

In the opinion of Quint & Thimmig LLP, Larkspur, California, Bond Counsel, interest on the Bonds is exempt from personal income taxation imposed by the State of California but is subject to all applicable federal taxation. See "TAX MATTERS" herein.



\$5,000,000
CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY
Taxable Variable Rate Demand Revenue Bonds
(Social Model Recovery Systems, Inc.), Series 2014

Dated: Date of Delivery

CUSIP†: 13033L 2U0

Due: April 1, 2039

The Bonds described herein are issued by the California Health Facilities Financing Authority (the "Authority") pursuant to the California Health Facilities Financing Authority Act constituting Part 7.2 of Division 3 of Title 2 of the California Government Code, and the Indenture of Trust, dated as of April 1, 2014 (the "Indenture"), by and between the Authority and U.S. Bank National Association, as trustee (the "Trustee"). It is anticipated that the Bonds will be issued and delivered on the date set forth below in fully registered form and, if and when issued, will be registered in the name of Cede & Co., as the registered owner and nominee for The Depository Trust Company, New York, New York ("DTC"). Purchases of beneficial interests in the Bonds will be made in book-entry-only form. Purchasers of beneficial interests (the "Beneficial Owners") will not receive certificates representing their interests in the Bonds. So long as Cede & Co., as nominee for DTC, is the registered owner of the Bonds, all references herein to Registered Owner shall mean Cede & Co., and not the Beneficial Owners of the Bonds. Payments of principal, redemption price, interest and, with respect to tendered Bonds, purchase price of the Bonds, will be made directly to DTC by the Trustee or U.S. Bank National Association, as tender agent (the "Tender Agent"), as applicable, so long as Cede & Co., as nominee for DTC, is the Registered Owner. Disbursement of such payments to the DTC Participants is the responsibility of DTC and disbursement of such payments to the Beneficial Owners is the responsibility of the DTC Participants and the Indirect Participants as more fully described herein. See APPENDIX B—BOOK-ENTRY-ONLY SYSTEM.

The Bonds are special, limited obligations of the Authority payable (except to the extent payable from certain amounts held by the Trustee under the Indenture including the proceeds of the Bonds) solely from and secured by loan repayments from Social Model Recovery Systems, Inc., a California nonprofit corporation (the "Corporation"), under a Loan Agreement, dated as of April 1, 2014, by and between the Authority and the Corporation. In addition, the Bonds are further secured by an irrevocable direct-pay letter of credit (the "Letter of Credit") issued by Preferred Bank.



(the "Bank") as described herein and by amounts received by the Trustee from draws on an irrevocable, transferable confirming letter of credit (the "Confirming Letter of Credit") issued by the Federal Home Loan Bank of San Francisco.



(the "Confirming Bank"). The Letter of Credit will be initially issued in an amount equal to the aggregate principal amount of the Bonds plus 43days' interest thereon calculated at the rate of 10% per annum. The Letter of Credit, unless extended, will initially expire on April 2, 2015, and will permit the Trustee to draw thereunder amounts sufficient to pay (a) the principal of the Bonds when due at maturity, upon earlier redemption or upon acceleration, (b) regularly scheduled interest on the Bonds or payment of interest on a date established for the redemption or acceleration of the Bonds, and (c) the purchase price of Bonds tendered or subject to mandatory tender and not remarketed. The Confirming Letter of Credit will be initially issued in an amount equal to the aggregate principal amount of the Bonds plus 43days' interest thereon calculated at the rate of 10% per annum. The Confirming Letter of Credit, unless extended, will initially expire on April 2, 2015. The Confirming Letter of Credit will permit the Trustee to draw thereunder an amount sufficient to pay the principal or purchase price of, and accrued interest on, the Bonds as the same become due in the event the Bank wrongfully dishonors a conforming draw under, or repudiates, the Letter of Credit.

From and including the date of initial authentication and delivery thereof, the Bonds will bear interest at a rate which is determined on a weekly basis (the "Weekly Interest Rate") by Gates Capital Corporation, as remarketing agent. The Bonds are subject to optional and mandatory redemption and optional and mandatory tender for purchase prior to maturity. See "DESCRIPTION OF THE BONDS" herein.

Interest on the Bonds bearing interest at the Weekly Interest Rate will be computed on the basis of a 365- or 366-day year, as appropriate, for the actual number of days elapsed, and is payable on the first day of each month, commencing May 1, 2014. Principal of the Bonds is payable at the principal corporate trust office of the Trustee, as paying agent, or at such other office as the Trustee may designate. See "DESCRIPTION OF THE BONDS-General" herein.

The proceeds of the Bonds will be used to (a) provide for the refunding of the portion of the outstanding California Health Facilities Financing Authority Insured Health Facility Revenue Bonds (Prototypes/Social Model), 2001 Series A, issued for the benefit of the Corporation, (b) provide for the refunding of the portion of the outstanding California Health Facilities Financing Authority Insured Refunding Revenue Bonds (Small Facilities Refinancing Program), 2005 Series A, issued for the benefit of the Corporation, (c) provide for the prepayment of the California Statewide Communities Development Authority 501(c)(3) Land, Building and Equipment Program Note (Mid Valley Recovery Services, Inc. Project), Series 2004-1, issued for the benefit of Mid Valley Recovery Services, Inc., since assumed by the Corporation, (d) provide for the prepayment of a taxable loan from a private party made to Stepping Stone Homes, since assumed by the Corporation, (e) finance the acquisition of an 86 bed, two story treatment facility, (f) finance the acquisition, construction and equipping of various improvements to various residential treatment facilities, (g) finance the future expansion of facilities for the Corporation, and (h) pay a portion of the costs of issuance of the Bonds, all as more particularly described herein.

THE BONDS SHALL NOT BE DEEMED TO CONSTITUTE A DEBT OR LIABILITY OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF OTHER THAN THE AUTHORITY OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF, BUT SHALL BE PAYABLE SOLELY FROM THE FUNDS THEREFOR PROVIDED. NEITHER THE STATE OF CALIFORNIA NOR THE AUTHORITY SHALL BE OBLIGATED TO PAY THE PRINCIPAL OR PURCHASE PRICE OF THE BONDS OR THE PREMIUM, IF ANY, OR THE INTEREST THEREON EXCEPT FROM THE FUNDS PROVIDED UNDER THE LOAN AGREEMENT AND THE OTHER ASSETS PLEDGED UNDER THE INDENTURE, AND NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OR PURCHASE PRICE OF OR THE PREMIUM, IF ANY, OR THE INTEREST ON THE BONDS. THE ISSUANCE OF THE BONDS SHALL NOT DIRECTLY OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OF CALIFORNIA OR ANY POLITICAL SUBDIVISION THEREOF TO LEVY OR TO PLEDGE ANY FORM OF TAXATION WHATSOEVER THEREFOR OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT. THE AUTHORITY HAS NO TAXING POWER.

This cover page contains certain information for general reference only. It is not intended to be a summary of all factors relating to an investment in the Bonds. Investors should review the entire Official Statement before making any investment decisions. Capitalized terms used on this cover page and not otherwise defined shall have the meanings set forth herein or in the hereinafter mentioned Indenture.

The Bonds are offered when, as and if issued by the Authority and accepted by the Underwriter, subject to prior sale, withdrawal or modification of the offer without notice, and the approval of legality by Quint & Thimmig LLP, Larkspur, California, Bond Counsel. Certain legal matters will be passed upon for the Authority by Quint & Thimmig LLP, Larkspur, California as disclosure counsel, for the Bank by the Law Offices of Kathleen L. Johnson, Santa Barbara, California, for the Confirming Bank by in-house counsel, for the Authority by the Attorney General of the State of California, and for the Corporation by Jennings, Strouss & Salmon, PLC, Phoenix, Arizona. It is expected that delivery of the Bonds will be made through the facilities of DTC on or about April 2, 2014.

HONORABLE BILL LOCKYER
Treasurer of the State of California
As Agent for Sale

WULFF, HANSEN & CO.
ESTABLISHED 1931
INVESTMENT BANKERS

The date of this Official Statement is March 24, 2014

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IN CONNECTION WITH THIS OFFERING, THE UNDERWRITER MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT LEVELS ABOVE THOSE WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

No broker, dealer, salesman or other person has been authorized by the Authority or the Underwriter to give any information or to make any representations other than those contained in this Official Statement in connection with the offering of the Bonds made hereby and, if given or made, such other information or representations must not be relied upon as having been authorized by the Authority or by the Underwriter. 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 any Bonds by any person in any jurisdiction in which such offer, solicitation or sale is not authorized, or in which the person making such offer, solicitation or sale is not qualified to do so or to any person to whom it is unlawful to make such offer, solicitation or sale. The information set forth under the captions "THE AUTHORITY" and "NO LITIGATION—The Authority" has been furnished by the Authority. All other information set forth herein has been obtained from the Corporation, the Bank, the Confirming Bank and other sources (other than the Authority) that are believed to be reliable. The adequacy, accuracy or completeness of such information is not guaranteed by, and is not to be construed as a representation of, the Authority or the Underwriter. The information and expressions of opinion contained herein are subject to change without notice after the date hereof and neither the 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 Authority, the Bank, the Confirming Bank or the Corporation since the date hereof.

The Bank and the Confirming Bank do not assume, nor will they assume, any responsibility as to the completeness or accuracy of any of the information contained in this Official Statement, all of which has been furnished by others, with the exception of the information which appears under the captions "THE BANK" and the "THE CONFIRMING BANK" which were provided by the Bank and the Confirming Bank, respectively. Without limiting the foregoing, neither the Bank nor the Confirming Bank makes any representation as to the suitability of the Bonds for any investor, the feasibility or performance of the Project, or compliance with any securities, tax or other laws or regulations. The Bank's and the Confirming Bank's roles with respect to the Bonds is limited to providing the Letter of Credit and the Confirming Letter of Credit, respectively, described herein to the Trustee.

The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibility to investors under the federal securities laws as applied to the facts and circumstances of this transaction but the Underwriter does not guarantee the accuracy or the completeness of such information.

The information relating to the Authority set forth herein under the captions "THE AUTHORITY" and "ABSENCE OF MATERIAL LITIGATION—The Authority" has been furnished by the Authority. The Authority does not warrant the accuracy of the statements contained herein relating to the Corporation nor does it directly or indirectly guarantee, endorse or warrant (1) the creditworthiness or credit standing of the Corporation, (2) the sufficiency of the security for the Bonds or (3) the value or investment quality of the Bonds. The Authority makes no representations or warranties whatsoever with respect to any information contained therein except for the information under the sections entitled "THE AUTHORITY" and "ABSENCE OF MATERIAL LITIGATION—The Authority."

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), IN RELIANCE UPON THE EXEMPTION CONTAINED IN SECTION 3(a)(2) OF THE SECURITIES ACT. THE INDENTURE HAS NOT BEEN QUALIFIED UNDER THE TRUST INDENTURE ACT OF 1939, AS AMENDED (THE "TRUST INDENTURE ACT"), IN RELIANCE UPON AN EXEMPTION CONTAINED IN THE TRUST INDENTURE ACT.

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OFFICIAL STATEMENT

\$5,000,000

**California Health Facilities Financing Authority
Taxable Variable Rate Demand Refunding Revenue Bonds
(Social Model Recovery Systems, Inc.), Series 2014**

INTRODUCTION

General

The purpose of this Official Statement, which includes the cover page and the appendices hereto, is to provide information in connection with the issuance and sale of California Health Facilities Financing Authority Taxable Variable Rate Demand Refunding Revenue Bonds (Social Model Recovery Systems, Inc.), Series 2014, in the aggregate principal amount of \$5,000,000 (the “Bonds”). The Bonds will be issued pursuant to Articles 1 through 4 (commencing with section 6500) of Chapter 5 of Division 7 of Title 1 of the California Government Code (the “Act”), an Indenture of Trust, dated as of April 1, 2014 (the “Indenture”), between the California Health Facilities Financing Authority (the “Authority”) and U.S. Bank National Association, as trustee (the “Trustee”), and a resolution of the Authority adopted on February 27, 2014.

Pursuant to a loan agreement (the “Loan Agreement”), dated as of April 1, 2014, between the Authority and Social Model Recovery Systems, Inc., a California nonprofit corporation (the “Corporation”), the Authority will loan the proceeds received from the sale of the Bonds to the Corporation for the following purposes (collectively, the “Project”):

(a)(1) provide for the refunding of the portion of the Authority’s outstanding Insured Health Facility Revenue Bonds (Prototypes/Social Model), 2001 Series A (the “2001 Bonds”), issued for the benefit of the Corporation, currently outstanding in the principal amount of \$1,245,000, the proceeds of which were used to finance the acquisition and renovation of a leased facility, known as River Community, a 38-bed licensed residential treatment facility for adults with co-occurring mental health and chemical dependency disorders, located at 23701 East Fork Road in the Angeles National Forest, approximately 15 miles north of the City of Azusa, California,

(2) provide for the refunding of the portion of the Authority’s outstanding Insured Refunding Revenue Bonds (Small Facilities Refinancing Program), 2005 Series A (the “2005 Bonds” and with the 2001 Bonds, “Prior Bonds”), issued for the benefit of the Corporation, the proceeds of which were used to refund the portion of the Authority’s Insured Health Facility Revenue Bonds (Small Facilities Pooled Loan Program), Series B (1994), issued for the benefit of the Corporation, currently outstanding in the principal amount of \$590,000, the proceeds of which were used to finance and refinance the acquisition, construction, installation, and/or equipping of projects at the health care facilities, known as Touchstones, a 23-bed licensed residential treatment facility for adolescents with alcohol and other drug problems, located at 525 North Parker Street, Orange, California,

(3) provide for the prepayment of the California Statewide Communities Development Authority 501(c)(3) Land, Building and Equipment Program Note (Mid Valley Recovery Services, Inc. Project), Series 2004-1 (the "2004 Note"), issued for the benefit of Mid Valley Recovery Services, Inc., since assumed by the Corporation, currently outstanding in the principal amount of \$815,000, the proceeds of which were used to finance the acquisition of three residential treatment facilities now operated by the Corporation, known as, Omni Center, located at 3430 Cogswell Road, El Monte, California, Mariposa, located at 453 South Indiana Street, Los Angeles, California, and Sabina House, located at 3543 Sabina Street, Los Angeles, California,

(4) provide for the prepayment of a taxable loan from a private party to Stepping Stones Home, since assumed by the Corporation (the "1999 Loan" and, with the refunding of the Prior Bonds and the prepayment of the 2004 Note, the "Prior Projects"), currently outstanding in the principal amount of \$45,000, the proceeds of which were used to finance the acquisition of a residential treatment facility known as, Stepping Stones, located at 17727 East Cypress, Covina, California (collectively, the "Prior Projects"),

(b)(1) finance the acquisition of an 86 bed, two story treatment facility, known as Bimini Recovery House, located at 155 Bimini Place Los Angeles, California,

(2) finance the acquisition, construction and equipping of various improvements to the following residential treatment facilities: (i) River Community, 23701 East Fork Road in the Angeles National Forest, approximately 15 miles north of the City of Azusa, California, (ii) Touchstones, 525 North Parker Street, Orange, California, (iii) Omni Center, 3430 Cogswell Road, El Monte, California, (iv) Mariposa, 453 South Indiana Street, Los Angeles, California, (v) Sabina House, 3543 Sabina Street, Los Angeles, California, and (vi) Stepping Stones, 17727 East Cypress, Covina, California, (collectively, the "Existing Facility New Project"), and

(3) finance the acquisition of a 135 bed, alcohol and drug treatment facility, known as Rena B, located at 4445 Burns Avenue, Los Angeles, California, and

(4) finance the acquisition of a 100 bed, alcohol treatment facility, known as Royal Palms, located at 360 South Westlake Avenue, Los Angeles, California (collectively, the "New Projects" and, with the Prior Projects, the "Project");

See "THE CORPORATION."

The Bonds will be secured by an irrevocable direct-pay letter of credit (the "Letter of Credit") issued by Preferred Bank, Los Angeles, California (the "Bank"). Under the Letter of Credit, the Trustee will be permitted to draw an amount not exceeding the stated amount indicated in the Letter of Credit (the "Stated Amount") for the payments of principal of, purchase price of and interest on, the Bonds (other than Bonds owned by or for the account of the Bank ("Bank Bonds")), whether at maturity, prior redemption, upon acceleration, purchase, on an Interest Payment Date (as defined below) or otherwise. The Stated Amount of the Letter of Credit on any date will be based upon the aggregate principal amount of the Outstanding Bonds on or prior to such date and interest on such Bonds for 43 days calculated at a rate of 10% per annum based on a 365-day year, the maximum interest rate payable on the Bonds. In consideration for issuing the Letter of Credit, the Corporation will enter into a Letter of Credit Reimbursement Agreement, dated as of April 1, 2014 (the "Reimbursement Agreement"), with the Bank. For a fur-

ther description of the Letter of Credit and the terms of the Reimbursement Agreement, see “THE LETTER OF CREDIT AND THE REIMBURSEMENT AGREEMENT.”

