in the period commencing with such starting date and ending with a date no more than ninety (90) days prior to the date of such projections; (iii) be consistent with Resolution RB-1; and (iv) assume compliance with the Program Operating Procedures.

(c) The Cash Flow Statement shall set forth for each scenario included therein the sets of assumptions on which it is based including, without limitation, the following:

- (i) the timing and terms of issuance or remarketing of Bonds and Veterans G.O. Bonds;
- (ii) the timing of the acquisition of Contracts of Purchase and the interest rates thereon and maturities thereof;
- (iii) the timing and amounts of the receipt of payments of scheduled principal or and interest on Contracts of Purchase;
- (iv) the timing and amounts of prepayments on Contracts of Purchase;
- (v) the timing and amount of defaults on Contracts of Purchase and disposition or recovery prices of defaulted Contracts of Purchase, which assumption may be based on a specified model of default frequency and loss severity as a function of Contract of Purchase portfolio characteristics;
- (vi) the investment return on Accounts and subaccounts, to the extent that amounts on deposit will not be subject to an investment agreement;
- (vii) the performance by the Department's counterparty with respect to obligations under an enhancement agreement or arrangement for Supplemental Contract of Purchase Coverage or investment of funds;
- (viii) the types of Primary Contract of Purchase Coverage and Supplemental Contract of Purchase Coverage; and
- (ix) the Loan Loss Requirement.

(d) If any Cash Flow Statement shall show that projected Revenues shall be insufficient to provide for timely payments of interest on and principal of the Bonds and Expenses, the Department shall not be in default under Resolution RB-1 but shall take all reasonable actions to eliminate such deficiency. The Department shall be precluded from taking the actions described or referenced in clauses (i) through (iv) of subsection (a) of the first paragraph of this section — “Cash Flow Statements” — if the Cash Flow Statement on file with the Trustee in accordance with the requirements of the first paragraph of this section shall show that the taking of such action shall cause a deficiency to occur or shall increase any existing deficiency.

Maintenance of Fund Parity (Section 608)

The Department shall cause a calculation to be made of Fund Parity, as evidenced in a Certificate of the Department filed with the Trustee as of the last day of each Fiscal Year (and upon receipt of the audited financial statements of the 1943 Fund), or more frequently in the discretion of the Department. If any such calculation shall not reflect that Fund Parity at least equals the Applicable Fund Parity Percentage[†] (provided that any Applicable Fund Parity Percentage which is less than 50% shall be the subject of a Rating Confirmation) of the then Outstanding aggregate principal amount of Bonds, all Excess Revenues shall thereafter be applied to redeem Bonds of the Series and in the manner reflected in the current Cash Flow Statement until (and if) the Department files with the Trustee a new Certificate of the Department reflecting a calculation of Fund Parity that at least equals such 50% (or such other percentage) level; *provided, however*, that no such Cash Flow Statement and no such redemption shall be required under Resolution RB-1 if the Department shall have provided a Rating Confirmation to the Trustee. But see “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS — Maintenance of Fund Parity” for the current percentage.

Tax Covenants (Section 609)

The Department shall at all times perform the applicable tax covenants contained in any applicable Series Resolution. In addition, the Department shall not amend the interest rates on any existing Contracts of Purchase unless the Department shall have provided the Trustee with an opinion of nationally recognized bond counsel to the effect that such action will not impair any exclusion of interest on the Bonds issued with the intent that such interest be excluded from gross income for federal income tax purposes. The Department shall prohibit any person (or any related person, as defined in Section 147(a)(2) of the Tax Code) for whom the Department may finance Contracts from purchasing Bonds or any other obligations issued by the Department to carry out the purposes of the Program in an amount related to the amount of the Contracts to be financed under the Program for such person by the Department.

Books and Records (Section 611)

(a) The Trustee shall keep proper books of record and account in which complete and correct entries shall be made of all transactions relating to the receipts, disbursements, allocations and applications of all moneys received by the Trustee under Resolution RB-1, and

[†] Currently, the applicable Fund Parity Percentage is 25%. Such Applicable Fund Parity Percentage has been subject to Rating Agency Confirmation. See “SECURITY FOR AND SOURCES OF PAYMENT OF THE OFFERED REVENUE BONDS — Maintenance of Fund Parity” in this Official Statement.

such books shall be available for inspection by the Department and any Bondowner during business hours, upon reasonable notice and under reasonable conditions.

(b) The Department shall keep proper books of records and account for all its transactions, other than those recorded in the books maintained by the Trustee pursuant to subsection (a) of Section 611 of Resolution RB-1, and such books shall be available for inspection by the Trustee and any Bondowner during business hours and upon reasonable notice.

Annual Audit, Report and No-Default Certificate (Section 612)

By the first day of the tenth month after the end of each Fiscal Year, the Department shall furnish to the Trustee (i) a statement of the revenues and expenses and of the changes in the fund balances during the previous Fiscal Year, in each case with respect to the 1943 Fund, the Bond Reserve Account and the Loan Loss Account, certified to by an Accountant; and (ii) a certificate from an Authorized Representative stating that there is no current Event of Default and that no Event of Default occurred during the preceding Fiscal Year (or if there has been an Event of Default, providing the details of Resolution RB-1 and describing the steps the Department took, or is taking, to cure such Event of Default).

