Dear Ms. Alexis Podesta,

In accordance with the State Leadership Accountability Act (SLAA), the California Housing Finance Agency submits this report on the review of our internal control and monitoring systems for the biennial period ending December 31, 2017.

Should you have any questions please contact Tony Sertich, Director of Enterprise Risk Management and Compliance, at (916) 326-8657 or tsertich@calhfa.ca.gov.

BACKGROUND

The California Housing Finance Agency (CalHFA) was established per Health and Safety Code (HSC) Sections 50900 - 52533. CalHFA's mission is to finance loans to create safe, decent and affordable rental housing and to assist first-time homebuyers in achieving the dream of homeownership. CalHFA was statutorily chartered in 1975 to be the State’s affordable housing bank. Per HSC 50956, “It shall be the policy of the agency to conduct its operations so as to be fiscally self-sufficient and so as not to require appropriations from the General Fund for payment of its administrative costs or to service bonds of the agency.” CalHFA is a professional organization charged with providing mortgages to the middle to low income home buyers and with lending to developers of affordable rental units. The agency sets the interest rates slightly above its cost of funds and charges fees for specific units. The agency sets loan interest rates slightly above its cost of funds and charges fees for specific services to cover its lending costs and risks.

The housing programs offered by CalHFA are the primary source of income. Various economic and regulatory factors such as prevailing economic conditions, mortgage interest rates, investment rates, the demand for housing, the cost of housing and of operating housing programs, the volume of mortgage lending activity in the State and other factors affecting the supply of housing in the State can create significant challenges for the agency in single-family and multi-family housing programs as well as its overall operations.

Historically, CalHFA has offered three main financial programs: 1) make loans to first-time homebuyers; 2) make loans to owners and developers of multifamily affordable rental units; 3) make loans to local governments to finance local housing initiatives. The objective of these programs is to finance housing at affordable interest rates using the proceeds of tax-exempt mortgage revenue bonds, State of California general obligation (GO) bonds, special federal program funds, and a limited amount of internal equity.

As a component of the State of California, CalHFA is administered by a Board of Directors consisting of 13 voting members and three non-voting members, including a chairperson selected by the Governor from among his or her appointees. Of the 13 voting members, seven are appointed by the Governor, four are ex-officio and two are appointed by the Legislature. The term of the appointed members of the board is six years.
The California Housing Finance Fund is continuously appropriated and expenditures of the fund are not subject to the supervision or approval of any other officer or division of State government. The Executive Director prepares a preliminary budget on or before December 1 of each year for the ensuing fiscal year to be transmitted to the Secretary of the Business, Consumer Services and Housing Agency, the Director of Finance, and the Joint Legislative Budget Committee. This preliminary budget is included in the Governor’s January Budget Proposal for informational purposes. The agency’s final budget is reviewed and approved by the CalHFA Board at its May meeting of each year.

According to HSC 51005, the agency shall, by November 1 of each year, submit an annual report of its activities under this division for the preceding year to the Governor, the Secretary of the Business, Consumer Services and Housing Agency, the Director of Housing and Community Development, the Treasurer, the Joint Legislative Budget Committee, the Legislative Analyst, and the Legislature. The report shall include specific information evaluating the extent to which the programs administered by the agency have attained the statutory objectives of the agency.

ONGOING MONITORING

As the head of California Housing Finance Agency, Tia Boatman Patterson, Executive Director, is responsible for the overall establishment and maintenance of the internal control and monitoring systems.

Executive Monitoring Sponsor(s)

The executive monitoring sponsor responsibilities include facilitating and verifying that the California Housing Finance Agency internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Don Cavier, Chief Deputy Director.

Monitoring Activities

While all employees and managers are empowered to identify risk and develop mitigation efforts to control the various risks, the Enterprise Risk Management (ERM) group is tasked with independent evaluations of program controls to identify and mitigate risk enterprise-wide. On an annual basis, the ERM team proactively meet with all divisions and program areas to conduct a risk assessment. On an ongoing basis, ERM reviews and monitors the agency’s activities to ensure compliance with policies and to identify any possible risks. These discussions assist in establishing the priorities for the year and the areas of focus based on the highest and most critical risks to the agency.