The Bonds are further secured by an irrevocable, transferable confirming Letter of Credit (the “Confirming Letter of Credit”) issued by the Federal Home Loan Bank of San Francisco (the “Confirming Bank”). Under the Confirming Letter of Credit, the Trustee will be permitted to draw an amount not exceeding the stated amount indicated in the Confirming Letter of Credit to pay all of the principal of, purchase price of and interest on, the Bonds (other than Bank Bonds), whether at maturity, prior redemption, upon acceleration, purchase, on an Interest Payment Date or otherwise, in the event the Bank wrongfully dishonors a properly presented and conforming draw on the Letter of Credit or if the Bank repudiates the Letter of Credit. Of such stated amount, the amount available to be drawn under the Confirming Letter of Credit on any date will be based upon the aggregate principal amount of the outstanding Bonds on or prior to such date and interest on such Bonds for 43 days calculated at a rate of 10% per annum, the maximum interest rate payable on the Bonds. See “THE CONFIRMING LETTER OF CREDIT.”

THE BONDS SHALL NOT BE DEEMED TO CONSTITUTE A DEBT OR LIABILITY OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF OTHER THAN THE AUTHORITY OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF, BUT SHALL BE PAYABLE SOLELY FROM THE FUNDS THEREFOR PROVIDED. NEITHER THE STATE OF CALIFORNIA NOR THE AUTHORITY SHALL BE OBLIGATED TO PAY THE PRINCIPAL OR PURCHASE PRICE OF THE BONDS OR THE PREMIUM, IF ANY, OR THE INTEREST THEREON EXCEPT FROM THE FUNDS PROVIDED UNDER THE LOAN AGREEMENT AND THE OTHER ASSETS PLEDGED UNDER THE INDENTURE, AND NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OR PURCHASE PRICE OF OR THE PREMIUM, IF ANY, OR THE INTEREST ON THE BONDS. THE ISSUANCE OF THE BONDS SHALL NOT DIRECTLY OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OF CALIFORNIA OR ANY POLITICAL SUBDIVISION THEREOF TO LEVY OR TO PLEDGE ANY FORM OF TAXATION WHATEVER THEREFOR OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT. THE AUTHORITY HAS NO TAXING POWER.

Certain Information Related to this Official Statement

Brief descriptions of the Authority, the Corporation, the Project, the Bonds, the Bank, the Confirming Bank, the Letter of Credit, the Confirming Letter of Credit, the Reimbursement Agreement, the Loan Agreement and the Indenture are included herein. Such descriptions do not purport to be comprehensive or definitive. All references herein to the Letter of Credit, the Confirming Letter of Credit, the Reimbursement Agreement, the Loan Agreement and the Indenture are qualified in their entirety by reference to such documents, and references herein to the Bonds are qualified in their entirety by reference to the form thereof included in the Indenture and the information with respect thereto included within the aforesaid documents, all of which are available for inspection at the office of the Trustee.

Any capitalized terms used in this Official Statement and not otherwise defined shall have the meanings ascribed to such terms as set forth in the Indenture.

During the period of the offering, copies of the forms of the Loan Agreement, the Indenture and the Reimbursement Agreement may be obtained from the Trustee at 1420 5th Avenue, 7th Floor, Seattle,

WA 98101, Attention: Global Corporate Trust Service, upon payment of reasonable copying and delivery expenses.

THE AUTHORITY

General

The Authority is a public instrumentality of the State organized and existing under and by virtue of the California Health Facilities Financing Authority Act, constituting Part 7.2 of Division 3 of Title 2 of the California Government Code (the "Act"). The intent of the California legislature in enacting the Act was to provide financing to health facilities and to pass along to the consuming public all or part of any savings realized by a participating health institution (as defined in the Act) as a result of tax-exempt financing. Pursuant to the Act, the Authority is authorized to issue its revenue bonds for the purpose of financing (including reimbursing expenditures made or refinancing indebtedness incurred for such purpose) the construction, expansion, remodeling, renovation, furnishing, equipping or acquisition of health facilities operated by participating health institutions. The State Treasurer is authorized under the Act to sell such revenue bonds on behalf of the Authority.

Organization and Membership

The Act provides that the Authority shall consist of nine members, including the Treasurer, who shall serve as Chairman, the State Controller, the Director of Finance and two members appointed by each of the State Senate Rules Committee, the Speaker of the State Assembly and the Governor of the State. The Chairman of the Authority appoints the Executive Director.

Outstanding Indebtedness of the Authority

As of December 31, 2013, the Authority had issued obligations aggregating \$30,866,947,017 in original principal amount and had outstanding obligations in the aggregate principal amount of \$13,009,302,152.

THE CORPORATION

General

Incorporated in 1986, the Corporation provides direct treatment services at eight locations in Los Angeles and Orange Counties. Services are directed at those whose lives have become unmanageable due to alcohol and other drug problems and/or whose mental health issues are interfering with leading productive lives. In addition, the Corporation operates a community-based alcohol and drug prevention program in the Central City East area in downtown Los Angeles. The program engages the most vulnerable populations of Central City East to challenge systemic conditions and social disparities that threaten a healthy environment. In FY 2013, SMRS served approximately 541 clients throughout its facilities.

As everyone in the Corporation's programs contributes in providing a safe and nurturing environment, each is expected to role model healthy behaviors for each other during the treatment process. In the Corporation's settings, the emphasis of recovery is based upon the relationship between the partici-

pant and his or her environment (including other participants and staff as a whole). It is the collective and integrated team of employees and participants more than one individual member which creates the ideal social model environment. The healing created by everyone's accumulated knowledge, collective experiences, and cohesiveness makes the social model process work.

Although individual interactions between single staff and participants are supportive, it is the group interactions which prove to be of greater benefit.

In addition to direct service programs, the Corporation operates a community-based alcohol and drug prevention program in the Central City East area (commonly known as Skid Row) in downtown Los Angeles. The mission of the program is to engage the most vulnerable populations of Central City East to challenge systemic conditions and social disparities that threaten a healthy environment.

Finally, the Corporation's Education Services Department provides training and consulting services to organizations throughout the state of California.

Existing Facilities and Services

The Corporation's service area includes Los Angeles and Orange Counties. The Corporation currently operates at eleven locations in five cities in Los Angeles County and at one location in Orange County. The programs at these locations serve approximately 950 people (for direct treatment services) and over 1,300 (participating in education and training events) annually.

The Corporation's main office (leased) is located at 223 E. Rowland Street, Covina, CA 91723.

Owned facilities are located at:

- 23701 E. Fork Road, Azusa, CA 91702; River Community, residential treatment program for adults with co-occurring disorders
- 525 N. Parker Street, Orange, CA 92868; Touchstones, residential and outpatient program for adolescents with substance abuse problems
- 3430 Cogswell Road, El Monte, CA 91732; Omni Center, residential and sober living program for men with substance abuse problems
- 453 S. Indiana Street, Los Angeles, CA 90063; Mariposa, residential treatment program for women with substance abuse problems (and their children)
- 3543 Sabina Street, Los Angeles, CA 90023; Sabina House, sober living for women with substance abuse problems (and their children)
- 17727 E. Cypress Street, Covina CA 91722, Stepping Stones, residential treatment program for women with substance abuse problems (and their children)

Leased facilities are located at:

- 508-510 S. Second Street, Covina, CA 91723; River Community Covina and Wellness Center, outpatient treatment program for adults with co-occurring disorders

- 1245 E. Walnut Street, Pasadena, CA 91106; Pasadena Council on Alcoholism, outpatient treatment services for adults and adolescents with substance abuse problems and adults with mental health issues.
- 4610 Santa Anita Avenue, El Monte, CA 91731; Mid Valley Outpatient, outpatient treatment services for adults with substance abuse problems
- 804 E. 6th Street, Los Angeles, CA 90021; UCEPP, prevention and community outreach program
- 823 E. Cypress Street, Covina, CA 91723, sober living for women with substance abuse problems (and their children)

Services

The Corporation has been a pioneer in providing adult treatment services since 1986. Three of its seven adult programs address both mental health and substance use issues simultaneously; these co-occurring disorders present unique challenges that can be met and treated successfully. We offer a continuum of care from residential treatment at River Community to the support of the Wellness Center. Day treatment, partial day treatment and outpatient services for those with co-occurring disorders are available at River Community Covina. Outpatient services for substance abuse or mental health issues are available at Pasadena Council on Alcoholism and Drug Dependence; outpatient services for substance abuse only are provided at Mid Valley Outpatient. Residential substance abuse treatment services for women and women and children are provided at Mariposa and Stepping Stones; residential services for men are provided at Omni Center.

Social Model Recovery Systems, Inc.
Clients Served
Fiscal Years 2011 to 2013

Facility Name	Service	2013	2012	2011
Mariposa	Residential treatment	51	45	48
	Substance Abuse, women & women w/ children			
Omni Center	Residential treatment	152	137	142
	Substance abuse, men			
River Community	Residential treatment	167	136	137
	Co-occurring disorders, men and women			
Sabrina House	Sober living house	49	19	16
	Substance abuse, women & women w/ children			
Stepping Stones	Residential treatment	48	48	48
	Substance abuse, women & women w/children			
Touchstones	Residential treatment	74	75	65
	Substance abuse, adolescent female and male			

Board of Directors

The business of the Corporation is governed currently by an eight-member volunteer Board of Directors (the “Board”) compiled from local businesses and other community members. The Board meets bi-monthly and is responsible for establishing policies and approving budgets, activities, programs, and capital expenditures. The Board Officers and Members and their occupations are as follows:

- Gerald Brown, President, Retired
- JH Barger MD, Vice President, LA County Dept. of Public Health
- Michael Butler, Secretary, Executive Vice President, Public Works, Inc.
- Patricia Fenoglio, LCSW, Treasurer, Retired
- Ulises Guterrez, Member, Program Director, Monrovia YMCA
- Paul Sharpe, Member, Professor, Mt. San Antonio College
- Kristine Larsen, Member, Homemaker
- Marie Flowers, Member, Retired

Management

The management of the Corporation is comprised of James O’Connell, Chief Executive Officer, and Tim Stevens, Chief Operating Officer.

Mr. O’Connell has expertise in the fields of environmental prevention, treatment, and recovery, and over 30 years experience in all aspects of business systems creation, board of director’s development, and policies and procedures implementation.

Mr. Stevens brings over 30 years experience in corporate administration, budgetary and fiscal operations, and human resources responsibilities.

Employees

The Corporation currently has 114 employees; 89 employees are full-time and 25 are part-time. None of the employees are represented by any bargaining unit. Group health, vision, dental, and life insurance is provided to all qualified regular employees.

Competition

Although a non-profit organization, the Corporation does not readily see itself as competing in the marketplace. There are a number of other agencies in Southern California that provide similar services. Undoubtedly the best known is the Betty Ford facility in Rancho Mirage. For over a decade the Corporation and Betty Ford have collaborated on numerous marketing projects, including routinely referring clients between the agencies in an effort to find the best treatment match for the clients.

At the other end of the amenities spectrum are organizations like Tarzana Treatment Centers (various locations in Southern California) and American Recovery Center, in Pomona. Both of these agencies tend to be a bit more spartan than the Corporation, but they are well known in the industry for doing good work in a professional manner. Both of these facilities regularly refer individuals to the Corporation that may be outside their area of expertise.

In the middle area of the pricing arena are agencies like Charter Hospital and Las Encinas Hospi-

tal, both of which are owned by a proprietary for-profit corporation, Aurora Behavioral Healthcare. In many ways the services provided by these two organizations are similar to the feel and flavor one receives at a Social Model program. The Corporation has a great working relationship with Charter and Las Encinas and frequently clients are referred between the three agencies.

Sources of Revenues

Nearly all of the Corporation's revenue is derived from government contracts and participant fees, accounting for approximately 72% and 25% of total revenue, respectively. Government contract revenue grew approximately 43% in FY 2012 from approximately \$3.7 million to nearly \$5.3 million, and then increased nominally by approximately 1% in FY 2013 to slightly more than \$5.3 million. According to management, with the implementation of the Affordable Care Act (ACA) and Medicaid expansion, the Corporation expects its contract with the Los Angeles County Department of Mental Health (LACDMH) to also increase as more individuals become eligible for services. The Corporation currently operates at near capacity on an ongoing basis, and according to management, if revenue from government contracts were to decrease, the Corporation would pursue other opportunities within the private sector. Participant fees rose from approximately \$1.5 million in FY 2011 to approximately \$1.8 million in FY 2013, an increase of about 24%, which appears to be primarily due to the Corporation's acquisition of Mid Valley Recovery Services, Inc. in FY 2012. According to management, the Corporation expects participant fees to continue growing in the coming years as the number of individuals insured through Medi-Cal and private insurance increases with the implementation of the ACA.

Financial Information

The tables below show the Corporation's Statement of Activities and Changes in Net Assets and certain financial ratios for the three fiscal years ended June 30, 2011, through June 30, 2013, compiled from the Corporation's audited financial statements. This information is qualified by reference to and should be read in conjunction with the Corporation's audited financial statements, including the notes there. See APPENDIX B—AUDITED FINANCIAL STATEMENTS OF THE CORPORATION FOR ITS FISCAL YEAR ENDED JUNE 30, 2013.

Social Model Recovery Systems, Inc. Statement of Activities Fiscal Years 2011 to 2013

	2011	2012	2013
Revenues and Support:			
Government Contracts	\$ 3,675,507	\$ 5,269,479	\$ 5,332,703
Government Subcontracts	56,409	48,652	48,720
Networking/TA/CEU fees	33,504	24,344	17,990
Participant Fees	1,464,310	1,748,762	1,810,888
Contributions	6,759	7,674	26,217
Interest and Dividends	1,188	3,444	1,005
Grant Revenue	27,500	34,323	37,000
DMH HER Initiative	0	0	52,425
Other Revenue	35,877	17,030	70,549
25 Year Anniversary Gala	0	61,290	125
Total Revenues and Support	<u>\$ 5,301,054</u>	<u>\$ 7,214,998</u>	<u>\$ 7,387,622</u>
Expenses:			
Salaries	\$ 2,751,090	\$ 3,633,816	\$ 3,803,738
Employee Benefits	667,280	975,868	1,025,033
Equipment Leases & Interest	27,741	49,811	47,685
Facilities Mortgage Interest	108,609	164,156	152,407
Facilities Leases & Property Taxes	322,849	383,439	322,451
Food & Kitchen Supplies	100,444	181,147	185,343
Insurance	61,308	85,869	87,399
Marketing, Outreach & Development	51,296	47,198	74,023
Networking Events and TA	2,063	7,168	(601)
Participant Supplies, Meds & Labs	87,228	168,091	147,593
Professional Fees and Consultants	316,721	315,173	279,466
EHR Development Costs	(2,375)	0	37,017
Staff Exp, Office, Tele, Postage/Printing	405,526	488,486	522,730
Vehicle Operations & Maintenance	27,818	37,080	31,751
Utilities & Building Maintenance	157,797	286,692	308,056
Deprecation	104,940	208,234	222,796
Restricted Grant Funds	6,100	0	32,163
25 Year Anniversary Gala	0	17,083	0
Total Expenses	<u>\$ 5,196,434</u>	<u>\$ 7,049,310</u>	<u>\$ 7,279,049</u>
Change in net assets from operations	104,620	165,688	108,573
Excess fair value of net assets received in acquisition of Mid Valley Recovery Services, Inc.	0	2,333,224	0
Net Assets release from restriction	103,000	75,000	0
Total Non-operating gain	<u>103,000</u>	<u>2,408,224</u>	<u>0</u>
Change in net assets with non-operating gain	<u>207,620</u>	<u>2,573,912</u>	<u>108,573</u>
Net assets beginning of year	\$ 1,252,006	\$ 1,459,626	\$ 4,033,538
Net assets end of year	\$ 1,459,626	\$ 4,033,538	\$ 4,142,111

Social Model Recovery Systems, Inc.
Financial Ratios
Fiscal Years 2011 to 2013

	2011	2012	2013
Debt service coverage—Operating (x)	1.20	1.68	1.15
Debt service coverage—Net Income (x)	1.59	9.14	1.15
Debt/Unrestricted Assets (x)	1.45	0.74	0.69
Margin (%)	1.97	2.30	1.47
Current Ratio (x)	2.70	2.44	2.20

ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds are as follows:

Sources

Principal Amount of Bonds	\$5,000,000.00
Plus: 2001 Bonds Released Moneys	217,427.53
Plus: 2005 Bonds Released Moneys	84,752.19
TOTAL SOURCES	\$5,302,179.72

Uses

Refunding of the 2001 Bonds	\$1,273,328.50
Refunding of the 2005 Bonds	561,131.26
Prepayment of the 2004 Note	817,118.67
Prepayment of the 1999 Loan	45,254.90
Bimini Recovery House Acquisition	465,000.00
Improvements to Existing Facilities/Future Acquisition/Construction	1,544,771.45
Costs of Issuance Fund ⁽¹⁾	595,574.94
TOTAL USES	\$5,302,179.72

⁽¹⁾ Includes Underwriter's discount, Letter of Credit fees, Confirming Letter of Credit fees, legal fees, printing costs, rating agency fees and other miscellaneous expenses.