Program Covenants (Section 614)

The Department shall from time to time, with all practical dispatch and in a sound and economical manner consistent in all respects with the Bond Act, the Program Acts, Resolution RB-1 and all other applicable laws and regulations and with sound banking practices and principles, use and apply the amounts held in the 1943 Fund and available to the financing of Contracts of Purchase and to other uses permitted under Resolution RB-1 and the law, and shall take all steps, actions and proceedings reasonable and necessary in the judgment of the Department to enforce the terms, covenants and conditions of each Contract of Purchase.

Issuance of Additional Obligations and Subordinate Obligations (Section 615)

The Department, so long as any Bonds shall be Outstanding under Resolution RB-1, shall not issue any bonds, notes or other evidences of indebtedness, other than the Bonds, secured by any pledge of or other lien or charge on the Pledged Property nor shall the Department create or cause to be created any lien or charge on the Pledged Property, other than the lien and pledge created under Resolution RB-1 and other than the rights of the State or the holders of the Veterans G.O. Bonds. Nothing contained in Section 615 of Resolution RB-1 shall prevent the Department from issuing any bonds, notes or other evidences of indebtedness which are payable from or secured by a lien and pledge on the Pledged Property provided that payment of such evidences of indebtedness and such lien and pledge shall be in all respects subordinate to the provisions of Resolution RB-1 and the lien and pledge created by Resolution RB-1 and any such evidences of indebtedness shall contain an appropriate recital with respect to such subordination.

Events of Default Defined (Section 702)

Each of the following events is by Resolution RB-1 declared an “Event of Default,” that is to say: If

(a) payment of the principal or Redemption Price of any of the Bonds shall not be made when the same shall become due and payable, either at maturity or by proceedings for redemption or otherwise; or

(b) payment of any installment of interest on any of the Bonds shall not be made when the same shall become due and payable; or

(c) the entry of a decree or order for relief by a court having jurisdiction in the premises in respect of the Department in an involuntary case under the Federal bankruptcy laws, as now or thereafter constituted, or any other applicable Federal or State bankruptcy, insolvency or other similar law, or appointing a receiver, liquidator, assignee, custodian, trustee, sequestrator (or similar official) of the Department or for any substantial part of its property, or ordering the winding-up or liquidation of its affairs and the continuance of any such decree or order unstayed and in effect for the period of 60 consecutive days; or

(d) the commencement by the Department of a voluntary case under the Federal bankruptcy laws, as constituted under Resolution RB-1 or hereafter amended, or any other applicable Federal or State bankruptcy, insolvency or other similar law, or the consent by it to the appointment of or taking possession by a receiver, liquidator, assignee, trustee, custodian, sequestrator (or other similar official) of the Department or for any substantial part of its property or the making by it of any assignment for the benefit of creditors, or the taking of action by the Department in furtherance of any of the events under Section 702 of Resolution RB-1; or

(e) failure by the Department to pay, when due or within any applicable grace period, any amount owing on account of indebtedness for money borrowed or for deferred purchases of property, or the failure by the Department to observe or perform any covenant or undertaking on its part to be observed or performed in any agreement evidencing, securing or relating to such indebtedness, resulting, in any such case, in an event of default or acceleration by the holder of such indebtedness of the date on which such indebtedness would otherwise be due and payable; or

(f) the Department defaults in the due and punctual performance of any other covenants or agreements contained in the Bonds or in Resolution RB-1 and such default continues for 90 days after written notice requiring the same to be remedied shall have been given to the Department by the Trustee, which may give such notice in its discretion and shall give such notice at the written request of the owners of not less than twenty per centum (20%) in aggregate principal amount of Bonds then Outstanding; *provided, however,* that so long as following such notice the Department is diligently taking actions to remedy such default, such default shall not be an Event of Default.

Enforcement of Remedies (Section 704)

Upon the happening and continuance of any Event of Default specified in Section 702 of Resolution RB-1, then and in every such case the Trustee may, and upon the written direction of the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then Outstanding under Resolution RB-1 shall, proceed, subject to the provisions of Section 802 of Resolution RB-1, to protect and enforce its rights and the rights of the Bondowners under

applicable laws or under Resolution RB-1 by such suits, actions or special proceedings in equity or at law, or by proceedings in the office of any board or officer having jurisdiction, either for the specific performance of any covenant or agreement contained in Resolution RB-1 or in aid or execution of any power in Resolution RB-1 granted or for the enforcement of any proper legal or equitable remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce such rights.

In the enforcement of any remedy under Resolution RB-1 the Trustee shall be entitled to sue for, enforce payment of and recover judgment for, in its own name as Trustee of an express trust, any and all amounts then or after any default becoming, and at any time remaining, due from the Department for principal, premium, if any, interest or otherwise under any of the provisions of Resolution RB-1 or the Bonds and unpaid, with, to the extent permitted by the applicable law, interest on overdue payments of principal of and interest at the rate or rates of interest specified in the Bonds, together with any and all costs and expenses of collection and of all proceedings under Resolution RB-1 and under the Bonds, without prejudice to any other right or remedy of the Trustee or of the Bondowners, and to recover and enforce any judgment or decree against the Department, but solely as provided in Resolution RB-1 and in the Bonds, for any portion of such amounts remaining unpaid and interest, costs and expenses as above provided, and to collect, in any manner provided by law, the money adjudged or decreed to be payable.