Senior management meets biweekly to discuss current issues which include risks. They identify potential risks and provide a plan to mitigate the risk. Reconciliation of key agency accounts is conducted on a daily, monthly and quarterly basis. Collections and foreclosures are audited monthly by an external firm. Various loan servicing functions are audited quarterly by an external firm. Operating payments are regularly verified for accuracy and compliance with contract terms or agreements. CalHFA reviews monthly reports from outside servicers and compares them to internal reports for purposes of accuracy. CalHFA conducts an annual onsite lender inspection of operations and quality control. CalHFA's information technology unit continuously monitors security measures in the areas of technical support, application support, and information security. CalHFA engages a large reputable accountancy firm to conduct an annual review of internal controls.

For fiscal risk management and oversight, CalHFA is audited by an outside independent accounting firm that certifies the accuracy and authenticity of our financial statements.
Addressing Vulnerabilities
Collaboratively, ERM and the program areas work together to come up with an action plan to address, mitigate, and/or eliminate the vulnerabilities to risk. These vulnerabilities are elevated to senior management which are discussed and solutions proposed for immediate action. This progress is monitored through the quarterly status update reports to senior management.

Deficiencies identified by external auditors require formal documentation and communication of our progress on mitigating the deficiencies with the auditor until the issue is adequately addressed.

Communication
Senior Staff meet on a bi-weekly basis to address the various issues of the agency. If there are critical risks, they are addressed at these meetings. In addition, emergency meetings are also held if the risk presented needs to be addressed right away. Quarterly updates on the status of the various identified risks are presented to senior management by ERM and ongoing monitoring and progress is discussed.

The top risks of the organization are included in the strategic planning and annual business planning process. The risks are also communicated to the organization by executive management. The Executive Director keeps the employees of CalHFA apprised of various issues and enterprise risk management initiatives through her “Director’s Corner” page on the CalHFA internal website.

Ongoing Monitoring Compliance
The California Housing Finance Agency has implemented and documented the ongoing monitoring processes as outlined in the monitoring requirements of California Government Code sections 13400-13407. These processes include reviews, evaluations, and improvements to the California Housing Finance Agency systems of controls and monitoring.

RISK ASSESSMENT PROCESS
The following personnel were involved in the California Housing Finance Agency risk assessment process: Executive Management, Middle Management, Front Line Management, and Staff.

Risk Identification
The Enterprise Risk Management Division (ERM) was formally established in 2017. In addition, the position of Director of Enterprise Risk Management and Compliance was established and approved by the CalHFA Board in 2017. CalHFA is formalizing its Enterprise Risk Management framework. The first line of defense for managing risk and internal controls comes from operational management. Each employee and manager in their day to day work owns and manages risks for the organization by implementing risk mitigating processes and putting controls in place. The new ERM division functions as the second line of defense. ERM assists the organization with collecting, mitigating, monitoring and reporting the various enterprise risks. The third line of defense is independent oversight and auditing of the operations.

In the fall of 2017, ERM met with program leaders to review their risks, discuss their operational efficiencies, and analyze their budgetary management and spending reports. The division directors and managers were asked to discuss the operations and existing procedures in their unit with a focus on any risks that may exist in their program area and the impact it would have to CalHFA. Once the risks were collected, each risk was analyzed for its potential impact, probability of occurrence, timeframe of the risk, and the risk management controls needed to address each risk.
Risk Ranking
The ERM division along with executive management ranked the risks based on various factors. These factors took into consideration operational risk, systematic risk, financial risk, environmental risk, risk to the sustainability of the agency, and conformity to regulatory compliance requirements.

RISKS AND CONTROLS

1 - Risk: Operations – Internal Staff – Key Person Dependence, Workforce Planning
CalHFA is a smaller organization with less than 230 employees. The agency strives to operate efficiently and at an optimal level. Some positions are held by key employees with extensive agency knowledge and tenured expertise where they have become a significant resource to the agency. Over time, the agency has become dependent upon them. If and when these key employees leave the agency for purposes of retirement or other career opportunities, this leaves the agency with a lack of historical knowledge and existing staff not having the expertise and skills to smoothly continue the operational sustainability of the organization.

This risk is due to the existence of long tenured key employees holding historical institutional knowledge. Transferring this expertise and knowledge to their co-workers and peers would mitigate this risk. In addition, CalHFA is beginning to actively implement their 2017-22 Workforce Plan. This will address both short-term and long-term staffing needs. The CalHFA Workforce Plan and Business Plan supports business continuity and a process to identify and supply a qualified and motivated workforce prepared to take over when senior staff and other key employees leave.