PLAN OF FINANCING

Refunding of the 2001 Bonds

Pursuant to an escrow deposit and trust agreement (the "2001 Escrow Agreement"), by and between the Corporation and U.S. Bank National Association, as escrow bank (the "Escrow Bank"), a portion of the proceeds of the Bonds and certain other moneys will be transferred to the Escrow Bank for deposit in the escrow fund established under the 2001 Escrow Agreement (the "2001 Escrow Fund"). The Escrow Bank will hold amounts deposited in the 2001 Escrow Fund uninvested. From the moneys on deposit in the 2001 Escrow Fund, the Escrow Bank will, on May 5, 2014, redeem all outstanding 2001 Bonds and will pay the accrued interest thereon to the redemption date (without premium).

The amounts held by the Escrow Bank in the 2001 Escrow Fund are pledged solely to the payment of amounts due and payable with respect to the 2001 Bonds. The moneys deposited in the 2001 Escrow Fund will not be available for the payment of debt service on the Bonds.

Refunding of the 2005 Bonds

Pursuant to an escrow deposit and trust agreement (the “2005 Escrow Agreement”), by and between the Corporation and the Escrow Bank, a portion of the proceeds of the Bonds and certain other moneys will be transferred to the Escrow Bank for deposit in the escrow fund established under the 2005 Escrow Agreement (the “2005 Escrow Fund”). The Escrow Bank will hold amounts deposited in the 2005 Escrow Fund uninvested. From the moneys on deposit in the 2005 Escrow Fund, the Escrow Bank will pay the principal of and interest on the 2005 Bonds to and including April 1, 2015, and will redeem all outstanding 2005 Bonds and will pay the accrued interest thereon to the redemption date (without premium).

The amounts held by the Escrow Bank in the 2005 Escrow Fund are pledged solely to the payment of amounts due and payable with respect to the 2005 Bonds. The moneys deposited in the 2005 Escrow Fund will not be available for the payment of debt service on the Bonds.

Prepayment of the 2004 Note

A portion of the proceeds of the Bonds will be applied to the prepayment of the 2004 Note.

Prepayment of the 1999 Loan

A portion of the proceeds of the Bonds will be applied to the prepayment of the 1999 Loan.

2014 Project

A portion of the proceeds of the Bonds will be applied to (a) the acquisition of an 86 bed, two story treatment facility, known as Bimini Recovery House, located at 155 Bimini Place Los Angeles, California, (b) the acquisition, construction and equipping of various improvements to the following residential treatment facilities: (i) River Community, 23701 East Fork Road in the Angeles National Forest, approximately 15 miles north of the City of Azusa, California, (ii) Touchstones, 525 North Parker Street, Orange, California, (iii) Omni Center, 3430 Cogswell Road, El Monte, California, (iv) Mariposa, 453 South Indiana Street, Los Angeles, California, (v) Sabina House, 3543 Sabina Street, Los Angeles, California, and (vi) Stepping Stones, 17727 East Cypress, Covina, California, and (c) the future acquisition or construction of facilities for the Corporation

DESCRIPTION OF THE BONDS

General

The Bonds will be issued in the aggregate principal amount, will be dated, and will mature as described on the cover of this Official Statement, subject to redemption and optional and mandatory tender for purchase prior to maturity as hereinafter described.

The Bonds initially will be issued in fully registered form and will be registered in the name of Cede & Co., as the Registered Owner and nominee for The Depository Trust Company, New York, New York (“DTC”). DTC will represent to the Authority that it will maintain a book-entry system for recording ownership interests of its participants (the “DTC Participants”) and that the ownership inter-

est of a purchaser of a beneficial interest in the Bonds (a “Beneficial Owner”) will be recorded through book entries on the records of the DTC Participants. Beneficial Owners will not receive any certificates representing their interest in the Bonds, except as described herein. For more information concerning the book-entry system, see “APPENDIX E—BOOK-ENTRY-ONLY SYSTEM.”

The Bonds will be issued as fully registered Bonds, without coupons, (a) prior to the Fixed Rate Date, in the denomination of \$100,000 or any multiple of \$5,000 in excess thereof, and (b) after the Fixed Rate Date, \$5,000 or any integral multiples thereof. The principal of and premium, if any, on the Bonds will be payable upon surrender at the Principal Office of the Trustee, as paying agent and registrar for the Bonds (in such capacities, the “Paying Agent” and the “Registrar”) or at such other office as the Trustee may designate.

Prior to the Fixed Rate Date interest on the Bonds shall be computed on the basis of a 365 or 366 day year, as appropriate, for the actual number of days elapsed, and shall be payable on the first day of each month, commencing May 1, 2014 (or, if any such day is not a Business Day, the next succeeding Business Day), and, after the Fixed Rate Date, on each April 1 and October 1 (each an “Interest Payment Date”). “Business Day” means a day which is not a Saturday, Sunday or legal holiday on which banking institutions in the State or the State of New York or in any state in which the principal office of the Bank, the Confirming Bank, the Tender Agent or the Trustee or the office of the Bank or the Confirming Bank designated for presentations under the Letter of Credit or the Confirming Letter of Credit is located are closed or a day on which the New York Stock Exchange is closed. The Bonds shall bear interest from and including the applicable Interest Payment Date next preceding the date of registration thereof (unless such Bond is registered after a record date and on or before the next succeeding applicable Interest Payment Date, in which event it shall bear interest from and including such Interest Payment Date, or unless such Bond is registered prior to April 30, 2014 in which event it shall bear interest from and including the date of delivery). The monthly period during which interest accrues on the Bonds prior to the Fixed Rate Date, and thereafter the semiannual period during which interest accrues on the Bonds, is sometimes referred to as an “Interest Period.” With respect to any Interest Payment Date on or prior to the Fixed Rate Date, the record date for the payment of interest on the Bonds is the Business Day preceding the applicable Interest Payment Date and with respect to any Interest Payment Date after the Fixed Rate Date, the record dates are the fifteenth day of the calendar month preceding each Interest Payment Date, whether or not such day is a Business Day (each a “Record Date”). Interest on Bonds will be payable by check or draft mailed on the applicable Interest Payment Date to the registered owners thereof (the “Registered Owners”) as of the close of business on the Record Date preceding the applicable Interest Payment Date, unless such interest is not punctually paid, in which event it shall be paid to the Registered Owners as of the close of business on the record date fixed by the Trustee for the payment of such interest. A Registered Owner of \$1,000,000 or more in aggregate principal amount of Bonds may submit to the Paying Agent a written request 15 days prior to the applicable Record Date that interest on such Bonds be payable by wire transfer to an account within the continental United States of immediately available funds to the Registered Owner of such Bonds. Bonds may be transferred or exchanged for Bonds of any other authorized denomination at the principal corporate trust office of the Trustee in Los Angeles, California. The Registrar may make a charge for every such exchange or any transfer of Bonds sufficient to reimburse the Authority and the Registrar.

The principal of the Bonds is payable on April 1, 2039, subject to prior redemption, upon presentation and surrender of the Bonds at the principal corporate trust office of the Trustee in Seattle, Washington.

Interest on the Bonds

Determination of the Weekly Interest Rate. Prior to the Fixed Rate Date, the interest rate borne by the Bonds will be determined for each weekly period, from and including Thursday in the week of determination thereof to and including the following Wednesday, by Gates Capital Corporation (the “Remarketing Agent”). The Weekly Interest Rate with respect to the Bonds shall be the rate determined by the Remarketing Agent (on the basis of the examination of obligations comparable to the Bonds known to the Remarketing Agent to have been priced or traded under then prevailing market conditions) to be the minimum interest rate which, if borne by the Bonds, would enable the Remarketing Agent to sell the Bonds on the date such rate becomes effective at a price equal to the principal amount thereof, plus accrued interest, if any, but in no event exceeding 10% per annum or the maximum rate allowed by law, whichever is lower. The Weekly Interest Rate shall be determined by the Remarketing Agent as of the close of business on Wednesday in each calendar week, except that (a) with respect to any Wednesday that is not a Business Day, the interest rate shall be determined on the next preceding Business Day, and provided, further, that the rate on the Bonds shall initially be determined by Wulff Hansen & Co., as underwriter for the Bonds (the “Underwriter”), on the Business Day preceding the Closing Date and the initial interest rate on the Bonds shall be effective from the Closing Date through the following Wednesday; (b) if for any reason a Weekly Interest Rate is not established as aforesaid by the Remarketing Agent in any week, the Weekly Interest Rate for the first such week shall remain the last Weekly Interest Rate announced by the Remarketing Agent and the Weekly Interest Rate thereafter shall be the “Alternate Weekly Rate” (as defined below); and (c) if the Weekly Interest Rate determined by the Remarketing Agent in accordance with clause (a) above is held by a court to be invalid or unenforceable, then the Weekly Interest Rate shall be the Alternate Weekly Rate. The “Alternate Weekly Rate” with respect to the Bonds shall be the one month London Interbank Offered Rate (LIBOR) established for such date, plus .10%. In no event, however, will the interest rate borne by the Bonds exceed 10% per annum or the maximum rate of interest which may be charged or collected pursuant to applicable provisions of federal or state law, whichever is lower.

Conversion to the Fixed Interest Rate. Subject to the terms and conditions of the Indenture, the Corporation may elect to have the interest rate on the Bonds converted from the Weekly Interest Rate to a Fixed Interest Rate for the remaining term of the Bonds (the “Fixed Interest Rate”) effective on any Interest Payment Date prior to the maturity of the Bonds. In the event the Corporation elects to convert the interest rate on the Bonds, all of the Outstanding Bonds under the Indenture will be converted pursuant to the provisions of the Indenture. The interest rate borne by the Bonds from and after the Fixed Rate Date shall be, except as otherwise provided in the Indenture, the rate determined by the Remarketing Agent, on or prior to, but not more than 15 days prior to, the Business Day preceding the Fixed Rate Date, to be the interest rate which, when borne by the Bonds, would equal the minimum interest rate necessary to enable the Remarketing Agent to remarket the Bonds on the Fixed Rate Date at 100% of the principal amount thereof. In no event will the interest rate borne by the Bonds on or after the Fixed Rate Date exceed 10% per annum or the maximum rate allowed by law, whichever is lower. Under certain circumstances the Fixed Interest Rate for the Bonds shall be determined by the Remarketing Agent by reference to the “Alternate Fixed Rate” determined by the Remarketing Agent all as defined in and set forth in the Indenture.

The Trustee, at least 30 days prior to the Fixed Rate Date, shall cause an irrevocable notice to be mailed to all Registered Owners stating, among other things, (a) the proposed Fixed Rate Date, (b) requiring that the Registered Owners of all of the Outstanding Bonds tender such Bonds for purchase by the Tender Agent on the Fixed Rate Date, and (c) stating that all Outstanding Bonds not purchased on or before the Fixed Rate Date will be deemed purchased on the Fixed Rate Date at a price equal to the

principal amount thereof, plus unpaid interest, if any, accrued to such date. See “Purchase of Bonds—Mandatory Purchase on Fixed Rate Date and Letter of Credit Substitution Date” below.

Purchase of Bonds

Purchase of Bonds Upon Demand of Registered Owner. The Bonds will be purchased at the option of the Registered Owners thereof under certain circumstances described below. Prior to the Fixed Rate Date, any Bonds shall be purchased by the Tender Agent, on demand of the Registered Owner thereof on any Business Day at a purchase price equal to the principal amount thereof plus accrued interest to, but not including, the date of purchase (unless such date is an Interest Payment Date, in which case the purchase price will be the principal amount of such Bonds) upon:

(a) delivery to the Tender Agent of an irrevocable written notice with respect to Bonds to be purchased by 2:00 p.m., California time (if not received by 2:00 p.m., California time, it shall be deemed received on the next succeeding Business Day), which states (i) the name and address of the Registered Owner, (ii) the number or numbers of the Bond or Bonds to be purchased, (iii) the aggregate principal amount of the Bond or Bonds to be purchased, and (iv) the date on which the Bonds are to be purchased, which date shall be a Business Day not prior to the seventh calendar day next succeeding the date of delivery of such notice to the Tender Agent (the “Purchase Date”); and

(b) delivery of the Bond or Bonds to the Tender Agent at or prior to 10:00 a.m., California time, on the Purchase Date specified in the aforesaid notice of the Bond or Bonds to be tendered; provided, however, that any Bond for which a notice of the exercise of the purchase option has been given as provided in paragraph (a) above and which is not so delivered shall be deemed delivered on the Purchase Date and shall be purchased in accordance with the Indenture.

Mandatory Purchase on Fixed Rate Date and Letter of Credit Substitution Date. Upon conversion of the interest rate on the Bonds to the Fixed Interest Rate and on each date (the “Letter of Credit Substitution Date”) the Corporation exercises its option to substitute an alternate letter of credit (the “Alternate Letter of Credit”) for then existing Letter of Credit as provided in the Loan Agreement, the Bonds are subject to mandatory tender for purchase by the Tender Agent at the principal amount thereof plus accrued interest, if any. See “THE LOAN AGREEMENT-Availability and Substitution of Letter of Credit.” The Fixed Rate Date and the Letter of Credit Substitution Date are also referred to herein as the “Mandatory Tender Date.” All Registered Owners of the Bonds are required to tender their Bonds for purchase by the Tender Agent on the Mandatory Tender Date. Any Bonds which on the Mandatory Tender Date have not been tendered for purchase (“Non-Tendered Bonds”) shall be deemed purchased by the Tender Agent on the Mandatory Tender Date at a price of the principal amount thereof plus unpaid interest accrued, if any, to such date. Replacement Bonds for Non-Tendered Bonds may be remarketed and delivered to new owners as instructed by the Corporation or the Remarketing Agent. The Tender Agent shall hold in trust for the owners of the Non-Tendered Bonds the purchase price thereof, and, after the Mandatory Tender Date, such owners will no longer be entitled to any of the benefits of the Indenture except for the payment of such purchase price.

Mandatory Purchase of Bonds at the Direction of the Bank. The Bonds are subject to mandatory tender for purchase for the account of the Bank in lieu of mandatory redemption as provided below under the caption “Redemption of Bonds—Mandatory Redemption for Reimbursement Agreement Default; Failure to Reinstate the Interest Component of the Letter of Credit” following the receipt by the Trustee of

written notice from the Bank stating that an event of default has taken place under the Reimbursement Agreement and directing the Trustee to purchase the Bonds. The Bonds shall be purchased on a Business Day which is at least three and no more than five calendar days after receipt of such notice (the “Mandatory Purchase Date”), at which time the Trustee shall draw under the Letter of Credit in an amount equal to 100% of the principal amount of the Bonds and accrued and unpaid interest thereon to the Mandatory Purchase Date. On the Mandatory Purchase Date, the Tender Agent shall pay the purchase price for the Bonds. Any Owner is required to tender its Bonds to the Tender Agent for purchase at or prior to 10:00 a.m., California time on the Mandatory Purchase Date specified in the aforesaid notice; provided, however, that any Bond which is required to be purchased on the Mandatory Purchase Date and which is not so delivered shall be deemed delivered on the Mandatory Purchase Date and shall be purchased in accordance with the Indenture.

Redemption of Bonds

Mandatory Sinking Fund Redemption. The Bonds are subject to redemption prior to their stated maturity in part by lot from mandatory sinking account payments on each April 1 on and after April 1, 2015, at the principal amount thereof together with interest accrued thereon to the date fixed for redemption, without premium, as follows:

Year	Amount	Year	Amount
2015	\$145,000	2028	\$200,000
2016	150,000	2029	205,000
2017	155,000	2030	210,000
2018	160,000	2031	215,000
2019	160,000	2032	225,000
2020	165,000	2033	230,000
2021	170,000	2034	235,000
2022	175,000	2035	240,000
2023	180,000	2036	245,000
2024	185,000	2037	250,000
2025	190,000	2038	260,000
2026	190,000	2039 [†]	265,000
2027	195,000		

[†] Maturity

Optional Redemption Prior to the Fixed Rate Date. On or prior to the Fixed Rate Date, the Bonds are subject to redemption, on any Business Day, in whole or in part to the extent of prepayments of amounts due under the Loan Agreement made at the option of the Corporation with the written approval of the Bank, at the redemption price of 100% of the principal amount of the Bonds redeemed, plus interest accrued thereon, if any, to the redemption date, without premium.