Regardless of the happening of an Event of Default, the Trustee may, and, subject to Section 802 of Resolution RB-1, if requested in writing by the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then Outstanding, shall institute and maintain such suits and proceedings as it may be advised shall be necessary or expedient (i) to prevent any impairment of the Pledged Property by any acts which may be unlawful or in violation of Resolution RB-1 or of any Series Resolution or (ii) to preserve or protect the interest of the Bondowners, provided that such request is in accordance with law and the provisions of Resolution RB-1 and, in the sole judgment of the Trustee, is not unduly prejudicial to the interests of the owners of Bonds not making such request.

If a covenant is set forth in a Series Resolution, limitations on the remedies available upon an Event of Default related to such covenant may be set forth in said Series Resolution.

Pro Rata Application of Funds (Section 706)

Anything in Resolution RB-1 to the contrary notwithstanding, if at any time the money in the Accounts maintained under Resolution RB-1 (other than any Rebate Account) shall not be sufficient to pay the principal of or interest on the Bonds as the same shall become due and payable such money, together with all amounts then on deposit in the 1943 Fund other than Veterans G.O. Bonds proceeds, together with any money then available or thereafter becoming available for such purpose, whether through the exercise of the remedies provided for in Article VII or otherwise, shall be applied, following the satisfaction of any payments due to the Trustee under the provisions of Section 802 and 805 of Resolution RB-1, as follows:

(a) Except in the case of amounts on deposit in the Bond Reserve Account and the Loan Loss Account and interest, profit or other income derived from the investment of such amounts, for transfer in accordance with and at the times stated in Sections 403(c)(2) and (3) of Resolution RB-1.

(b) After application pursuant to clause (a) of Section 706 of Resolution RB-1, all such money shall be applied:

First: to the payment to the persons entitled thereto of all installments of interest on Bonds (*except* interest on overdue principal) then accrued and unpaid in the chronological order in which such installments of interest accrued and, if the amount available shall not be sufficient to pay in full any particular daily installment, then to the payment, ratably, according to the amounts due on such daily installment, to the persons entitled thereto as owners of Bonds, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds;

Second: to the payment to the persons entitled thereto of the unpaid principal of any of the Bonds which shall have become due and payable (*except* Bonds called for redemption for the payment of which money is held pursuant to the provisions of Resolution RB-1) in the order of their stated payment dates, with interest on the principal amount of such Bonds at the respective rates specified in Resolution RB-1 from the respective dates upon which such Bonds became due and payable, and, if the amount available shall not be sufficient to pay in full the principal of the Bonds by their stated terms due and payable on any particular date, together with such interest, then to the payment first of such interest, ratably, according to the amount of such interest due on such date, with such payment being made to owners of Bonds, and then to the payment of such principal, ratably, according to the amount of such principal due on such date, to the persons entitled thereto as owners of Bonds, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bonds;

Third: to the payment of the interest on and the principal of the Bonds, to the purchase and retirement of Bonds and to the redemption of the Bonds, all in accordance with the provisions of Article III of Resolution RB-1.

The provisions of subsection (a) of Section 706 of Resolution RB-1 are in all respects subject to the provisions of Section 701 of Resolution RB-1.

(c) Whenever money is to be applied by the Trustee pursuant to the provisions of Section 706 of Resolution RB-1, such money shall be applied by the Trustee at such times, and from time to time, as the Trustee in its sole discretion shall determine, having due regard to the amount of such money available for application and the likelihood of additional money becoming available for such application in the future; the deposit of such money with any paying agent, or otherwise setting aside such money, in trust for the proper purpose shall constitute proper application by the Trustee; and the Trustee shall incur no liability whatsoever to the Department, to any Bondowner or to any other person for any delay in applying any such money, so long as the Trustee acts with reasonable diligence, having due regard to the circumstances, and ultimately applies the same in accordance with such provisions of Resolution RB-1 as may be applicable at the time of application by the Trustee. Whenever the Trustee shall exercise such discretion in applying such money, it shall fix the date (which shall be an interest payment date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee shall give such notice as it may deem appropriate of the fixing of any such date, and shall not be required to make payment to the owner of any Bond until such Bond shall be surrendered to the Trustee for appropriate endorsement, or for cancellation if fully paid.

Owners of Majority in Principal Amount of Bonds May Control Proceedings (Section 708)

Anything in Resolution RB-1 to the contrary *notwithstanding*, the owners of a majority in principal amount of the Bonds then Outstanding under Resolution RB-1 shall have the right, subject to the provisions of Section 802 of Resolution RB-1, by an instrument or concurrent instruments in writing executed and delivered to the Trustee, to direct the method and place of conducting all remedial proceedings to be taken by the Trustee under Resolution RB-1 or exercising any trust or power conferred upon the Trustee, provided that such direction shall not be otherwise than in accordance with law and the provisions of Resolution RB-1, and the Act and, in the sole judgment of the Trustee, is not unduly prejudicial to the interests of Bondowners not joining in such direction and *provided, further*, that nothing in Section 708 of Resolution RB-1 shall impair the right of the Trustee in its discretion to take any other action under Resolution RB-1 which it may deem proper and which is not inconsistent with such direction by Bondowners.