As a result of this identified risk, CalHFA has started to implement efforts towards knowledge transfer among its employees. In addition, CalHFA participated in the CalHR pilot program for implementing an enterprise wide workforce plan.

Control A
Senior management and managers are aware of the key employee dependency risk and are putting measures in place to mitigate the risk. Managers are setting up plans and schedules with key employees where they are to share their knowledge (knowledge transfer) with their peers and provide training and shadowing with staff to assure more than one person knows how to do that specific duty or work assignment.

2 - Risk, Compliance-External Service Provider-Internal Control System Adequacy
CalHFA recently moved the Single Family Division loan servicing work to a third party provider through a sub-servicing agreement. This is a new operational framework for the Loan Administration Unit which resides in the Single Family Division. Although it is common to contract with a subservicer, CalHFA needs to set up formal oversight processes and procedures to assure that the subservicer operates according to the required compliance guidelines.

The cause for this new risk is due to the change in the way the Loan Administration Unit within the Single Family Division now operates.

Utilizing a subservicer realized cost savings and more efficient operations for CalHFA. By assuring compliance and oversight is adhered to, this risk will be mitigated.

Control A
The Single Family Division has started establishing policies and procedures to be used to manage the
new subservicer. The Loan Administration Unit within the Single Family Division will actively manage
the subservicing agreement and assure compliance and oversight of the third party vendor.

3 - Risk: Operations-Internal-Oversight, Monitoring and Reporting Consistency
The Asset Management Unit within the Multi-Family Lending Division is in need of stronger internal controls
and oversight over their processes to ensure that CalHFA is in compliance with its agreement with the U.S.
Department of Housing and Urban Development and other control agencies. Updated policies and
procedures are necessary for staff to complete their jobs efficiently and completely.

The cause of this risk is due to the lack of updated policies and procedures. Recent staff departures and
existing staff taking on new roles have made this issue more pronounced. These issues led to a break down
in the required oversight of some of the properties. This issue was discovered as a result of an independent
audit in 2017 that recommended the Asset Management Unit formalize their policies and procedures.

Staff are more aware of the importance of good oversight and monitoring activities. New leadership has
been put in place with the recent hire of the Director of MultiFamily Programs. Management reports on the
status of the portfolio and compliance requirements will be communicated regularly to Senior and Executive
management.

Control A
An outside consultant who specializes in operational efficiencies has been retained to provide
an independent review of the Asset Management program area.

Control B
Staff are working with the ERM team to formalize and implement updated policies and procedures to
assist the Asset Management program in assuring tighter controls and program oversight.

4 - Risk: Operations-Internal-Data Management and Reporting Consistency
CalHFA has many sources of information and data that need to be compiled, stored and analyzed to
meet the agencies business goals.

Currently CalHFA has multiple data storage systems for different programs and functions. These systems
reside in different divisions throughout the agency. There is no single owner of the data or reviewer for
purposes of data integrity and consistency.

Reporting and analysis from the various systems could provide inconsistent or incomplete information to
the end user.

Control A
To help mitigate this risk, CalHFA will strive to achieve a better data interface between systems to
ensure data consistency.

Control B
The newly created Enterprise Risk Management Division will become the owner of the data and
provide a single source of truth of data analysis and reporting. This will be a collaborative effort
between the various units throughout the agency and the Enterprise Risk Management Division.
CONCLUSION

The California Housing Finance Agency strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising controls to prevent those risks from happening. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Tia Boatman Patterson, Executive Director
California Housing Finance Agency

cc: California Legislature
    California State Auditor
    California State Library
    California State Controller
    Director, California Department of Finance
    Secretary, California Government Operations Agency
December 29, 2017

Alexis Podesta, Secretary
California Business, Consumer Services and Housing Agency
915 Capitol Mall, Suite 350-A
Sacramento, CA 95814

Dear Ms. Alexis Podesta,

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Should you have any questions please contact Tony Sertich, Director of Enterprise Risk Management and Compliance, at (916) 326-8657, tsertich@calhfa.ca.gov.

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ONGOING MONITORING

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EXECUTIVE MONITORING SPONSOR(S)

The executive monitoring sponsor responsibilities include facilitating and verifying that the California Housing Finance internal control monitoring practices are implemented and functioning as intended. The responsibilities as the executive monitoring sponsor(s) have been given to: Don Cavier, Chief Deputy Director.