Extraordinary Optional Redemption. The Bonds are subject to optional redemption in a whole or in part, on any date, at a redemption price equal to the principal amount thereof, plus interest accrued thereon to the redemption date, to the extent of prepayments of amounts due under the Loan Agreement made, following the occurrence of certain extraordinary events, including damage to or the destruction of the Project or the taking thereof under the power of eminent domain or if the Loan Agreement should become void, unenforceable, impossible to perform or unlawful.

Termination of Letter of Credit. The Bonds are subject to mandatory redemption in whole at a redemption price equal to 100% of the principal amount thereof, plus interest accrued thereon to the redemption date, on a redemption date selected by the Trustee not less than 15 days prior to the scheduled expiration date of the Letter of Credit if no Alternate Letter of Credit has been delivered to the Trustee in accordance with the Loan Agreement or if no Alternate Letter of Credit has been delivered to the Trustee in accordance with the Loan Agreement in connection with the conversion of the interest rate on the Bonds to the Fixed Interest Rate.

Mandatory Redemption for Reimbursement Agreement Default; Failure to Reinstate the Interest Component of the Letter of Credit. The Bonds are subject to redemption, in whole, at a redemption price equal to 100% of the principal amount thereof, plus interest accrued thereon to the redemption date, within five days (and before the fifth calendar day if the fifth calendar day is not a Business Day) from the date the Trustee receives written notice from the Bank that an event of default has taken place under the Reimbursement Agreement and directing the Trustee to redeem such Bonds or that the Bank will not reinstate the interest component of the Letter of Credit.

Termination of Confirming Letter of Credit. The Bonds are subject to mandatory redemption in whole at a redemption price equal to 100% of the principal amount thereof, plus interest accrued thereon to the redemption date, on a redemption date selected by the Trustee not less than 15 days prior to the scheduled expiration date of the Confirming Letter of Credit if no Alternate Confirming Letter of Credit has been delivered to the Trustee in accordance with the Loan Agreement.

Optional Redemption After the Fixed Rate Date. After the Fixed Rate Date, the Bonds are subject to redemption to the extent of prepayments of amounts due under the Agreement made at the option of the Corporation, with the written consent of the Bank, in whole or in part, on any Interest Payment Date during the applicable periods specified below, at the applicable redemption price stated below, plus interest accrued thereon to the redemption date:

Number of Years From Fixed Rate Date to Final Maturity	First Optional Redemption Date	Redemption Price
Greater than nine years	Seven years from conversion	102%, declining 1% annually to 100%
Six to nine years	Six years from conversion	101%, declining 1% annually to 100%
Less than six years	No optional redemption	

Notwithstanding the optional redemption schedule set forth above, on or prior to the Fixed Rate Date, pursuant to a Supplemental Indenture, the Remarketing Agent may provide an alternate optional redemption schedule with respect to the Bonds, which Supplemental Indenture and alternate redemption schedule.

Selection of Bonds to be Redeemed

In the case of the redemption of less than all of the Outstanding Bonds, the Bonds to be redeemed shall be selected by the Trustee from all Bonds, in such manner as the Trustee in its sole discretion may determine to be fair and appropriate, as required by the Indenture and shall be credited against the principal of the Bonds; provided, however, that Bank Bonds shall be redeemed first and provided that the Bonds Outstanding after giving effect to any redemption shall be in authorized denominations.

Notice and Effect of Redemption

Notice of redemption of Bonds shall be mailed, (a) prior to the Fixed Rate Date, not less than 20 days before such redemption date, (except in the case of redemptions pursuant to a failure to replace the Letter of Credit upon expiration, in which case not less than five days before such redemption date, and except in the case of redemptions pursuant to a default under the Reimbursement Agreement, in which case notice shall be given as soon before the redemption date as practicable) and (b) after the Fixed Rate Date, not less than 30 days before such redemption date (except in the case of redemptions pursuant to a failure to replace the Letter of Credit upon expiration, in which case not less than five days before such redemption date and except in the case of redemptions pursuant to a default under the Reimbursement Agreement in which case notice shall be given as soon before the redemption date as practicable), to the respective Registered Owners designated for redemption at their addresses on the registration books maintained by the Registrar and to the Authority. Each notice of redemption shall state the redemption date, the place or places of redemption, if less than all of the Bonds are to be redeemed, the distinctive number of the Bonds to be redeemed, and in the case of Bonds to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed. Each such notice shall also state that on said date there will become due and payable on each of said Bonds the principal thereof or of said specified portion of the principal thereof in the case of a Bond to be redeemed in part only, and that from and after such redemption date interest thereon shall cease to accrue, and shall require that such Bonds be then surrendered. Receipt of such notice shall not be a condition precedent to such redemption and failure to mail any such notice to a Registered Owner shall not affect the validity of the proceedings for the redemption of Bonds of any other Registered Owner.

Notice of redemption having been duly given as aforesaid, and moneys for payment of the redemption price of the Bonds, together with interest accrued to the date fixed for redemption, being held by the Trustee, the Bonds (or portions thereof) so called for redemption shall become due and payable on the redemption date designated in such notice, interest on the Bonds (or portions thereof) so called for redemption shall cease to accrue, said Bonds (or portions thereof) shall cease to be entitled to any benefit or security under the Indenture, and the Registered Owners shall have no rights in respect thereof except to receive payment of said principal and interest from the funds set aside therefor.

Remarketing of Bonds; Remarketing Agent

Gates Capital Corporation (in such capacity, together with any successor appointed pursuant to the Indenture, the “Remarketing Agent”) has been appointed the initial Remarketing Agent pursuant to the Indenture and has entered into a separate Remarketing Agreement with the Corporation, dated as of April 1, 2014 (the “Remarketing Agreement”). The Remarketing Agent will use its best efforts to remarket the Bonds (or portions thereof) at a price of par plus accrued interest, if any, on each date that such Bonds (or portions thereof) are required to be purchased pursuant to the Indenture, and, if such Bonds are not remarketed on such date (such Bonds being hereinafter referred to as “Unremarketed Bonds”), the Remarketing Agent will continue to use its best efforts to place such Unremarketed Bonds at a price of par plus accrued interest, if any.

The Remarketing Agent may at any time resign and be discharged of its duties and obligations under the Indenture and the Remarketing Agreement by giving no less than forty-five (45) days’ written notice to the Corporation, the Trustee, the Tender Agent, the Bank, the Authority and each rating agency then rating the Bonds. The Remarketing Agent may be removed by the Corporation by an instrument filed with the Remarketing Agent, the Authority, the Trustee, the Tender Agent, the Bank and signed by the

Corporation, but such removal will not become effective until the appointment of a successor remarketing agent as provided in the Indenture.

The Remarketing Agent is Paid by the Corporation

The Remarketing Agent's responsibilities include determining the interest rate from time to time and remarketing the Bonds that are optionally tendered by the owners thereof, all as further described in this Official Statement. The Remarketing Agent is appointed by the Corporation and is paid by the Corporation for its services. As a result, the interests of the Remarketing Agent may differ from those of existing holders and potential purchasers of the Bonds.

The Remarketing Agent Routinely Purchases Bonds for its Own Account

The Remarketing Agent is permitted, but not obligated, to purchase tendered Bonds for its own account. The Remarketing Agent, in its sole discretion, routinely acquires tendered Bonds for its own inventory in order to achieve a successful remarketing of the Bonds (i.e., because there otherwise are not enough buyers to purchase the Bonds) or for other reasons. However, the Remarketing Agent is not obligated to purchase Bonds, and may cease doing so at any time without notice. The Remarketing Agent may also make a market in the Bonds by routinely purchasing and selling Bonds other than in connection with an optional tender and remarketing. Such purchases and sales may be at or below par. However, the Remarketing Agent is not required to make a market in the Bonds. If the Remarketing Agent purchases Bonds for its own account, it may offer those Bonds at a discount to par to some investors. The Remarketing Agent may also sell any Bonds it has purchased to one or more affiliated investment vehicles for collective ownership or enter into derivative arrangements with affiliates or others in order to reduce its exposure to the Bonds. The purchase of Bonds by the Remarketing Agent may create the appearance that there is greater third party demand for the Bonds in the market than is actually the case. The practices described above also may reduce the supply of Bonds that may be tendered in a remarketing.

Bonds May be Offered at Different Prices on any Date

The Remarketing Agent is required to determine the applicable rate of interest that, if borne by the Bonds, would, in its judgment, having due regard for the prevailing financial market conditions for revenue bonds or other securities, be the interest rate necessary, but would not exceed the interest rate necessary, to enable the Remarketing Agent to remarket the Bonds at a price of par (plus accrued interest, if any) on the date the rate becomes effective (the "Effective Date"). The interest rate will reflect, among other factors, the level of market demand for the Bonds (including whether the Remarketing Agent is willing to purchase Bonds for its own account). The Remarketing Agreement requires that the Remarketing Agent use its best efforts to sell tendered bonds at par, plus accrued interest. There may or may not be Bonds tendered and remarketed upon a determination of a new interest rate or an Effective Date, the Remarketing Agent may or may not be able to remarket any Bonds tendered for purchase on such date at par and the Remarketing Agent may sell Bonds at varying prices to different investors on such date or any other date. The Remarketing Agent is not obligated to advise purchasers in a remarketing if it does not have third party buyers for all of the Bonds at the remarketing price.

The Ability to Sell the Bonds other than through Tender Process May Be Limited

While the Remarketing Agent may buy and sell the Bonds, it is not obligated to do so and may cease doing so at any time without notice. Thus, investors who purchase the Bonds, whether in a re-

marketing or otherwise, should not assume that they will be able to sell their Bonds other than by tendering the Bonds in accordance with the tender process.

SECURITY FOR THE BONDS

The Bonds are special, limited obligations of the Authority and the principal of and premium, if any, and interest on the Bonds will be payable solely from, and will be secured by a pledge of, the loan payments required to be paid by the Corporation pursuant to the Loan Agreement, except to the extent payable from certain amounts held by the Trustee under the Indenture, including the proceeds of the Bonds and moneys drawn under the Letter of Credit. All rights of the Authority under the Loan Agreement will be pledged and assigned to the Trustee, except as more particularly described in the Indenture. In addition, the payment of the principal and purchase price of and interest on the Bonds is supported by the Letter of Credit issued by the Bank and the Confirming Letter of Credit issued by the Confirming Bank for the benefit of the Registered Owners. See “THE LETTER OF CREDIT AND THE REIMBURSEMENT AGREEMENT” and “THE CONFIRMING LETTER OF CREDIT.”

THE BONDS ARE NOT A DEBT OR LIABILITY OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF OR A PLEDGE OF THE FAITH AND CREDIT OF THE STATE OF CALIFORNIA OR ANY SUCH POLITICAL SUBDIVISION BUT SHALL BE PAYABLE SOLELY FROM THE FUNDS PROVIDED THEREFOR. NEITHER THE STATE OF CALIFORNIA NOR THE AUTHORITY SHALL BE OBLIGATED TO PAY THE PRINCIPAL OF THE BONDS OR INTEREST THEREON, EXCEPT FROM THE FUNDS PROVIDED UNDER THE LOAN AGREEMENT AND THE INDENTURE, AND NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA OR OF ANY POLITICAL SUBDIVISION THEREOF, INCLUDING THE AUTHORITY, IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF OR INTEREST ON THE BONDS. THE ISSUANCE OF THE BONDS SHALL NOT DIRECTLY OR INDIRECTLY OR CONTINGENTLY OBLIGATE THE STATE OF CALIFORNIA OR ANY POLITICAL SUBDIVISION THEREOF TO LEVY OR TO PLEDGE ANY FORM OF TAXATION OR TO MAKE ANY APPROPRIATION FOR THEIR PAYMENT. THE AUTHORITY HAS NO TAXING POWER.

THE BANK

The following information concerning the Bank has been provided by representatives of the Bank and has not been independently confirmed or verified by the Underwriter, the Authority, the Corporation or the Confirming Bank. No representation is made herein as to the accuracy or adequacy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof, or that the information given below or incorporated herein by reference is correct as of any time subsequent to its date.

The Bank was established on December 23, 1991, as a California state chartered bank, insured by the Federal Deposit Insurance Corporation. The Bank is a full service commercial bank with its headquarters located at 601 South Figueroa Street in Downtown Los Angeles. The Headquarters Office is a full service banking office occupying the 29th floor. This facility houses Preferred Bank's Executive, Finance, Operations and Credit Administration offices, as well as the Commercial, International Loan /Trade Finance and Real Estate Lending groups.

The Bank conducts banking business from our main office in Los Angeles, California, and through our other 10 full-service branch banking offices in Alhambra, Century City, City of Industry, Torrance, Arcadia, Irvine, Diamond Bar, Anaheim, Pico Rivera and San Francisco, California. Preferred Bank offers a broad range of deposit and loan products and services to both commercial and consumer customers. We provide personalized deposit services as well as real estate finance, commercial loans and trade finance to small and mid-sized businesses, entrepreneurs, real estate developers, professionals and high net worth individuals.

- Middle Market Business consisting of manufacturing, service and distribution companies with sales of \$3 million to \$50 million annually and with borrowing requirements up to \$29 million dollars. Preferred Bank provides a complete range of lending services to this market, including working capital loans, equipment financing and commercial real estate loans. Additionally, we provide a full range of depository products including, account reconciliation, courier service and a full complement of cash management services.
- International Market Business consisting of importers and exporters requiring both borrowing and operational products. We offer a full range of financing vehicles including trade financing, acceptance financing and other specialized lending programs. We pride ourselves on the efficiency of our operational staff that provides a complete group of services such as commercial and standby letters of credit, documentary collections, collections of foreign drafts, international wires and foreign exchange.
- Professionals consisting of physicians, accountants, attorneys and professionals associated with the entertainment industry. We understand the unique nature of managing a professional practice and being involved in a creative industry such as the entertainment field. Our staff provides specialized personal services including courier service, several types of depository accounts and business loans and lines of credit.
- Real Estate Financing for residential, commercial, industrial and other income producing properties in Los Angeles and Orange Counties. The Bank maintains a group of specialists to provide construction and mini-perm loans.
- International Private Banking incorporates a group of highly trained professionals handling international private banking needs in the Pacific Rim area. Our multi-lingual staff is knowledgeable in the business environment and financial affairs of the Pacific Rim countries. This provides us with tremendous leverage when assisting in banking matters both locally and internationally on behalf of our Private Banking clientele.
- Consumer and Business Products include checking, savings, money market and certificate of deposit accounts at competitive rates. Coupled with our extensive offering of eServices including Online Banking and Bill Pay, Debit and Credit Cards, and eStatements, Preferred Bank has the right account for you.
- Treasury Management Services consisting of Account Reconciliation, Remote Deposit, Cash & Check Courier Service, Merchant Processing and ACH Credit Origination allows our customers to increase productivity and reduce expenses in today's competitive environment.

As of December 31, 2013, the Bank had approximately total assets of \$1.77 billion, total deposits of \$1.53 billion and stockholder's equity of \$207 million.

The Bank submits quarterly to the Federal Deposit Insurance Corporation (the "FDIC"), on behalf of the Board of Governors of the Federal Reserve System, a report regarding its financial condition and results of operations (the "Call Report") entitled "Consolidated Reports of Condition and Income for a Bank with Domestic Offices Only." The Call Report consists of a Balance Sheet, Income Statement, Changes in Equity Capital and other supporting schedules as of the end of the period to which such Call Report relates. The Call Report is prepared in accordance with regulatory instructions issued by the Federal Financial Institutions Examination Council. Because of the special supervisory, regulatory and economic policy needs served by the Call Report, such regulatory instructions do not in all cases follow generally accepted accounting principles or the opinions and statements of the Accounting Principles Board of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board. While the Call Report is a supervisory and regulatory document, not a primarily accounting document, and does not provide a complete range of financial disclosure about the Bank, the Call Report, nevertheless, provides important information concerning the financial condition of the Bank. The publicly available portions of the Call Report with respect to the Bank are on file with, and publicly available at, the FDIC, 250 E. Street, S.W., Washington, D.C. 20219. The Call Report may be obtained by calling the FDIC at (800) 945-2186. The FDIC also maintains a website (<http://www.fdic.gov>) that contains reports and certain other information regarding depository institutions, such as the Bank, which file reports with the FDIC.