Restrictions Upon Actions by Individual Bondowner (Section 709)

No owner of any of the Bonds shall have any right to institute any suit, action or proceeding in equity or at law on any Bond or for the execution of any trust under Resolution RB-1 or for the enforcement of any remedy under Resolution RB-1 unless such owner previously shall have given to the Trustee written notice of the Event of Default on account of which such suit, action or proceeding is to be instituted, and unless, also, the owners of not less than fifteen per centum (15%) in aggregate principal amount of the Bonds then Outstanding shall have made written request of the Trustee after the right to exercise such powers or right of action, as the case may be, shall have accrued, and shall have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers granted in Resolution RB-1 or to institute such action, suit or proceeding in its or their name, and *unless*, also, there shall have been offered to the Trustee reasonable security and indemnity against the costs, expenses and liabilities to be incurred therein or by Resolution RB-1, and the Trustee shall have refused or neglected to comply with such request within a reasonable time; and such notification, request and offer of indemnity are by Resolution RB-1 declared in every such case, at the option of the Trustee, to be conditions precedent to the execution of the powers and trusts of Resolution RB-1 or to any other remedy under Resolution RB-1; *provided, however*, that *notwithstanding* the foregoing provisions of Section 709 of Resolution RB-1 and without complying therewith, the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds then Outstanding may institute any such suit, action or proceeding in their own names for the benefit of all owners of Bonds under Resolution RB-1. It is understood and intended that, *except* as otherwise provided in Resolution RB-1, no one or more owners of the Bonds by Resolution RB-1 secured shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of Resolution RB-1, or to enforce any right under Resolution RB-1 except in the manner in Resolution RB-1 provided, that all suits, actions and proceedings at law or in equity shall be instituted, had and maintained in the manner provided in Resolution RB-1 and for the benefit of all owners of such Outstanding Bonds, and that any individual right of action or other right given to one or more of such owners by law is restricted by Resolution RB-1 to the rights and remedies provided in Resolution RB-1.

Waiver of Defaults (Section 713)

The Trustee may, and upon written direction of the owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding shall, waive any default which in their opinion shall have been remedied before the entry of final judgment or decree in any suit, action or proceeding instituted by them under the provisions of Resolution RB-1 or before the completion of the enforcement of any other remedy under Resolution RB-1, but no such waiver shall extend to or affect any other existing or any subsequent default or defaults or impair any rights or remedies consequent thereon.

Notice of an Event of Default (Section 714)

The Trustee shall mail to the Department and to all Bondowners written notice of the occurrence of any Event of Default set forth in Section 702 of Article VII of Resolution RB-1 within thirty (30) days after the Trustee shall have received written notice thereof from the Department, subject to the provisions of Section 708 of Resolution RB-1, that any such Event of Default shall have occurred. The Trustee shall not, *however*, be subject to any liability to any Bondowner by reason of a failure to mail any such notice.

Acceptance of Trusts (Section 801)

(a) The Treasurer of the State shall act as trustee for the Department and the owners of the Bonds to receive and disburse all Revenues and other moneys applicable to the payment of the principal of or interest on the Bonds, including moneys in the 1943 Fund and the Veterans Debenture Fund, and otherwise to hold all the offices and to perform all the functions and duties provided in Resolution RB-1 to be held and performed by the Trustee, including acting as Bond Registrar pursuant to Section 208 of Resolution RB-1. For purposes of Article VIII of Resolution RB-1 only, the term "Trustee" does not include any co-Trustee appointed pursuant to Section 801 of Resolution RB-1.

(b) Upon the occurrence and continuance of an Event of Default, the Department shall, upon the request of the Trustee or of the owners of twenty percent (20%) in aggregate principal amount of the Bonds at the time Outstanding, appoint a co-Trustee to represent and enforce the rights of the owners of the Bonds during the continuance of such or any other concurrent Event of Default.

(c) The Trustee shall, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in Resolution RB-1. The Trustee and the co-Trustee shall, during the continuance of any Event of Default (which has not been cured), exercise such of the rights and powers vested in the Trustee and co-Trustee by Resolution RB-1, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.

(d) The Department may at any time or from time to time appoint one or more Paying Agents, in addition to the Trustee and the co-Trustee, for the purpose of paying the principal or Redemption Price of and the interest on the Bonds of any Series. Each Paying Agent shall signify its acceptance of the duties and obligations imposed on it by Resolution RB-1 by executing and delivering to the Department and to the Trustee a written acceptance of Resolution RB-1. The Department may remove any Paying Agent at any time by giving written notice of such removal to such Paying Agent and to the Trustee. Any Paying Agent may at any time

resign by giving notice of such resignation to the Department. In the event of the resignation or removal of any Paying Agent, such Paying Agent shall pay over, transfer, assign and deliver any moneys held by it to its successor or, if there be no successor then appointed, to the Trustee. The Department shall give prompt notice to Bondowners of the acceptance of appointment by any successor Paying Agent.

Trustee or Co-Trustee Entitled to Indemnity (Section 802)

The Trustee or co-Trustee shall be under no obligation to institute any suit, or to take any remedial proceeding under Resolution RB-1, or to enter any appearance or in any way defend in any suit in which it may be named as a defendant, or to take any steps in the execution of the trusts created by Resolution RB-1 or in the enforcement of any rights and powers under Resolution RB-1, until it shall be indemnified to its satisfaction against any and all costs and expenses, outlays and counsel fees and other reasonable disbursements, and against all liability; the Trustee or co-Trustee may, nevertheless, begin suit, or appear in and defend suit, or do anything else in its judgment proper to be done by it as such Trustee or co-Trustee, without indemnity, and in such case the Department shall reimburse the Trustee or co-Trustee for all costs and expenses, outlays and counsel fees and other reasonable disbursements properly incurred in connection therewith.