MONITORING ACTIVITIES

While all employees and managers are empowered to identify risk and develop mitigation efforts to control the various risks, the Enterprise Risk Management (ERM) group is tasked with independent evaluations of program controls to identify and mitigate risk enterprise-wide. On an annual basis, the ERM team proactively meet with all divisions and program areas to conduct a risk assessment. On an ongoing basis, ERM reviews and monitors the agency’s activities to ensure compliance with policies and to identify any possible risks. These discussions assist in establishing the priorities for the year and the areas of focus based on the highest and most critical risks to the agency. Senior management meets biweekly to discuss current issues which include risks. They identify potential risks and provide a plan to mitigate the risk. Reconciliation of key agency accounts is conducted on a daily, monthly and quarterly basis. Collections and foreclosures are audited monthly by an external firm. Various loan servicing functions are audited quarterly by an external firm. Operating payments are regularly verified for accuracy and compliance with contract terms or agreements. CalHFA reviews monthly reports from outside servicers and compares them to internal reports for purposes of accuracy. CalHFA conducts an annual onsite lender inspection of operations and quality control. CalHFA’s information technology unit continuously monitors security measures in the areas of technical support, application support, and information security. CalHFA engages a large reputable accountancy firm to conduct an annual review of internal controls. For fiscal risk management and oversight, CalHFA is audited by an outside independent accounting firm that certifies the accuracy and authenticity of our financial statements.
**Addressing Vulnerabilities**

Collaboratively, ERM and the program areas work together to come up with an action plan to address, mitigate, and/or eliminate the vulnerabilities to risk. These vulnerabilities are elevated to senior management which are discussed and solutions proposed for immediate action. This progress is monitored through the quarterly status update reports to senior management. Deficiencies identified by external auditors require formal documentation and communication of our progress on mitigating the deficiencies with the auditor until the issue is adequately addressed.

**Communication**

Senior Staff meet on a bi-weekly basis to address the various issues of the agency. If there are critical risks, they are addressed at these meetings. In addition, emergency meetings are also held if the risk presented needs to be addressed right away. Quarterly updates on the status of the various identified risks are presented to senior management by ERM and ongoing monitoring and progress is discussed. The top risks of the organization are included in the strategic planning and annual business planning process. The risks are also communicated to the organization by executive management. The Executive Director keeps the employees of CalHFA apprised of various issues and enterprise risk management initiatives through her "Director's Corner" page on the CalHFA internal website.

**Ongoing Monitoring Compliance**

The California Housing Finance has implemented and documented the ongoing monitoring processes as outlined in the monitoring requirements of California Government Code sections 13400-13407. These processes include reviews, evaluations, and improvements to the California Housing Finance systems of controls and monitoring.

**Risk Assessment Process**

The following personnel were involved in the California Housing Finance risk assessment process: Executive Management, Middle Management, Front Line Management, and Staff.

**Risk Identification**

The Enterprise Risk Management Division (ERM) was formally established in 2017. In addition, the position of Director of Enterprise Risk Management and Compliance was established and approved by the CalHFA Board in 2017. CalHFA is formalizing its Enterprise Risk Management framework. The first line of defense for managing risk and internal controls comes from operational management. Each employee and manager in their day to day work owns and manages risks for the organization by implementing risk mitigating processes and putting controls in place. The new ERM division functions as the second line of defense. ERM assists the organization with collecting, mitigating, monitoring and reporting the various enterprise risks. The third line of defense is independent oversight and auditing of the operations.

In the fall of 2017, ERM met with program leaders to review their risks, discuss their operational efficiencies, and analyze their budgetary management and spending reports. The division directors and managers were asked to discuss the operations and existing procedures in their unit with a focus on any risks that may exist in their program area and the impact it would have to CalHFA. Once the risks were collected, each risk was analyzed for its potential impact, probability of occurrence, timeframe of the risk, and the risk management controls needed to address each risk.
Risk Ranking
The ERM division along with executive management, ranked the risks based on various factors. These factors took into consideration operational risk, systematic risk, financial risk, environmental risk, risk to the sustainability of the agency, and conformity to regulatory compliance requirements.