The selected financial information of the Bank, set forth above, should be read in connection with, and is qualified in its entirety by, the Call Reports filed by the Bank.

THE LETTER OF CREDIT AND THE REIMBURSEMENT AGREEMENT

The following is a summary of certain provisions of the Letter of Credit and the Reimbursement Agreement. This summary is not to be considered a full statement of the terms of either the Letter of Credit or the Reimbursement Agreement and accordingly, is qualified by reference thereto and is subject to the full text thereof. Unless otherwise defined, capitalized terms used herein shall have the same meanings given such terms in the Reimbursement Agreement.

Letter of Credit

On the date of issuance of the Bonds, the Bank will issue in favor of the Trustee the Letter of Credit in the original principal amount of the Bonds plus an amount equal to 43 days of interest on all Outstanding Bonds calculated at the rate of 10% per annum, on the basis of a 365-day year (as such amount may from time to time be reduced and reinstated as provided in the Letter of Credit). The Letter of Credit will permit the Trustee to draw up to an amount equal to then outstanding principal amount and up to 43 days of interest on the Bonds at a maximum rate of 10% per annum to pay the unpaid principal thereof and accrued interest on the Bonds.

The Letter of Credit shall expire on the date that is the earliest of (a) April 2, 2015; (b) the date on which the Bank receives notice from the Trustee that all of the Bonds have been paid or provision for the payment of the Bonds has been made; (c) the date the Bank receives notice from the Trustee that the interest rate mode with respect to the Bonds has been converted from a Weekly Interest Rate to the Fixed

Interest Rate under the Indenture; (d) the date the Bank receives notice from the Trustee that an Alternate Letter of Credit has been substituted for the Letter of Credit with respect to the Bonds; or (e) the first to occur of (i) the date which is seven (7) calendar days after the Trustee has received a notice from the Bank that an Event of Default has occurred and is continuing under the Reimbursement Agreement or (ii) the date, following receipt of such notice of an Event of Default under the Reimbursement Agreement upon which the Trustee has drawn upon the Letter of Credit the amount required thereby and as permitted under the Letter of Credit and the proceeds of the drawing have been distributed to the Trustee.

The Letter of Credit shall be automatically extended each April 2 for an additional year unless the Bank gives the Trustee at least 90 days prior notice of its election not to extend.

While in effect, the Letter of Credit entitles the Trustee to draw on the Letter of Credit, on such dates and at such times as are specified in the Letter of Credit. Notwithstanding the foregoing, in no event shall the Trustee draw under the Letter of Credit to pay the principal of and interest on Bank Bonds.

Each drawing honored by the Bank under the Letter of Credit will immediately reduce the Stated Amount by the amount of such drawing, subject to reinstatement on the terms set forth in the Letter of Credit. All drawings under the Letter of Credit will be paid with the Bank's own funds.

Reimbursement Agreement

The Bank has entered into the Reimbursement Agreement with the Corporation providing for, among other things, the Corporation's reimbursement to the Bank of all amounts drawn upon under the Letter of Credit. Capitalized terms used in this section and not otherwise defined shall have the meanings given such terms as set forth in the Reimbursement Agreement.

Each of the following events shall, at the option of the Bank, constitute an "Event of Default" under the Reimbursement Agreement:

(a) Any event of default or termination event (however denominated) with respect to the Bond Documents (other than the Reimbursement Agreement) has occurred and is continuing after lapse of any applicable notice and cure periods provided for in such document;

(b) The Corporation shall fail to pay any amount payable by the Corporation under the Reimbursement Agreement or under the Loan Agreement, as and when the same becomes due and payable, or fail to timely cause any redemption of the Bonds or to pay the Purchase Price of the Bonds, as and when the same becomes due and payable, as required by the Reimbursement Agreement or the Loan Agreement;

(c) The Corporation shall fail to perform certain nonmonetary terms, covenants, conditions or provisions of the Reimbursement Agreement;

(d) Failure of the Corporation to observe or perform any of the other covenants, conditions or provisions of the Reimbursement Agreement or any other Bond Documents (other than as specified in subparagraphs (a), (b) or (c) above) and to remedy such default within thirty (30) days after the Bank gives the Corporation notice of such failure; except that, if such failure or breach can be remedied but not within such thirty (30) day period and if the Corporation has taken all action reasonably possible to remedy such failure or breach within such thirty (30) day period, such failure or breach shall not become an Event

of Default for so long as the Corporation shall diligently proceed to remedy the same in accordance with and subject to any limitations of time or other requirements established by the Bank;

(e) Any representation or warranty made or deemed to be made by or on behalf of the Corporation in the Reimbursement Agreement or in any other Bond Document or in any certificate, financial or other statement furnished by or on behalf of the Corporation to the Bank pursuant hereto or thereto shall prove to have been inaccurate, misleading or incomplete in any material respect when made or deemed to have been made;

(f) The Corporation shall default (after any applicable grace and/or cure period, if any, allowed with respect to such default) in the performance of any of its obligations under any Contract (other than the Reimbursement Agreement) with the Bank or the Bank's Affiliates;

(g) Default by the Corporation in the payment when due of any amount due in respect of any Material Indebtedness or under any Contract under or pursuant to which such Material Indebtedness is incurred or issued, and continuance of such default beyond the period of grace, if any, allowed with respect thereto; or the occurrence of any act or omission by the Borrower under any such Contract which results in such Indebtedness becoming, or being capable of becoming (after any applicable grace and/or cure period, if any, allowed with respect thereto), immediately due and payable (or, with respect to any Hedge Agreement, which results in such Hedge Agreement being terminated early or being subject to early termination);

(h) (i) An Event of Insolvency shall occur with respect to the Corporation, or (ii) the Corporation shall suspend or discontinue substantially all its business operations for more than ten (10) days;

(i) The Reimbursement Agreement or any of the other Bond Documents or any material provision of the Reimbursement Agreement or any of the other Bond Documents shall at any time for any reason cease to be the legal, valid and binding obligation of the Corporation or shall cease to be in full force and effect, or shall be declared to be unenforceable, invalid or void, or the validity or enforceability thereof shall be contested by the Corporation, or the Corporation shall renounce the same or deny that it has any further liability thereunder;

(j) Any court of competent jurisdiction or other Governmental Authority with jurisdiction to rule on the validity of any provision of the Reimbursement Agreement or any of the other Bond Documents shall find or rule that the Reimbursement Agreement or any of the other Bond Documents are not valid or not binding on the Corporation.

(k) (i) Any Lien created by any of the Bond Documents in favor of the Trustee or the Bank at any time and for any reason (except as expressly permitted to be released by the terms of such governing document) shall not constitute a valid and perfected Lien or shall fail to have the priority required by such Bond Document, or, except as permitted under the Bond Documents, the Corporation shall so assert in writing, or (ii) any rescission of or amendment to or any other action under or in connection with any legislation, law or regulation which would impair or adversely affect the rights or security of the Trustee or the Bank or of any other Holder or Beneficial Owner under the Indenture;

(l) The entry or filing of one or more judgments or orders or of any similar decrees or decisions for the payment of money (each, a "Judgment") which, individually or in the aggregate, equals or exceeds in any fiscal year \$50,000 against the Borrower, and (i) such Judgment shall be undischarged, unstayed or

unbonded for a period of 30 consecutive days, or (ii) any action shall be taken by a judgment creditor to attach, execute or levy upon all or any portion of the Collateral, the Facilities, the Gross Revenues or the Trust Estate to enforce any such Judgment;

(m) Any levy, seizure or attachment of the Collateral, the Facilities, the Gross Revenues or any other material Property of the Corporation, which the Corporation fails to satisfy or cause the removal or return of within sixty (60) days of the date of such levy, seizure or attachment;

(n) Dissolution, termination of existence, insolvency or business failure of the Corporation;

(o) Any accreditation, license, permit, certificate, consent, approval or authorization granted by any federal authority or by any state or local commission or authority (including, without limitation, a state regulatory agency), whether presently existing or hereafter granted or obtained by the Corporation that is, in the reasonable judgment of the Bank, material to the operations of the Corporation shall expire without renewal or shall be suspended or revoked; or the Corporation shall become subject to any injunction or other order prohibiting it from operating under any such material license, permit, certificate, consent, approval or authorization; or the Corporation shall fail to apply for any license, permit, certificate, consent, approval or authorization that is, in the reasonable judgment of the Bank, material to the operation of the Corporation within thirty (30) days of the later of (i) the date required to be obtained, or (ii) the date written notice thereof is delivered to the Corporation;

(p) The adoption of any resolution by the Corporation to authorize any action or event that would constitute an Event of Default hereunder or under any instrument, document or agreement made or entered into in connection herewith, including without limitation the Bond Documents;

(q) Any event which in the reasonable judgment of the Bank could reasonably be expected to result in a Material Adverse Effect; or

(r) The occurrence of an event described in Reimbursement Agreement entitled "Compliance with ERISA" that, when taken together with all other events that have occurred with respect to the ERISA Group, could reasonably be expected to result in liability to the Corporation in an aggregate amount in excess of \$100,000.

(s) The breach by the Corporation of any material covenant of the Remarketing Agreement or (i) the breach by the Remarketing Agent of any material covenant of the Remarketing Agreement or the suspension or termination by the Remarketing Agent of its obligations under the Remarketing Agreement and the failure of the Corporation within fifteen (15) days thereafter to either cause such breach to be cured or to replace such Remarketing Agent with a successor acceptable to the Bank.

(a) If an Event of Default occurs and is continuing, the Bank may, in its sole discretion:

(i) notify the Trustee and the Corporation that an Event of Default has occurred and is continuing,

(ii) (A) notify the Trustee that an Event of Default has occurred and is continuing and that the Letter of Credit shall terminate and (B) in such notice further direct the Trustee to (1) draw upon the Letter of Credit in accordance with its terms and purchase all Outstanding Bonds, whereupon such Bonds shall be Bank Bonds, and may direct the Trustee to declare the principal

of all Outstanding Bonds and the accrued interest thereon to be due and payable immediately upon the completion of such purchase, or (2) declare the principal of all Outstanding Bonds and the accrued interest thereon to be immediately due and payable,

(iii) at any time subsequent to any notice under subpart (ii), and the Bank has not already directed such action in such notice under subpart (ii), the Bank may direct the Trustee to declare the principal of all Outstanding Bonds and the accrued interest thereon to be immediately due and payable,

(iv) by notice to the Corporation, declare the entire unpaid principal and interest amount of any advances outstanding as a result of any Purchase Drawing (including any Purchase Drawing following such notice to the Trustee) together with accrued interest thereon, and all other amounts owing under the Reimbursement Agreement, to be, whereupon the same shall become, immediately due and payable without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Corporation thereof; provided that if any Event of Default specified in Section 6.01(i) hereof shall occur, without any notice to the Corporation or any other Person or any other act by the Bank, the entire unpaid principal and interest amount of any advances outstanding as a result of any Drawing (including any Drawing thereafter occurring), together with accrued interest thereon, and all other amounts owing under the Reimbursement Agreement, shall be immediately due and payable without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Corporation thereof,

(v) (A) cure any Default, Event of Default or event of nonperformance under the Reimbursement Agreement or under any of the Bond Documents (in which event the Corporation shall reimburse the Bank therefor pursuant to the Reimbursement Agreement), (B) exercise its banker's lien, or right of set off, (C) exercise any right it or the Trustee may have under the Deeds of Trust, including without limitation any right it may have to direct or cause the Trustee to foreclose, marshal, dispose of or otherwise realize on the Facilities and other Collateral pursuant to and in compliance with the Deeds of Trust or to otherwise direct or control the enforcement of remedies and proceedings taken under the Deeds of Trust, and foreclose, marshal, dispose of and otherwise realize on any other collateral of the Corporation pledged hereunder or under the Bond Documents, on such terms and in such manner as the Bank may determine, or (D) exercise any other rights or remedies available under any Bond Document, any other agreement or at law or in equity including to (x) apply to any court of competent jurisdiction for, and obtain appointment of, a receiver for the Corporation, and (y) either personally or by attorney or agent and without bringing any action or proceeding, or by such a receiver, take whatever action at law or in equity may appear necessary or desirable to collect the amounts due and payable under the Bond Documents or to enforce performance or observance of any of the Obligations of the Corporation under the Bond Documents, whether for specific performance of any agreement or covenant of the Corporation or in aid of the execution of any power granted to the Purchaser in the Bond Documents or as otherwise available at law or in equity;

(vi) Upon receipt by the Trustee of a notice from the Bank pursuant to subparts (ii)(B) or (iii) of above and to the extent it has not already done so, the Trustee shall immediately draw under the Letter of Credit in accordance with its terms and to the extent permitted by the Letter of Credit, to purchase the Outstanding Bonds, whereupon such Bonds shall be Bank Bonds, or shall draw to pay principal of and interest on the Outstanding Bonds, as may be directed by the Bank under the Letter of Credit. The Letter of Credit shall then terminate immediately upon distribu-

tion of the proceeds of such drawing to the Trustee. Upon receipt by the Trustee of a notice from the Bank pursuant to subparts (ii) or (iii) of above directing the acceleration of the principal of all Outstanding Bonds, the Trustee shall immediately declare the entire principal amount of the unpaid Bonds and the interest accrued thereon immediately due and payable pursuant to the Indenture and shall apply all payments from the Corporation and products and proceeds of the amounts recovered from or paid by the Borrower upon or following an Event of Default as provided in the Indenture.

(b) If the Event of Default is the failure by the Corporation to reimburse the Bank on a timely basis for an Interest Drawing, as provided in the Letter of Credit the Bank may deliver to the Trustee notice that the Letter of Credit will not be reinstated. The rights and remedies of the Bank specified herein are for the sole and exclusive benefit, use and protection of the Bank, and the Bank is entitled, but shall have no duty or obligation to the Corporation, the Trustee, the Owners or any other Person, (i) to exercise or to refrain from exercising any right or remedy reserved to the Bank hereunder, or (ii) to cause the Trustee or any other party to exercise or to refrain from exercising any right or remedy available to it under any of the Bond Documents.

(c) From and after the occurrence of an Event of Default, all amounts owing to the Bank under the Reimbursement Agreement shall bear interest at the Default Rate.

THE CONFIRMING BANK

The following information concerning the Confirming Bank has been provided by the Confirming Bank and has not been independently confirmed or verified by the Underwriter, the Authority, the Corporation or the Bank. No representation is made herein as to the accuracy or adequacy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof, or that the information given below or incorporated herein by reference is correct as of any time subsequent to its date.

Excerpts from the Confirming Bank's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the Securities and Exchange Commission appear in appear in APPENDIX C—FINANCIAL REPORTS OF THE CONFIRMING BANK. The Confirming Bank has represented that such financial statements were prepared using generally accepted accounting principles in the United States and were audited using generally accepted auditing standards.

THE CONFIRMING LETTER OF CREDIT

The following is a summary of certain provisions of the Confirming Letter of Credit. This summary is not to be considered a full statement of the terms of the Confirming Letter of Credit and accordingly is qualified by reference thereto and is subject to the full text thereof. Unless otherwise defined, capitalized terms used herein shall have the same meanings given such terms in the Confirming Letter of Credit.

Concurrently with the issuance of the Letter of Credit, the Confirming Bank will issue the Confirming Letter of Credit. The Confirming Letter of Credit will be an irrevocable, transferable confirming letter of credit which provides that the Trustee shall draw moneys under the Confirming Letter of Credit for the benefit of the Registered Owners of the Bonds only if the Bank has wrongfully dishonored a

properly presented and conforming draw on the Letter of Credit or if the Bank repudiates the Letter of Credit.

The Confirming Letter of Credit shall expire at 4:00 p.m., California time, on the earliest to occur of the following dates: (a) April 2, 2015; (b) the date any demand for payment is honored by the Confirming Bank under the Confirming Letter of Credit; or (c) the date on which the Confirming Letter of Credit is surrendered by the Trustee to the Confirming Bank for cancellation.

BONDHOLDERS' RISKS

The following is a discussion of certain risks that could affect payments to be made with respect to the Bonds. Such discussion is not, and is not intended to be, exhaustive and should be read in conjunction with all other parts of this Official Statement and should not be considered as a complete description of all risks that could affect such payments. Prospective purchasers of the Bonds should analyze carefully the information contained in this Official Statement, including the Appendices hereto.