Limitation on Obligations and Responsibilities of Trustee or Co-Trustee (Section 803)

The Trustee or co-Trustee shall be under no obligation (a) to effect or maintain insurance or to renew any policies of insurance or to inquire as to the sufficiency of any policies of insurance carried by the Department; (b) to report, or make or file claims or proof of loss for, any loss or damage insured against or which may occur; or (c) to keep itself informed or advised as to the payment of any taxes or assessments, or to require any such payment to be made. The Trustee or co-Trustee shall be under no obligation to record or file Resolution RB-1, or any other security instruments and financing statements, or continuation statements with respect thereto, except pursuant to directions from the Department, in form and substance satisfactory to the Trustee or co-Trustee, set forth in a Department Request. The Trustee or co-Trustee shall have no responsibility in respect of the validity, sufficiency, due execution or acknowledgment by the Department of this Resolution, or, except as to the authentication thereof, in respect of the validity of the Bonds or the due execution or issuance thereof. The Trustee or co-Trustee shall be under no obligation to see that any duties imposed in Resolution RB-1 upon the Department or any party other than itself, or any covenants contained in Resolution RB-1 on the part of any party other than itself to be performed, shall be done or performed, and the Trustee or co-Trustee shall be under no obligation for failure to see that any such duties or covenants are so done or performed.

Trustee or co-Trustee Not Liable for Failure of Department to Act (Section 804)

The Trustee or co-Trustee shall not be liable or responsible because of the failure of the Department or of any of its employees or agents to make any collections or deposits or to perform any act required of the Department in Resolution RB-1 or, except as provided in Resolution RB-1, because of the loss of any moneys arising through the insolvency or the act or default or omission of any other depository in which such moneys shall have been deposited under the provisions of Resolution RB-1. The Trustee or co-Trustee shall not be responsible for the application of any of the proceeds of the Bonds or any other moneys deposited with it and paid out, withdrawn or transferred under Resolution RB-1 if such application, payment,

withdrawal or transfer shall be made in accordance with the provisions of Resolution RB-1. The immunities and exemptions from liability of the Trustee and co-Trustee under Resolution RB-1 shall extend to its directors, officers, employees and agents.

Compensation and Indemnification of Trustee and Co-Trustee (Section 805)

The Department shall pay, from the Pledged Property, to the Trustee and co-Trustee reasonable compensation for all services performed by it under Resolution RB-1 and also all its reasonable expenses, charges and other disbursements and those of its attorneys, agents and employees incurred in and about the administration and execution of the trusts created by Resolution RB-1 and the performance of its powers and duties under Resolution RB-1, and from such source only, shall indemnify and save the Trustee and co-Trustee harmless against any liabilities which it may incur in the exercise and performance of its powers and duties under Resolution RB-1.

Notice of Default (Section 807)

Except upon the happening of any Event of Default specified in clauses (a) and (b) of Section 702 of Resolution RB-1, the Trustee or co-Trustee shall not be obliged to take notice or be deemed to have notice of any Event of Default, unless specifically notified in writing of such Event of Default by the Department or by the owners of not less than twenty per centum (20%) in aggregate principal amount of the Bonds secured by Resolution RB-1 and then Outstanding.

Trustee or Co-Trustee Protected in Relying on Certain Documents (Section 810)

The Trustee and co-Trustee shall be protected and shall incur no liabilities in acting or proceeding, or in not acting or not proceeding, in good faith, reasonably and in accordance with the terms of Resolution RB-1, upon any resolution, order, notice, request, consent, waiver, certificate, statement, affidavit, requisition, bond or other paper or document which it shall in good faith reasonably believe to be genuine and to have been adopted or signed by the proper board or person to have been prepared and furnished pursuant to any of the provisions of Resolution RB-1, or upon the written opinion of any attorney, engineer or accountant believed by the Trustee or co-Trustee to be qualified in relation to the subject matter, and the Trustee or co-Trustee shall be under no duty to make any investigation or inquiry as to any statement contained or matters referred to in such instrument. The Trustee or co-Trustee shall not be under any obligation to see to the recording or filing of Resolution RB-1.

Resignation and Removal of Co-Trustee Subject to Appointment of Successor (Section 811)

No resignation or removal of the co-Trustee and no appointment of a successor co-Trustee pursuant to Article VIII of Resolution RB-1 shall become effective until the acceptance of appointment by the successor co-Trustee under Section 814 of Resolution RB-1.

Resignation of Co-Trustee (Section 812)

Subject to Section 811 of Resolution RB-1, the co-Trustee may resign and by Resolution RB-1 become discharged from the trusts created by Resolution RB-1, by notice in writing to be given to the Department and mailed, first class postage prepaid, to all owners of Bonds at their addresses as they appear on the registration books kept by the Trustee, not less than sixty (60) days before such resignation is to take effect, but such resignation shall take effect immediately upon the appointment of a new co-Trustee under Resolution RB-1, if such new Trustee or

co-Trustee shall be appointed before the time limited by such notice and shall then accept the trusts of Resolution RB-1.