Risks and Controls
Risk: Operations - Internal Staff — Key Person Dependence, Workforce Planning
CalHFA is a smaller organization with less than 230 employees. The agency strives to operate efficiently and at an optimal level. Some positions are held by key employees with extensive agency knowledge and tenured expertise where they have become a significant resource to the agency. Over time, the agency has become dependent upon them. If and when these key employees leave the agency for purposes of retirement or other career opportunities, this leaves the agency with a lack of historical knowledge and existing staff not having the expertise and skills to smoothly continue the operational sustainability of the organization.

This risk is due to the existence of long tenured key employees holding historical institutional knowledge. Transferring this expertise and knowledge to their co-workers and peers would mitigate this risk. In addition, CalHFA is beginning to actively implement their 2017-22 Workforce Plan. This will address both short-term and long-term staffing needs. The CalHFA Workforce Plan and Business Plan supports business continuity and a process to identify and supply a qualified and motivated workforce prepared to take over when senior staff and other key employees leave.

As a result of this identified risk, CalHFA has started to implement efforts towards knowledge transfer among its employees. In addition, CalHFA participated in the CalHR pilot program for implementing an enterprisewide workforce plan.

Control A
Senior management and managers are aware of the key employee dependency risk and are putting measures in place to mitigate the risk. Managers are setting up plans and schedules with key employees where they are to share their knowledge (knowledge transfer) with their peers and provide training and shadowing with staff to assure more than one person knows how to do that specific duty or work assignment.

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CalHFA recently moved the Single Family Division loan servicing work to a third party provider through a sub-servicing agreement. This is a new operational framework for the Loan Administration Unit which resides in the Single Family Division. Although it is common to contract with a subservicer, CalHFA needs to set up formal oversight processes and procedures to assure that the subservicer operates according to the required compliance guidelines.

The cause for this new risk is due to the change in the way the Loan Administration Unit within the Single Family Division now operates.

Utilizing a subservicer realized cost savings and more efficient operations for CalHFA. By assuring compliance and oversight is adhered to, this risk will be mitigated.

Control A
The Single Family Division has started establishing policies and procedures to be used to manage the
new subservicer. The Loan Administration Unit within the Single Family Division will actively manage the subservicing agreement and assure compliance and oversight of the third party vendor.

**RISK: Operations - Internal - Oversight, Monitoring, Internal Control Systems**

The Asset Management Unit within the Multi-Family Lending Division is in need of stronger internal controls and oversight over their processes to ensure that CalHFA is in compliance with its agreement with the U.S. Department of Housing and Urban Development and other control agencies. Updated policies and procedures are necessary for staff to complete their jobs efficiently and completely.

The cause of this risk is due to the lack of updated policies and procedures. Recent staff departures and existing staff taking on new roles have made this issue more pronounced. These issues led to a break down in the required oversight of some of the properties. This issue was discovered as a result of an independent audit in 2017 that recommended the Asset Management Unit formalize their policies and procedures.

Staff are more aware of the importance of good oversight and monitoring activities. New leadership has been put in place with the recent hire of the Director of MultiFamily Programs. Management reports on the status of the portfolio and compliance requirements will be communicated regularly to Senior and Executive management.

**Control A**

An outside consultant who specializes in operational efficiencies has been retained to provide an independent review of the Asset Management program area.

**Control B**

Staff are working with the ERM team to formalize and implement updated policies and procedures to assist the Asset Management program in assuring tighter controls and program oversight.

**RISK: Operations - Internal - Data Management and Reporting Consistency**

CalHFA has many sources of information and data that need to be compiled, stored and analyzed to meet the agencies business goals.

Currently CalHFA has multiple data storage systems for different programs and functions. These systems reside in different divisions throughout the agency. There is no single owner of the data or reviewer for purposes of data integrity and consistency.

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**Control A**

To help mitigate this risk, CalHFA will strive to achieve a better data interface between systems to ensure data consistency.

**Control B**

The newly created Enterprise Risk Management Division will become the owner of the data and provide a single source of truth of data analysis and reporting. This will be a collaborative effort between the various units throughout the agency and the Enterprise Risk Management Division.
CONCLUSION

The California Housing Finance strives to reduce the risks inherent in our work and accepts the responsibility to continuously improve by addressing newly recognized risks and revising controls to prevent those risks from happening. I certify our internal control and monitoring systems are adequate to identify and address current and potential risks facing the organization.

Tia Boatman Patterson, Executive Director

CC: California Legislature [Senate (2), Assembly (1)]
    California State Auditor
    California State Library
    California State Controller
    Director of California Department of Finance
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