Security of the Bonds

The Bonds are special, limited obligations of the Authority payable exclusively out of the loan payments payable under the Loan Agreement and draws on the Letter of Credit (and, in certain circumstances, Bond proceeds and income from the temporary investment thereof) (the “Revenues”). The Bonds are secured by a pledge by the Authority of the Revenues to the Trustee in favor of the Registered Owners of the Bonds in accordance with the Indenture. The Bonds are being offered solely on the basis of the Letter of Credit and the Confirming Letter of Credit and the financial strength of the Bank and the Confirming Bank, and not the operations, financial strength or condition of the Corporation or any other security. This Official Statement does not describe the financial condition of the Corporation.

The rating assigned to the Bonds is based primarily on the credit-worthiness of the Confirming Bank. Prospective purchasers of the Bonds that wish to make a full evaluation of the financial status of the Confirming Bank are advised to obtain financial statements of the Confirming Bank.

Expiration of the Letter of Credit and Confirming Letter of Credit

The initial Letter of Credit expires on April 2, 2015 (the “Stated Expiration Date”) and the Confirming Letter of Credit expires on April 2, 2015, subject to extension or earlier termination in certain circumstances as described therein. If the Letter of Credit and/or the Confirming Letter of Credit are not extended or an Alternate Letter of Credit is not obtained by the Corporation, the Bonds will be subject to mandatory redemption. There can be no assurance that the Corporation will be able to obtain an extension of the Letter of Credit and/or the Confirming Letter of Credit or an Alternate Letter of Credit. The Bank is under no obligation to extend the Letter of Credit beyond the scheduled expiration thereof and the Confirming Bank is under no obligation to extend the Confirming Letter of Credit beyond the stated expiration thereof. See “DESCRIPTION OF THE BONDS—Redemption of Bonds—Termination of Letter of Credit and the Confirming Letter of Credit” and “THE LETTER OF CREDIT AND THE REIMBURSEMENT AGREEMENT—Letter of Credit” and “THE CONFIRMING LETTER OF CREDIT” herein. The Stated Expiration Date for the Letter of Credit and the Confirming Letter of Credit should not adversely affect any Registered Owners during any Interest Period that does not extend beyond the Stated Expiration Date.

Bank's Obligations Unsecured

The ability of the Bank to honor draws upon the Letter of Credit is based solely upon the Bank's general credit and is not collateralized or otherwise guaranteed by the United States of America or any agency or instrumentality thereof. No provision has been made for replacement of or substitution for the Letter of Credit in the event of any deterioration in the financial condition of the Bank. None of the Authority, the Corporation or the Bank assumes any liability to any purchaser of the Bonds as result of any deterioration of the financial condition of the Bank. Upon any insolvency of the Bank, any claim by the Trustee against the Bank would be subject to bank receivership proceedings.

Confirming Bank's Obligation Unsecured

The ability of the Confirming Bank to honor draws upon the Confirming Letter of Credit is based solely upon the Confirming Bank's general credit and is not collateralized or otherwise guaranteed by the United States of America or any agency or instrumentality thereof. No provision has been made for replacement of or substitution for the Confirming Letter of Credit in the event of any deterioration in the financial condition of the Confirming Bank. None of the Authority, the Corporation or the Confirming Bank assumes any liability to any purchaser of the Bonds as result of any deterioration of the financial condition of the Confirming Bank. Upon any insolvency of the Confirming Bank, any claim by the Trustee against the Confirming Bank would be subject to receivership proceedings.

Default by the Corporation under the Reimbursement Agreement

No representation or assurance can be made that any revenues will be generated by the Corporation in amounts sufficient to make the payments required under the Reimbursement Agreement. If the Corporation is unable to make the payments required under the Reimbursement Agreement, the Bank will have the right, among other things, to direct the Trustee to redeem the Bonds or give notice of the mandatory tender of the Bonds. See "DESCRIPTION OF THE BONDS—Redemption of Bonds—Mandatory Redemption for Reimbursement Agreement Default; Failure to Reinstate the Interest Component of the Letter of Credit," "DESCRIPTION OF THE BONDS—Purchase of Bonds—Mandatory Purchase of Bonds at the Direction of the Bank" and "THE LETTER OF CREDIT AND REIMBURSEMENT AGREEMENT" herein.

Limitation on Enforcement of Remedies

Enforcement of the remedies under the Indenture, the Loan Agreement, the Letter of Credit and the Confirming Letter of Credit may be limited or restricted by laws relating to bankruptcy and insolvency, and rights of creditors under application of general principles of equity, and may be substantially delayed in the event of litigation or statutory remedy procedures. All legal opinions delivered in connection with the Bonds relating to the enforceability of the Indenture, the Loan Agreement, the Letter of Credit, the Confirming Letter of Credit will contain an enforceability exception relating to the limitations which may be imposed by bankruptcy and insolvency laws, and the rights of creditors under general principles of equity.

Suitability of Investment

An investment in the Bonds involves a certain degree of risk. Prospective investors should carefully examine this Official Statement, including the Appendices hereto, and their ability to bear the economic risk of such an investment, and then determine whether or not the Bonds are an appropriate investment for them.

General Factors Affecting the Bank and the Confirming Bank

The Bank and the Confirming Bank are subject to regulation and supervision by various regulatory bodies. New regulations could impose restrictions upon the Bank and/or the Confirming Bank which would restrict its ability to respond to competitive pressures. Various legislative or regulatory changes could dramatically impact the banking industry as a whole and the Bank and/or the Confirming Bank specifically. The banking industry is highly competitive in many of the markets in which the Bank and/or the Confirming Bank operate. Such competition directly impacts the financial performance of the Bank and/or the Confirming Bank. Any significant increase in such competition could adversely impact the Bank and/or the Confirming Bank.

Prospective purchasers of the Bonds should evaluate the financial strength of the Bank and the Confirming Bank based upon the information contained in and referred to under the caption "THE BANK" and "THE CONFIRMING BANK" and other information available upon request from the Bank and the Confirming Bank and should not rely upon any governmental supervision by any regulatory entity.

General Factors Affecting the Corporation

No representation or assurance can be made that operating revenues will be realized by the Corporation in amounts sufficient to make the payments required under the Reimbursement Agreement or to make other payments in amounts sufficient to pay the principal of and interest on the Bonds in the event the Bank wrongfully dishonors a properly presented and conforming draw under the Letter of Credit or repudiates the Letter of Credit or the Confirming Bank fails to make payment under the Confirming Letter of Credit. Future revenues and expenses are subject to, among other things, the capabilities of the Corporation and future economic and other conditions that are unpredictable.

Unrelated Business Income

In recent years, the IRS and state, county and local taxing authorities have been undertaking audits and reviews of the operations of tax-exempt entities with respect to their exempt activities and the generation of unrelated business taxable income ("UBTI"). The Corporation does not currently participate in activities which generate UBTI. If the Corporation participates in UBTI generating activities in the future it covenants that it will comply with federal and state guidelines for the proper reporting of such income.

THE LOAN AGREEMENT

The following is a summary of certain provisions of the Loan Agreement. This summary is not to be considered a full statement of the terms of the Loan Agreement and accordingly is qualified by refer-

ence thereto and is subject to the full text thereof. Unless otherwise defined, capitalized terms used herein shall have the same meanings given such terms in the Indenture.

Loan Repayments

On or before each payment date for the Bonds (each a “Bond Payment Date”) until the principal of, premium, if any, and interest on the Bonds shall have been fully paid or provision for such payment shall have been made as provided in the Indenture, the Corporation agrees to pay to the Trustee as a repayment on the loan made to the Corporation from Bond proceeds, a sum equal to the amount payable on such Bond Payment Date as principal of (whether at maturity, or upon redemption or acceleration) and premium, if any, and interest on the Bonds as provided in the Indenture (the “Loan Repayments”).

In addition, the Corporation agrees to cause to be paid from the Letter of Credit, on the date on which any Bonds are to be purchased, as described under the heading “DESCRIPTION OF THE BONDS—Purchase of Bonds,” an amount which, together with proceeds available from the remarketing of such Bonds will equal the purchase price of such Bonds.

If the Corporation fails to make any of these payments and any additional payments required pursuant to the Loan Agreement, the payment in default will be considered an obligation of the Corporation until it is paid, to the extent permitted by law, with interest thereon at the rate of 10% per annum.

All of the payments by the Corporation under the Loan Agreement, with certain limited exceptions, are assigned by the Authority to the Trustee. The Corporation agrees in the Loan Agreement that its obligation to make payments to the Trustee is absolute and unconditional.

Maintenance and Operation of Project; Insurance and Condemnation

The Corporation will maintain the Project in a safe condition and in good repair and operating condition.

During the term of the Loan Agreement, the Corporation shall keep the Project insured for such amounts and for such occurrences as are customary for similar facilities within the State of California or as may be required by the Bank. Subject to the terms of the Loan Agreement, insurance and condemnation proceeds may be used by the Corporation to repair, restore or relocate the Project or to prepay amounts due under the Loan Agreement.

Selected Covenants of the Corporation

The Corporation covenants in the Loan Agreement that it will maintain its existence and will not dissolve, sell or dispose of all, or substantially all, of its assets, or consolidate with or merge into another entity, provided, however, that such Corporation may merge, consolidate, sell or transfer its assets, or dissolve if (a) the surviving, resulting or transferee Person, as the case may be: (i) assumes in writing, all of the obligations of the Corporation under this Agreement and the Remarketing Agreement; (ii) is not, after such transaction, otherwise in default under any provisions of this Agreement and the Remarketing Agreement; (iii) is an organization described in Section 501(c)(3) of the Code or a political subdivision under the Code; and (iv) is qualified to transact and is engaged in business in the State; and (v) qualifies as a “participating health institution” under the Act; (b) the Trustee and the Authority shall have received an opinion of counsel acceptable to the Authority that such merger, consolidation, sale, or other transfer

will result in the Corporation surviving, resulting or transferee Person being an organization described in § 501(c)(3) of the Code and a participating health institution under the Act; (c) the surviving, resulting or transferee Person, as the case may be, shall deliver to the Trustee and the Authority a Statement of an Authorized Representative to the effect that it will continue to operate the Facilities in a manner which will allow it to continue to meet all of the Corporation's obligations hereunder; and (d) the written consent of the Bank has been received by the Trustee, together with an acknowledgment that the Letter of Credit and the Confirming Letter of Credit will remain in effect.

Availability and Substitution of Letter of Credit

The Corporation will at all times throughout the term of the Loan Agreement (but subject to the terms of the Loan Agreement allowing the Corporation to substitute an Alternate Letter of Credit) maintain or cause to be maintained the Letter of Credit and the Confirming Letter of Credit with respect to the Bonds. The Letter of Credit shall be an obligation of the Bank to pay to the Trustee, against presentation of a certificate required by the Bank, up to (a) an amount equal to the aggregate principal amount of the Bonds then outstanding as necessary to pay the principal of such Bonds whether at maturity, redemption, acceleration or otherwise or upon the purchase of such Bonds upon the optional tender of the Bonds pursuant to the Indenture and on the Mandatory Tender Date and (b) an amount equal to 40 days (or such other number of days as may be required to obtain a rating on the Bonds if the Bonds are then rated) of interest on the Bonds at an interest rate of 10% per annum on the basis of a 365-or-366-day year, as applicable, for the number of days actually elapsed prior to the Fixed Rate Date, or an amount equal to 210 days (or such other number of days as may be required to obtain a rating on the Bonds if the Bonds are then rated) of interest on the Bonds at the actual interest rate or rates on the Bonds on the basis of a 360-day year of twelve 30-day months after the Fixed Rate Date to pay interest on the Bonds when due. The Confirming Letter of Credit shall be an obligation of the Confirming Bank to pay the Trustee, against presentation of sight drafts and certificates required by the Confirming Bank, the principal of and interest on the Bonds (but not exceeding the Stated Amount of the Confirming Letter of Credit) due to the Registered Owners under the Indenture in the event that the Bank has failed to honor a properly presented drawing under the Letter of Credit or repudiated the Letter of Credit.

On any Business Day, the Corporation may, at its option, provide or cause to be provided to the Trustee an Alternate Letter of Credit and the Corporation shall, in any event, cause to be delivered to the Trustee an extension of the Expiration Date of the Letter of Credit, the Confirming Letter of Credit or an Alternate Letter of Credit at least (a) 23 days before the Expiration Date of then existing Letter of Credit or the Confirming Letter of Credit while the Bonds bear interest at the Weekly Interest Rate, or (b) 45 days before the Expiration Date of then existing Letter of Credit or the Confirming Letter of Credit while the Bonds bear interest at the Fixed Interest Rate. At least 30 days prior to the Letter of Credit Substitution Date, the Corporation will provide the Authority, the Trustee, the Bank, the Tender Agent and the Remarketing Agent with a written notice of its intention to provide an Alternate Letter of Credit pursuant to the provisions of the Loan Agreement. Such notice will include the proposed Letter of Credit Substitution Date, which will be an Interest Payment Date, and identify the provider of the Alternate Letter of Credit. An Alternate Letter of Credit shall be an irrevocable letter of credit or other irrevocable credit facility delivered to the Trustee on or prior to 8:00 a.m. (California time) on the Letter of Credit Substitution Date, issued by a commercial bank or other financial institution, the terms of which shall in all material respects be the same as the Letter of Credit or the Confirming Letter of Credit, as applicable. On or prior to the date of the delivery of an Alternate Letter of Credit to the Trustee, the Corporation

shall cause to be furnished to the Authority and the Trustee (i) an opinion of Bond Counsel stating that the delivery of such Alternate Letter of Credit to the Trustee is authorized pursuant to the Loan Agreement, (ii) such opinions regarding the validity of the Alternate Letter of Credit as the Authority, the Trustee and any rating agency then rating the Bonds may reasonably require, and (iii) written evidence from Fitch Ratings (“Fitch”), if the Bonds are then rated by Fitch, Moody’s Investors Service, Inc. (“Moody’s”), if the Bonds are then rated by Moody’s, and Standard & Poor’s Ratings Services, a Division of the McGraw-Hill Companies, Inc. (“S&P”), if the Bonds are then rated by S&P, to the effect that such rating agency has reviewed the proposed Alternate Letter of Credit and that the substitution of the proposed Alternate Letter of Credit will not, by itself, result in a reduction of its long term rating of the Bonds below “A-” if the Bonds are rated by Fitch, below “A-” if the Bonds are rated by S&P or below “A3” if the Bonds are rated by Moody’s (or such lower ratings as may be permitted by the Authority’s policies or guidelines then in effect).

Prepayments

The Corporation has the option to prepay its Loan, with the prior written consent of the Bank, which consent will not be unreasonably withheld: (a) in whole, and cause all of the Outstanding Bonds to be redeemed in the event of certain damage or destruction of the Project by fire or other casualty or title to all or substantially all of the Project shall have been taken by power of eminent domain; (b) in whole or in part, out of the net proceeds of any insurance or condemnation awards as provided in the Loan Agreement; and (c) at the times and in the amounts set forth in the Indenture in connection with certain optional redemptions of the Bonds (see “DESCRIPTION OF THE BONDS—Redemption of Bonds—Optional Redemption Prior to the Fixed Rate Date”). Additionally, the Corporation must prepay its Loan (i) if the Loan Agreement should become void, unenforceable, impossible to perform or unlawful and (ii) at the times and in the amounts set forth in the Indenture in connection with certain mandatory redemptions of the Bonds (see “DESCRIPTION OF THE BONDS—Redemption of Bonds”). In the case of a prepayment of the entire amount due under the Loan Agreement, the amount to be paid will be a sum sufficient, together with other funds deposited with the Trustee and available for such purpose, to pay the redemption price of all Bonds Outstanding on the redemption date specified in the notice of redemption, plus interest accrued to the redemption date of the Bonds, plus all reasonable and necessary fees and expenses of the Authority, the Trustee and any paying agent allowable pursuant to the Loan Agreement and the Indenture accrued and to accrue through final payment of the Bonds and all other liabilities of the Corporation accrued under the Loan Agreement. In the case of partial prepayment, the amount payable will be a sum sufficient, together with other funds deposited with the Trustee and available for such purpose, to pay the redemption price plus all interest accrued and to accrue and to pay expenses of redemption of such Bonds.

Events of Default

The following constitute “events of default” under the Loan Agreement:

- (a) the failure of the Corporation to pay any Loan Repayment when and as the same shall become due and payable;
- (b) the failure of the Corporation to pay any amounts payable under the Loan Agreement, other than Loan Repayments, when and as the same shall become due, which failure continues for a period of 30 days after written notice delivered to the Corporation and the Bank, which notice shall specify such failure and request that it be remedied, given by the Authority or the Trustee;

(c) the failure of the Corporation to observe and perform any covenant, condition or agreement on its part required to be observed or performed by the Loan Agreement other than as described in (a) or (b) above, which failure continues for a period of 30 days after written notice delivered to the Corporation and the Bank, which notice shall specify such failure and request that it be remedied, given to the Corporation by the Authority or the Trustee, unless the Authority and the Trustee shall agree in writing to an extension of such time; provided, however, that if the failure stated in the notice cannot be corrected within such period, the Authority and the Trustee will not unreasonably withhold their consent to an extension of such time if corrective action is instituted within such period and diligently pursued until the default is corrected; or

(d) the existence of an Event of Default under the Indenture.