Removal of Co-Trustee (Section 813)

Subject to Section 811 of Resolution RB-1, the co-Trustee may be removed at any time by an instrument or concurrent instruments in writing executed by the Department without the consent of Bondowners or by the owners of not less than a majority in principal amount of the Bonds secured by Resolution RB-1 and then Outstanding and filed with the Department. A facsimile copy of each such instrument shall be delivered promptly by the Department to the co-Trustee. The co-Trustee may also be removed at any time for reasonable cause by any court of competent jurisdiction upon the application of the owners of not less than ten per centum (10%) in aggregate principal amount of the Bonds then Outstanding under Resolution RB-1.

Appointment of Successor Co-Trustee (Section 814)

(a) If at any time the co-Trustee shall resign, be removed, be dissolved or otherwise become incapable of acting, or the bank or trust company acting as co-Trustee shall be taken over by any governmental official, agency, department or board, the position of co-Trustee shall thereupon become vacant. If the position of co-Trustee shall become vacant for any of the foregoing reasons or for any other reason, the Department shall cause notice of such appointment to be mailed, first class postage prepaid, to all owners of Bonds at their addresses as they appear on the registration books kept by the Bond Registrar(s).

(b) At any time within one year after any such vacancy shall have occurred, the owners of a majority in principal amount of the Bonds secured by Resolution RB-1 and then Outstanding, by an instrument or concurrent instruments in writing, executed by such Bondowners and filed with the Department, may appoint a successor co-Trustee, which shall supersede any co-Trustee theretofore appointed by the Department. Facsimile copies of each such instrument shall be delivered promptly by the Department to the predecessor co-Trustee and to the co-Trustee so appointed by the Bondowners.

(c) If no appointment of a successor co-Trustee shall be made pursuant to the provisions of Section 813 of Resolution RB-1 within ten (10) days after the vacancy shall have occurred, the owner of any Bond Outstanding under Resolution RB-1 or any retiring co-Trustee may apply to any court of competent jurisdiction to appoint a successor co-Trustee. Such court may thereupon, after such notice, if any, as such court may deem proper and prescribed, appoint a successor co-Trustee.

(d) Any co-Trustee hereafter appointed shall be a bank or trust company duly qualified to do business in the State, duly authorized to exercise corporate trust powers and subject to examination by Federal or State authority, of good standing, and having at the time of its appointment a combined capital and surplus aggregating not less than Fifty Million Dollars (\$50,000,000) as shown on its most recently published report of its financial condition.

No Implied Duty; Standard of Care (Section 816)

The Trustee or co-Trustee shall have no duty or obligation *except* as expressly provided in Resolution RB-1 and no implied duties or obligations shall be read into Resolution RB-1 against the Trustee or co-Trustee. The Trustee or co-Trustee shall not incur any liability for any act or omission in performing its duties under Resolution RB-1, *except* in the case of its own negligence or willful misconduct.

Bondowners' Consent Not Required (Section 1001)

The Department may, from time to time and at any time, adopt such resolutions supplemental to Resolution RB-1 which are filed with the Trustee (which Supplemental Resolutions shall thereafter form a part of Resolution RB-1):

- (a) to cure any ambiguity or defect or omission in Resolution RB-1; or
- (b) to grant to or confer upon the Trustee for the benefit of the Bondowners any additional rights, remedies, powers, authority or security that may lawfully be granted to or conferred upon the Bondowners or the Trustee; or
- (c) to include as pledged revenues or money under, and subject to the provisions of, Resolution RB-1 any additional revenues or money legally available therefor; or
- (d) to make any other provisions with respect to matters or questions arising under Resolution RB-1 which shall not be inconsistent with the provisions of Resolution RB-1, provided such action shall not materially adversely affect the interests of the Bondowners; or
- (e) to add to the covenants and agreements of the Department in Resolution RB-1 other covenants and agreements thereafter to be observed by the Department or to surrender any right or power in Resolution RB-1 reserved to or conferred upon the Department; or
- (f) to add provisions relating to Bonds with coupons appertaining thereto or Bonds issued with full book-entry delivery, if necessary, if the Department shall determine to so issue Bonds in such form under Resolution RB-1; or
- (g) to modify any of the provisions of Resolution RB-1 in any respect whatever not otherwise set forth in the Section 1001 of Resolution RB-1; *provided, however*, that either (i) such modification shall apply only to Series of Bonds issued after the effective date of the Supplemental Resolution and shall not materially adversely affect the interests of the owners of Bonds of any Series Outstanding on the effective date of the Supplemental Resolution; or (ii) (a) such modification shall be, and be expressed to be, effective only after all Bonds of any Series Outstanding at the date of the adoption of such Supplemental Resolution shall cease to be Outstanding; and (b) such Supplemental Resolution shall be specifically referred to in the text of all Bonds of any Series authenticated and delivered after the date of the adoption of such Supplemental Resolution and of Bonds issued in exchange therefor or in place thereof; or
- (h) to modify, amend or supplement Resolution RB-1 or any Supplemental Resolution in such manner as to permit, if presented, the qualification of Resolution RB-1 and of the Supplemental Resolution under the Trust Indenture Act of 1939 or any similar Federal statute hereafter in effect or under any state Blue Sky Law; or
- (i) to surrender any right, power or privilege reserved to or conferred upon the Department by the terms of Resolution RB-1, provided that the surrender of such right, power or privilege is not contrary to or inconsistent with the covenants and agreements of the Department contained in Resolution RB-1; or
- (j) if the subject of a Rating Confirmation and if approved by the Trustee, to add to the definition of Investment Obligations pursuant to the last proviso of the definition thereof; or
- (k) [reserved]; or

(l) accompanied by a Rating Confirmation, to make any amendment or supplement necessary to accommodate credit enhancement or liquidity support for any or all Series of Bonds; or

(m) to increase the amount of the combined Bond Reserve Requirement and Loan Loss Requirement to an amount greater than ten percent (10%) of the initial principal amount of all Series of which any Bonds are Outstanding Bonds; or

(n) to amend and supplement provisions of Resolution RB-1 regarding the Trustee, and the rights of the Department and the owners of Bonds with respect to appointment and replacement of the Trustee, in the event and to the extent the laws of the State are amended to allow an institution other than the State Treasurer to act as Trustee, provided, that any such institution shall meet the qualifications set forth in Section 814(d) of Resolution RB-1 as if such institution were acting as co-Trustee under Resolution RB-1; or

(o) to make any other change which, in the judgment of the Trustee, does not materially adversely affect the interests of the Bondowners.

Supplements and Amendments Requiring Consent of Owners of a Majority in Principal Amount of Bonds (Section 1002)

Subject to the terms and provisions contained in Section 1002 of Resolution RB-1, and not otherwise, (i) the owners of not less than fifty-one per centum (51%) in aggregate principal amount of the Bonds then Outstanding; and (ii) if less than all of the Bonds then Outstanding are affected, the owners of not less than fifty-one per centum (51%) in principal amount of Bonds so affected then Outstanding, shall have the right, from time to time, anything contained in Resolution RB-1 to the contrary *notwithstanding*, to consent to and approve the adoption by the Department and the Trustee of such resolution or resolutions supplemental to Resolution RB-1 as shall be deemed necessary or desirable by the Department for the purpose of modifying, altering, amending, adding to, repealing or rescinding, in any particular, any of the terms or provisions contained in Resolution RB-1 or in any Supplemental Resolution. Notwithstanding the foregoing, nothing in Resolution RB-1 contained shall permit, or be construed as permitting, without the consent of all materially adversely affected Bondowners, (a) any change in the terms of redemption or of the maturity of the principal of or the interest on any Bond issued under Resolution RB-1; or (b) a reduction in the principal amount of any Bond or the redemption premium or the rate of interest thereon; or (c) the creation of a lien upon or a pledge of the Pledged Property, or any part thereof, other than the lien and pledge created or permitted by Resolution RB-1; or (d) a preference or priority of any Bond or Bonds over any other Bond or Bonds, except as may be permitted by the applicable Series Resolution(s); or (e) a reduction in the aggregate principal amount or classes of the Bonds required for consent to such Supplemental Resolution; or (f) an amendment or modification of the rights or obligations of the Trustee without the written consent of the Trustee. Nothing in Resolution RB-1 contained, however, shall be construed as making necessary the approval by Bondowners of the execution of any Supplemental Resolution as authorized in Section 1001 of Article X of Resolution RB-1. If any such modification or amendment will, by its terms, not take effect so long as any Bonds of any specified like Series and maturity remain Outstanding, the consent of the owners of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Outstanding Bonds under Section 1002 of Resolution RB-1. For the purpose of Section 1002 of Resolution RB-1, a Series shall be deemed to be affected by a

modification or amendment of Resolution RB-1 or a Supplemental Resolution if the same adversely affects or diminishes the rights of the owner of Bonds of such Series. The Trustee may in its discretion determine whether or not in accordance with the foregoing powers of amendment, Bonds of any particular Series and maturity would be affected by any modification or amendment of Resolution RB-1 or a Supplemental Resolution and any such determination shall be binding and conclusive on the Department and all owners of Bonds.

Whenever, at any time within one year after the date of the first giving of such notice, the Department shall deliver to the Trustee an instrument or instruments in writing purporting to be executed by the owners of not less than fifty-one per centum (51%) in aggregate principal amount of the affected Bonds then Outstanding, which instrument or instruments shall refer to the proposed Supplemental Resolution described in such notice and shall specifically consent to and approve the execution thereof in substantially the form of the copy thereof referred to in such notice, thereupon, but not otherwise, the Trustee may perform its duties under such Supplemental Resolution in substantially such form, without liability or responsibility to any Bondowner, whether or not such Bondowner shall have consented thereto.

Discretion of Trustee in Performing Under Supplemental Resolutions (Section 1004)

In each and every case provided for in Article X of Resolution RB-1, the Trustee shall be entitled to exercise its discretion in determining whether or not to perform under any proposed Supplemental Resolution, or any term or provision therein contained, if the rights, obligations and interests of the Trustee would be affected, having in view the purposes of such instrument, the rights and interests of the Bondowners, the respective rights and interests of the Department and the rights, obligations and interests of the Trustee, and the Trustee shall not be under any responsibility or liability to the Department, any Bondowner or to anyone whomsoever for its refusal in good faith to perform under any such Supplemental Resolution, if such Supplemental Resolution is deemed by it to be contrary to the provisions of Article X of Resolution RB-1. The Trustee shall be entitled to receive, and shall be fully protected in relying upon, the opinion of any counsel approved by it, who may be counsel for the Department, as conclusive evidence that any such proposed Supplemental Resolution does or does not comply with the provisions of Resolution RB-1, and that it is or is not proper for it, under the provisions of Article X of Resolution RB-1, to perform under such Supplemental Resolution.