The Corporation shall not be deemed in default pursuant to (c) above if by reason of force majeure the Corporation is unable to carry out such obligations.

Remedies

Whenever any such event of default shall have occurred and shall be continuing, the Loan Agreement provides that:

(a) the Trustee, by written notice to the Corporation, the Confirming Bank and the Bank, shall declare the unpaid balance of the loan payable under the Loan Agreement to be due and payable immediately, provided that concurrently with or prior to such notice the unpaid principal amount of the Bonds shall have been declared to be due and payable under the Indenture. Upon any such declaration such amount shall become and shall be immediately due and payable in the amount set forth in the Indenture;

(b) the Trustee shall have access to and may inspect, examine and make copies of the books and records and any and all accounts, data and federal income tax and other tax returns of the Corporation;

(c) the Trustee may take whatever action at law or in equity as may be necessary or desirable to collect the payments and other amounts then due and thereafter to become due or to enforce performance and observance of any obligation, agreement or covenant of the Corporation under the Loan Agreement; or

(d) the Trustee shall immediately draw upon the Letter of Credit or the Confirming Letter of Credit, if permitted by their terms and required by the terms of the Indenture, and apply the amount so drawn in accordance with the Indenture and may exercise any remedy available to it thereunder.

Amendment

Except as otherwise provided in the Loan Agreement or the Indenture, the Loan Agreement may not be effectively amended, changed, modified, altered or terminated without the written consent of the Trustee and the Bank.

THE INDENTURE

The following is a summary of certain provisions of the Indenture. This summary is not to be considered a full statement of the terms of the Indenture and accordingly is qualified by reference thereto and is subject to the full text thereof. Unless otherwise defined, capitalized terms used herein shall have the same meanings given such terms in the Indenture.

Security

Pursuant to the Indenture, the Bonds are secured by a lien on all Revenues and other amounts (including proceeds of the sale of the Bonds) held in the funds or accounts established pursuant to the Indenture (other than moneys set aside in the Rebate Fund and as otherwise provided in the Indenture). All such moneys are irrevocably pledged to the punctual payment of the principal and purchase price of, premium, if any, and the interest on the Bonds.

“Revenues” means all amounts received by the Authority or the Trustee for the account of the Authority pursuant or with respect to the Loan Agreement, the Letter of Credit or the Confirming Letter of Credit, including, without limiting the generality of the foregoing, loan repayments (including both timely and delinquent payments and any late charges, and paid from whatever source), prepayments, insurance proceeds, condemnation proceeds, and all interest, profits or other income derived from the investment of amounts in any fund or account established pursuant to the Indenture, but not including any Additional Payments.

Covenants of the Authority

The Authority has agreed among other things, to punctually pay, or cause to be paid, but only from Revenues and other assets pledged for such payment pursuant to the Indenture, the principal, premium, if any, and interest to become due on the Bonds; not to extend the maturity of the Bonds or the time of payment of interest; not to allow the creation of any liens or other encumbrances (other than those created under the Indenture) on the Revenues and other assets pledged or assigned under the Indenture.

Costs of Issuance Fund

Under the Indenture, the Trustee will deposit a portion of the proceeds of the Bonds into the Costs of Issuance Fund to pay the costs of issuing the Bonds. Upon the earlier of June 26, 2014 or the receipt by the Trustee of a certificate or letter signed by an Authorized Representative of the Corporation stating that all Costs of Issuance have been paid or adequately provided for, any money remaining in the Costs of Issuance Fund shall be transferred to the Revenue Fund.

Revenue Fund

Under the Indenture, the Trustee is required to deposit all Revenues upon receipt thereof in a special fund designated as the “Revenue Fund” which the Trustee shall establish, maintain and hold in trust, except that all moneys received by the Trustee and required to be deposited in the Redemption Account shall be promptly deposited in said account, which the Trustee shall establish, maintain and hold in trust. All Revenues deposited with the Trustee are to be held, disbursed, allocated and applied by the Trustee only as provided in the Indenture.

Loan Repayments received by the Trustee from the Corporation pursuant to the Loan Agreement shall be deposited by the Trustee into the Revenue Fund. On or before each Interest Payment Date, the Trustee shall transfer from the Revenue Fund and deposit into the following respective accounts (each of which the Trustee shall establish and maintain within the Revenue Fund), in the following amounts, in the following order of priority, and the requirements of each such account (including the making up of any deficiencies in any such account resulting from lack of Revenues sufficient to make any earlier required deposit) at the time of deposit will be satisfied before any transfer is made to any account subsequent in priority, and provided, that all moneys representing drawings under the Letter of Credit for payments of scheduled principal and interest on the Bonds shall be transferred into the Letter of Credit Account:

First, to the Interest Account, the amount paid by the Corporation and designated as or attributable to interest on the Bonds so that the aggregate of such amounts will, on the next Interest Payment Date, equal the amount of interest due on the Bonds on such Interest Payment Date;

Second, to the Principal Account, the amount paid by the Corporation and designated as or attributable to principal of the Bonds so that the aggregate of such amounts will, on the next succeeding principal payment date equal the amount of principal due (whether at maturity or by acceleration) on such principal payment date; and

Third, to the Redemption Account, the aggregate amount of principal and premium, if any, next coming due by redemption permitted (as directed in writing by the Corporation) or required under the Indenture, or any portion thereof paid by the Corporation.

To the extent the Trustee receives moneys from the Bank pursuant to a draw under the Letter of Credit to make the above payments, the moneys deposited in the Interest, Principal and Redemption Accounts shall be used by the Trustee to reimburse the Bank for such draws.

Priorities of Application of Moneys

Funds for the payment of the principal or redemption price of and interest on the Bonds will be derived from the following sources in the order of priority indicated in each of the accounts in the Revenue Fund. Amounts in the respective accounts in the Revenue Fund will be used to pay the principal or redemption price of and interest on the Bonds held by Registered Owners other than the Bank or the Corporation prior to the payment of the principal and interest on the Bonds held by the Bank or the Corporation. If principal or redemption price (or any portion thereof) of and interest on the Bonds is paid with moneys described in subparagraph (a) below, any other moneys on deposit in the respective accounts in the Revenue Fund will be applied to immediately reimburse the Bank by wire transfer in the amount of such drawings:

(a) moneys paid into the Letter of Credit Account of the Revenue Fund representing the proceeds of drawings by the Trustee under the Letter of Credit;

(b) moneys paid into the Confirming Letter of Credit Account of the Revenue Fund representing the proceeds of drawings by the Trustee under the Confirming Letter of Credit;

(c) moneys paid into the Interest Account, if any, representing accrued interest received at the initial sale of the Bonds and proceeds from the investment thereof which shall be applied to the payment of interest on the Bonds;

(d) moneys paid into the Revenue Fund pursuant to the Indenture and proceeds from the investment thereof, which constitute Available Moneys (as defined in the Indenture);

(e) moneys deposited into the Redemption Account and proceeds from the investment thereof, which constitute Available Moneys;

(f) any other moneys (not derived from drawings under the Letter of Credit or the Confirming Letter of Credit) paid into the Revenue Fund and proceeds from the investment thereof, which constitute Available Moneys; and

(g) any other moneys paid into the Revenue Fund and proceeds from the investment thereof, which are not Available Moneys.

The Trustee will create within the Revenue Fund separate accounts called the “Letter of Credit Account,” and the “Confirming Letter of Credit Account,” into which all moneys drawn under the Letter of Credit and the Confirming Letter of Credit, respectively, to make payments of principal of, premium, if any, and interest on the Bonds shall be deposited and disbursed. None of the Corporation, any member, affiliate or guarantor of the Corporation (a “Related Party”), the Trustee or the Authority will have any legal, equitable or beneficial right, title or interest in the Letter of Credit Account or the Confirming Letter of Credit Account.

Purchase Fund

There is established under the Indenture with the Tender Agent, in a trust capacity, a fund to be designated as the “Purchase Fund” to be used to purchase Bonds tendered for purchase. All moneys drawn by the Trustee under the Letter of Credit for such purpose and all moneys received from the sale of Bonds upon remarketing (which moneys are to be immediately available on the Purchase Date) shall be deposited into the Purchase Fund.

The Indenture also establishes within the Purchase Fund two separate accounts called the “Liquidity Account,” into which all moneys drawn under the Letter of Credit are to be deposited and disbursed and a “Remarketing Account,” into which all moneys representing proceeds of remarketing shall be deposited. None of the Corporation, any Related Party, the Trustee or the Authority will have any legal, equitable or beneficial right, title or interest in the moneys held in the Purchase Fund, or in the Remarketing Account or the Liquidity Account therein. On each day on which Bonds have been tendered for purchase or are deemed to have been tendered for purchase pursuant to the Indenture, after paying or making provision for the payment of the purchase price of such Bonds as provided in the Indenture, the Tender Agent will promptly remit to the Bank any moneys in the Liquidity Account not used to purchase Bonds, but not exceeding the amount drawn on the Letter of Credit for such purchase.

Funds for the purchase of Bonds at the principal amount thereof plus unpaid interest accrued to the purchase date, if any, will be paid out of the Purchase Fund in the following order of priority:

(a) from the Remarketing Account, proceeds from the remarketing of Bonds;

(b) from the Liquidity Account, moneys representing proceeds of a drawing by the Trustee under the Letter of Credit.

In the event that Bonds are not purchased with money from the sources described above, the Trustee will pay the principal amount of Bonds tendered with moneys on deposit in the Revenue Fund and cancel such Bonds.

Supplemental Indentures

The Authority and the Trustee may enter into a supplemental indenture or indentures, without the consent of any of the Registered Owners, but with the written consent of the Corporation and the Bank, amending or modifying the rights and obligations of the Authority, the Trustee and the Registered Owners, for any one or more of the following purposes:

(a) to add to the covenants and agreements of the Authority in the Indenture other covenants and agreements thereafter to be observed, to pledge or assign additional security for the Bonds, or to surrender any right or power reserved to or conferred upon the Authority by the Indenture;

(b) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing or correcting any defective provision, contained in the Indenture, or in regard to matters or questions arising under the Indenture as the Authority may deem necessary or desirable which do not adversely affect the rights of the Registered Owners;

(c) to modify, amend or supplement the Indenture in such manner as to permit the qualification thereof under the Trust Indenture Act of 1939, as amended, or any similar federal statute hereafter in effect, and to add such other terms, conditions and provisions as may be permitted by said act or similar federal statute;

(d) to make such provisions for the purpose of conforming to the terms and provisions of any Alternate Letter of Credit or Alternate Letter of Credit or to obtain a rating on the Bonds which do not adversely affect the rights of the Registered Owners under the Indenture; and

(e) to modify, amend or supplement the Indenture in any other respect which does not adversely affect the rights of the Registered Owners under the Indenture.

Except as described above, the Authority and the Trustee must obtain the consent of the Registered Owners of a majority in aggregate principal amount of all Bonds then Outstanding, the Corporation and the Bank in order to enter into a Supplemental Indenture. No such Supplemental Indenture may (a) extend the fixed maturity of any Bond, or reduce the amount of principal thereof, or extend the time of payment, or change the method of computing the rate of interest thereon, or extend the time of payment of interest thereon, without the consent of the Registered Owner of each Bond so affected, (b) reduce the aforesaid percentage of Bonds the consent of the Registered Owners of which is required to effect any such modification or amendment, or permit the creation of any lien on the Revenues and other assets pledged under the Indenture prior to or on a parity with the lien created by the Indenture, or deprive the Registered Owners of the lien created by the Indenture on such Revenues and other assets (except as ex-

pressly provided in the Indenture), without the consent of the Registered Owners of all the Bonds then Outstanding, or (c) adversely affect the interests of the Tender Agent without its prior written consent.

Events of Default

Each of the following events shall constitute an “Event of Default” under the Indenture:

(a) default in the due and punctual payment of the principal of, or premium (if any) on, any Bond when and as the same shall become due and payable, whether at maturity as therein expressed, by proceedings for redemption, by declaration or otherwise;

(b) default in the due and punctual payment of any installment of interest on any Bond, when and as such interest installment shall become due and payable;

(c) failure to pay the purchase price of any Bond tendered in accordance with the provisions of the Indenture;

(d) failure by the Authority to perform or observe any other of the covenants, agreements or conditions on its part in the Indenture or in the Bonds contained, and the continuation of such failure for a period of 60 days after written notice thereof, specifying such default and requiring the same to be remedied, shall have been given to the Authority, the Bank and the Corporation by the Trustee, or to the Authority, the Bank, the Corporation and the Trustee by the Registered Owners of not less than 25% in aggregate principal amount of the Bonds at the time Outstanding;

(e) the occurrence and continuation of certain events of default under the Loan Agreement; or

(f) the dishonor by the Bank of a properly presented and conforming draw on the Letter of Credit or the repudiation of the Letter of Credit

No default specified in (d) above shall constitute an Event of Default unless the Authority and the Corporation shall have failed to correct such default within the applicable period; provided, however, that if the default shall be such that it cannot be corrected within such period, it shall not constitute an Event of Default if corrective action is instituted by the Authority or the Corporation within the applicable period and diligently pursued. With regard to any alleged default concerning which notice is given to the Corporation, the Corporation may perform any covenant or obligation the non-performance of which is alleged in said notice to constitute a default with full power to do any and all things and acts to the same extent that the Authority could do and perform any such things and acts.

Remedies

During the continuance of an Event of Default, unless the principal of all the Bonds has already become due and payable, the Trustee may, and upon the written request of the Registered Owners of not less than 25% in aggregate principal amount of the Bonds at the time Outstanding, or upon the occurrence of an Event of Default described in (a), (b), (c), (e) or (f) above, the Trustee shall, by notice in writing to the Authority, the Tender Agent, the Remarketing Agent, the Corporation and the Bank, declare the principal of all the Bonds then Outstanding, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable,

anything in the Indenture or in the Bonds contained to the contrary notwithstanding. Upon any such declaration the Trustee shall immediately draw upon any then existing Letter of Credit or Confirming Letter of Credit in accordance with the terms thereof and apply the amount so drawn to pay the principal of and interest on the Bonds (other than Bank Bonds) so declared to be due and payable. Interest on the Bonds shall cease to accrue upon the declaration of acceleration. The Trustee shall notify the Registered Owners of the date of acceleration and the cessation of accrual of interest on the Bonds in the same manner as for a notice of redemption.

If, at any time after the principal of the Bonds shall have been so declared due and payable, and before any judgment or decree for the payment of the moneys due shall have been obtained or entered as hereinafter provided, and before the Letter of Credit or the Confirming Letter of Credit have been drawn upon in accordance with their terms and honored, there shall have been deposited with the Trustee a sum sufficient to pay all the principal of the Bonds matured prior to such declaration and all matured installments of interest (if any) upon all the Bonds, with interest on such overdue installments of principal as provided in the Loan Agreement, and the reasonable expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment of principal of and interest on the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall have been made therefor, then, and in every such case, the Registered Owners of at least a majority in aggregate principal amount of the Bonds then Outstanding, by written notice to the Authority and to the Trustee, may, on behalf of the Registered Owners, rescind and annul such declaration and its consequences and waive such default. No such rescission and annulment shall extend to or shall affect any subsequent default, or shall impair or exhaust any right or power as a consequence thereof.

Trustee to Represent Registered Owners

The Trustee is irrevocably appointed as trustee and the true and lawful attorney-in-fact of the Registered Owners for the purpose of exercising and prosecuting on their behalf such rights and remedies as may be available to such Registered Owners under the provisions of the Bonds, the Indenture, the Loan Agreement, the Act and applicable provisions of any other law. Upon the occurrence and continuance of an Event of Default or other occasion giving rise to a right in the Trustee to represent the Registered Owners, the Trustee in its discretion may, and upon the written request of the Registered Owners of not less than 25% in aggregate principal amount of the Bonds then Outstanding, and upon being indemnified to its satisfaction therefor (except any actions required to be taken by the Indenture to apply Revenues and other funds following an Event of Default, in which event no indemnification shall be required), shall, proceed to protect or enforce its rights or the rights of such Registered Owners by such appropriate action, suit, mandamus or other proceedings as it shall deem most effectual to protect and enforce any such right, at law or in equity, either for the specific performance of any covenant or agreement contained in the Indenture, or in aid of the execution of any power granted in the Indenture, or for the enforcement of any other appropriate legal or equitable right or remedy vested in the Trustee or in such Registered Owners under the Indenture, the Loan Agreement, the Act or any other law. Upon instituting such proceedings, the Trustee shall be entitled, as a matter of right, to the appointment of a receiver of the Revenues and other assets pledged under the Indenture, pending such proceedings.