Defeasance (Section 1101)

If, when the Bonds secured by Resolution RB-1 shall have become due and payable in accordance with their terms or otherwise as provided in Resolution RB-1, or shall have been duly called for redemption or irrevocable instructions to call the Bonds for redemption shall have been given by the Department to the Trustee and (a) the whole amount of the principal of, Redemption Price and the interest on all of such Bonds shall be paid; or (b) the Trustee shall hold money or Government Obligations or shall hold money and Government Obligations, sufficient to pay the principal of, Redemption Price and interest on all Outstanding Bonds on their respective interest payment, stated maturity or prescribed redemption dates, provided that such Government Obligations shall be in such amount that the principal of and the interest on such Government Obligations so held by the Trustee, when due and payable, will provide sufficient money which, with any and all other money held by the Trustee for such purpose under the provisions of Resolution RB-1, shall be sufficient to pay such principal of, Redemption Price, and the interest on such Bonds and, if sufficient funds shall also have been provided for paying all other

obligations payable under Resolution RB-1 by the Department, then and in that case the right, title and interest of the Trustee under Resolution RB-1 shall thereupon cease, terminate and become void, and the Trustee in such case, on demand of the Department, shall release Resolution RB-1 and shall release the security, and shall execute such documents to evidence such release as may be reasonably required by the Department, and shall turn over to the Department or to such officer, board, or body as may then be entitled to receive the same, all the remaining property held by the Trustee under Resolution RB-1. Otherwise, Resolution RB-1 shall be, continue and remain in full force and effect; provided, however, that in the event money or Government Obligations shall be deposited with and held by the Trustee as provided in Resolution RB-1, applicable provisions of Resolution RB-1, particularly Articles II, III, VII and XI, pertaining to the payment of the principal and Redemption Price of, or interest on the Bonds issued under Resolution RB-1 and other obligations payable under Resolution RB-1 by the Department, shall be continued in force until such Bonds and other obligations have been fully paid.

APPENDIX J

LETTERS FROM CERTAIN UNDERWRITERS

J.P.Morgan

January 20, 2012

Mr. Blake Fowler
Director, Public Finance Division
Office of the Treasurer of the State of California
915 Capitol Mall, Room 261
Sacramento, CA 95814

Mr. Eric Tiche
Assistant Deputy Secretary of Bond Finance
State of California – Department of Veterans Affairs
1227 "O" Street, Room 200
Sacramento, CA 95814

RE: Department of Veterans Affairs of the State of California Home Purchase Revenue Bonds (the "Bonds")

Dear Mr. Fowler and Mr. Tiche:

J.P. Morgan Securities LLC ("JPMS"), one of the Underwriters of the Bonds, has entered into negotiated dealer agreements (each, a "Dealer Agreement") with each of UBS Financial Services Inc. ("UBSFS") and Charles Schwab & Co., Inc. ("CS&Co.") for the retail distribution of certain securities offerings at the original issue prices. Pursuant to each Dealer Agreement (if applicable to this transaction), each of UBSFS and CS&Co. will purchase Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any Bonds that such firm sells.

J.P. MORGAN SECURITIES LLC

January 20, 2012

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

Mr. Eric Tiche
Assistant Deputy Secretary of Bond Finance
State of California – Department of Veterans Affairs
1227 “O” Street, Room 200
Sacramento, CA 95814

**RE: State of California -- Department of Veterans Affairs Home Purchase Revenue Bonds
2012 Series A (Non-AMT) (“the Bonds”)**

Dear Ms. Carroll and Mr. Tiche:

Fidelity Capital Markets (“FCM”), one of the underwriters of the Bonds, is a division of National Financial Services LLC (“NFS”), which provides fully-disclosed clearing and other services to correspondent broker-dealers (the “correspondent broker-dealers”). NFS has entered into Master Reallowance Agreements with several of the correspondent broker-dealers to allow them to redistribute municipal securities underwritten by NFS to their retail investors at the original offering price. Pursuant to these Master Reallowance Agreements, NFS may share a portion of the underwriting compensation with respect to this bond offering with its correspondent broker-dealers.

Fidelity Capital Markets

Morgan Stanley

January 18, 2012

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

Mr. Eric Tiche
Assistant Deputy Secretary of Bond Finance
State of California – Department of Veterans Affairs
1227 “O” Street, Room 200
Sacramento, CA 95814

RE: California Department of Veteran Affairs , Home Purchase Revenue Bonds 2012

Dear Ms. Carroll and Mr. Tiche:

Morgan Stanley & Co. LLC is providing the following language for inclusion in the Official Statement:

Morgan Stanley, the parent company of Morgan Stanley & Co. LLC, an underwriter of the Bonds, has entered into a retail brokerage joint venture with Citigroup Inc. As part of the joint venture, Morgan Stanley & Co. LLC will distribute municipal securities to retail investors through the financial advisor network of a new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, Morgan Stanley & Co. LLC will compensate Morgan Stanley Smith Barney LLC for its selling efforts with respect to the Bonds.

Morgan Stanley & Co. LLC