Registered Owners' Direction of Proceedings

The Registered Owners of a majority in aggregate principal amount of the Bonds then Outstanding shall have the right to direct the method of conducting all remedial proceedings taken by the Trustee

under the Indenture. Such direction shall not be otherwise than in accordance with law and the provisions of the Indenture. The Trustee shall have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Registered Owners not parties to such direction or for which it has not been provided adequate indemnity to its satisfaction.

TAX MATTERS

In the opinion of Bond Counsel, interest on the Bonds is exempt from California personal income taxes. The interest on the Bonds is subject to all applicable federal taxation.

Owners of the Bonds should also be aware that the ownership or disposition of, or the accrual or receipt of interest on the Bonds may have federal or state tax consequences. Bond Counsel expresses no opinion regarding any federal or state tax consequences arising with respect to the Bonds other than as expressly described above.

Bond Counsel expects to deliver an opinion at the time of delivery of the Bonds in substantially the form set forth in APPENDIX A—FORM OF BOND COUNSEL’S OPINION.

Bond Counsel’s opinion represents its legal judgment based upon its review of the law and the facts that it deems relevant to render such opinion and is not a guarantee of a result.

ENFORCEABILITY OF REMEDIES

The remedies available to the Trustee or the Registered Owners of the Bonds upon an event of default under the Indenture or the Loan Agreement are in many respects dependant upon judicial actions which are often subject to discretion and delay, and such remedies may not be readily available or may be limited. In particular, under the United States Bankruptcy Code, a bankruptcy case may be filed by or against the Corporation. In general, the filing of such petition operates as a stay against enforcement of the terms of the agreements to which the bankrupt entity is a party, and in the bankruptcy process, executory contracts such as the Loan Agreement or the Indenture may be subject to assumption or rejection by the bankrupt party. In the event of any such rejection, the non-rejecting party or its assigns may become an unsecured claimant of the rejecting party. The various legal opinions to be delivered concurrently with the Bonds (including Bond Counsel’s approving opinion) will be qualified, as to the enforceability of the various legal instruments, by limitations imposed by bankruptcy, reorganization, insolvency or other similar laws affecting the rights of creditors generally and by general principals of equity applied in the exercise of judicial discretion.

RATINGS

Standard & Poor’s Ratings Services (“S&P”) has assigned the ratings of “AA+/A-1+” to the Bonds (a long-term rating of “AA+” and a short-term rating of “A-1+”). The long-term rating reflects S&P’s assessment of the likelihood of repayment of the Bonds to maturity based primarily on the credit of the Letter of Credit Bank. The short-term rating reflects the likelihood of repayment based on the availability of the Letter of Credit during the “put” period. Such ratings reflect only the view of S&P at the time

such ratings are given, and the Authority, the Corporation and the Underwriter make no representation as to the appropriateness of such ratings or that such ratings will not be changed, suspended or withdrawn.

S&P relies on the Underwriter, the Bank and its counsel, Bond Counsel and other experts for the accuracy and completeness of the information submitted in connection with the ratings. The ratings are not “market” ratings nor a recommendation to buy, hold or sell the Bonds, and such ratings may be changed, suspended or withdrawn as a result of changes in, or unavailability of, information. Any downward revision, suspension or withdrawal of such ratings could have an adverse effect on the market price and marketability of the Bonds. An explanation of the significance of such ratings may be obtained only from S&P at the following address: 55 Water Street, New York, NY 10041.

UNDERWRITING

The Authority has agreed to sell, and the Underwriter has agreed to purchase, the Bonds at a price equal to the aggregate principal amount thereof, less an Underwriters discount of \$81,250. The Underwriter’s obligation is subject to certain conditions precedent, and the Underwriter does not have the right to purchase less than all the Bonds. The Underwriter intends to offer the Bonds to the public initially at the offering price set forth on the cover page hereof and may subsequently change such offering price and other selling terms from time to time without prior notice. The Bonds may be offered by the Underwriter and sold to certain dealers (including dealers depositing such Bonds into investment trusts, accounts or funds) and others at prices lower than the public offering price set forth on the cover page hereof.

ABSENCE OF MATERIAL LITIGATION

The Authority

To the knowledge of the Authority, there is no pending (with service of process against the Authority having been accomplished) or threatened litigation against the Authority seeking to restrain or enjoin the sale or issuance of the Bonds, or in any way contesting or affecting any proceedings of the Authority taken concerning the sale thereof, the pledge or application of any moneys or security provided for the payment of the Bonds, the validity or enforceability of the documents executed by the Authority in connection with the Bonds, the completeness or accuracy of the Official Statement or the existence or powers of the Authority relating to the sale of the Bonds.

The Corporation

There is no pending or threatened litigation against the Corporation seeking to restrain or enjoin the issuance, sale, execution or delivery of the Bonds, or in any way contesting or affecting the validity of the Bonds, the existence or powers of the Corporation, or the authority of the Corporation to enter into any document relating to the Loan Agreement, or any documents executed by the Corporation in connection with the issuance of the Bonds, or the completeness or accuracy of the Official Statement, or that would materially adversely affect the operations or financial condition of the Corporation.

LEGAL MATTERS

The Bonds are offered when, as and if issued by the Authority and accepted by the Underwriter, subject to prior sale, withdrawal or modification of the offer without notice, and the approval of legality by Quint & Thimmig LLP, Larkspur, California, Bond Counsel. Certain legal matters will be passed upon for the Authority by Quint & Thimmig LLP, Larkspur, California as disclosure counsel, for the Bank by the Law Offices of Kathleen L. Johnson, Santa Barbara, California, for the Confirming Bank by in-house counsel, for the Authority by the Attorney General of the State of California, and for the Corporation by Jennings, Strouss & Salmon, PLC, Phoenix, Arizona.

The Authority furnished only the information contained under the captions “THE AUTHORITY” and “ABSENCE OF MATERIAL LITIGATION—The Authority” and, except for such information, makes no representation as to the adequacy, completeness or accuracy of this Official Statement or the information contained herein.

CONTINUING DISCLOSURE

The Authority has determined that no financial or operating data concerning the Authority is material to any decision to purchase, hold or sell Bonds and the Authority will not provide any such information. The Authority shall have no liability to the Owners of the Bonds or any other person with respect to Rule 15c2-12 promulgated by the Securities and Exchange Commission (the “Rule”).

The Corporation has undertaken all responsibility for any continuing disclosure to Owners of the Bonds as described below.

The Corporation has agreed in a Continuing Disclosure Certificate for the benefit of owners of the Bonds to provide certain financial information and operating data relating to the Borrower by not later than 270 days after the end of the Corporation’s fiscal year (presently June 30) in each year commencing with its report for the 2014 fiscal year (due March 31, 2015) and to provide notices of the occurrence of certain enumerated events. The Annual Report required under the Continuing Disclosure Certificate will be filed with the Municipal Securities Rulemaking Board’s Electronic Municipal Marketplace Access system (“EMMA”).

These covenants have been made in order to assist the Underwriter in complying with the Rule. The specific nature of the information to be contained in the Annual Report and the notices of enumerated events by the Certificate are set forth in their entirety in APPENDIX D—FORM OF CONTINUING DISCLOSURE CERTIFICATE.

In preparation for issuance of the Bonds, the Corporation determined that it had not filed any Annual Reports, financial and operating data or material event notifications within the previous five years as required by its continuing disclosure undertakings with respect to the 2001 Bonds and the 2005 Bonds. Prior to the date of this Official Statement, the Corporation arranged, through a newly appointed dissemination agent, submission of Annual Reports, financial and operating data and material event notifications for the Corporation’s fiscal years ended June 30, 2009, through 2013, with EMMA.

MISCELLANEOUS

The foregoing and subsequent summaries, descriptions or provisions of the Bonds, the Indenture, Loan Agreement, the Reimbursement Agreement, the Letter of Credit and the Confirming Letter of Credit, and all references to other materials not purporting to be quoted in full are only brief outlines of some of the provisions thereof and do not purport to summarize or describe all of the provisions thereof.

This Official Statement has been delivered by the Authority and approved by the Borrower.

The Authority furnished only the information contained under the captions “THE AUTHORITY” and “ABSENCE OF MATERIAL LITIGATION—The Authority” and, except for such information, makes no representation as to the adequacy, completeness or accuracy of this Official Statement or the information contained herein.

This Official Statement is not to be construed as a contract or agreement between the Authority or the Corporation and the Owners of any of the Bonds.

**CALIFORNIA HEALTH FACILITIES
FINANCING AUTHORITY**

By /s/ Barbara J. Liebert
Barbara J. Liebert
Executive Director

**SOCIAL MODEL RECOVERY SYSTEMS,
INC.**

By /s/ James L. O’Connell
James L. O’Connell
Chief Executive Officer

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APPENDIX A

FORM OF OPINION OF BOND COUNSEL

[Letterhead of Quint & Thimmig LLP]

[Closing Date]

California Health Facilities Financing Authority
915 Capitol Mall, Suite 590
Sacramento, CA 95814
Oakland, CA 94607-4756

OPINION: \$5,000,000 California Health Facilities Financing Authority Taxable Variable Rate Demand Refunding Revenue Bonds (Social Model Recovery Systems, Inc.), Series 2014

Members of the Authority:

We have acted as bond counsel in connection with the issuance by the California Health Facilities Financing Authority (the "Authority") of \$5,000,000 California Health Facilities Financing Authority Taxable Variable Rate Demand Refunding Revenue Bonds (Social Model Recovery Systems, Inc.), Series 2014 (the "Bonds"), pursuant to the California Health Facilities Financing Authority Act, constituting Part 7.2 of Division 3 of Title 2 of the California Government Code (the "Law"), an Indenture, dated as of April 1, 2014, by and between the Authority and U.S. Bank National Association, as trustee (the "Indenture"), and a resolution adopted by the Authority on February 27, 2014. The Bonds have been issued by the Authority to provide funds to finance and refinance projects for Social Model Recovery Systems, Inc., a California nonprofit public benefit corporation (the "Corporation"), to be loaned to the Corporation pursuant to a Loan Agreement, dated as of April 1, 2014, by and between the Authority and the Corporation (the "Loan Agreement"). We have examined the law and such certified proceedings and other papers as we deem necessary to render this opinion.

As to questions of fact material to our opinion, we have relied upon representations of the Authority contained in the Indenture, of the Corporation contained in the Loan Agreement and in the certified proceedings and certifications of public officials and others furnished to us, without undertaking to verify the same by independent investigation.

Based upon the foregoing we are of the opinion, under existing law, as follows:

1. The Authority is duly created and validly existing as a public body with the power to enter into the Indenture and the Loan Agreement, to perform the agreements on its part contained therein and to issue the Bonds.
2. The Indenture and the Loan Agreement have been duly approved by the Authority and constitute valid and binding special obligations of the Authority enforceable against the Authority in accordance with their respective terms.
3. Pursuant to the Law, the Indenture creates a valid lien on the funds pledged by the Indenture for the security of the Bonds, on a parity with other bonds (if any) issued or to be issued under the Indenture, subject to no prior lien granted under the Law.

4. The Bonds have been duly authorized, executed and delivered by the Authority and are valid and binding special obligations of the Authority, payable solely from the sources provided therefor in the Indenture.

5. Interest on the Bonds is exempt from personal income taxation imposed by the State of California.

Ownership of the Bonds may result in other tax consequences to certain taxpayers, and we express no opinion regarding any such collateral consequences arising with respect to the Bonds.

In rendering this opinion, we have relied upon certifications of the Authority and the Corporation with respect to certain material facts within the Authority's and the Corporation's knowledge. Our opinion represents our legal judgment based upon our review of the law and the facts that we deem relevant to render such opinion, and is not a guarantee of a result. This opinion is given as of the date hereof and we assume no obligation to revise or supplement this opinion to reflect any facts or circumstances that may hereafter come to our attention or any changes in law that may hereafter occur.

The rights of the owners of the Bonds and the enforceability of the Bonds and the Indenture may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted and also may be subject to the exercise of judicial discretion in accordance with general principles of equity.

Respectfully submitted,

APPENDIX B

AUDITED FINANCIAL STATEMENTS OF THE CORPORATION FOR ITS FISCAL YEAR ENDED JUNE 30, 2013

The Corporation's auditor was not requested to consent to the inclusion of its report in this Appendix B and it has not undertaken to update financial statements included in this Appendix B. No opinion is expressed by the Corporation's auditor with respect to any event subsequent to its report.

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SOCIAL MODEL RECOVERY SYSTEMS, INC
(a Not-for-Profit Corporation)

FINANCIAL STATEMENTS

WITH INDEPENDENT AUDITORS' REPORT

AND

SINGLE AUDIT REPORTS

FOR THE YEAR ENDED JUNE 30, 2013

SOCIAL MODEL RECOVERY SYSTEMS, INC
(a Not-for-Profit Corporation)

FINANCIAL STATEMENTS

JUNE 30, 2013

WITH INDEPENDENT AUDITORS' REPORT

DILLON & AVEDISSIAN/ACCOUNTANCY CORPORATION

CERTIFIED PUBLIC ACCOUNTANTS

260 S. LOS ROBLES, SUITE 218
PASADENA, CA 91101

TEL (626) 577-8885
FAX (626) 577-8889

INDEPENDENT AUDITORS' REPORT

To the Board of Directors,

Social Model Recovery Systems, Inc.
Covina, California

Report on the Financial Statements

We have audited the accompanying statement of financial position of Social Model Recovery Systems, Inc. (a nonprofit corporation) as of June 30, 2013, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

INDEPENDENT AUDITORS' REPORT (continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Social Model Recovery Systems, Inc. as of June 30, 2013, and the changes in its net assets and its cash flows for the year ended in accordance with accounting principles generally accepted in the United States of America.

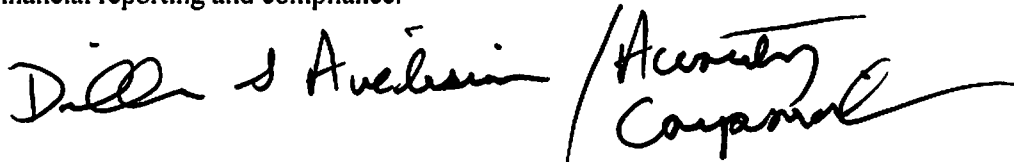
Other Matters

Other information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Office of Management and Budget Circular A-133, *Audits of State, Local Governments, and Non-profit Organizations*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 30, 2013, on our consideration of Social Model Recovery System, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Social Model Recovery Systems, Inc.'s internal control over financial reporting and compliance.


Diller S. Aviles / Accountant

October 30, 2013

Pasadena, California

SOCIAL MODEL RECOVERY SYSTEMS, INC
(a Not-for-profit Corporation)

STATEMENT OF FINANCIAL POSITION

JUNE 30, 2013

ASSETS

CURRENT ASSETS:

Cash	\$ 395,204
Contracts and accounts receivable, net of allowance for doubtful accounts of \$21,338	1,730,177
Prepaid expenses	92,579
Total current assets	<u>2,217,960</u>

PROPERTY AND EQUIPMENT, net

5,316,375

OTHER ASSETS

Debt service reserve funds	254,644
Bond issuance cost	40,783
Deposits and other assets	24,205

Total assets

\$ 7,853,967

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:

Accounts payable and accrued expenses	\$ 537,920
Current portion of long-term debt	304,260
Deferred revenue	165,535
Total current liabilities	<u>1,007,715</u>

OTHER LIABILITIES:

Deferred revenue	130,000
Long-term debt	2,574,141

Total liabilities

3,711,856

NET ASSETS:

Unrestricted	4,142,111
Total net assets	<u>4,142,111</u>

Total liabilities and net assets

\$ 7,853,967

See accompanying notes to financial statements.

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-profit Corporation)

STATEMENT OF ACTIVITIES

YEAR ENDED JUNE 30, 2013

	<u>Unrestricted</u>
REVENUES AND SUPPORT:	
Government contracts and grants	\$ 5,407,673
Program service fees	1,955,658
Contributions	26,217
Rental Income	26,126
Interest Income	1,005
Management Services Income	63,610
Total revenue and support	<u>7,480,289</u>
EXPENSES:	
Program services	6,146,694
Support services – General and administrative	<u>1,225,022</u>
Total expenses	<u>7,371,716</u>
Increase in unrestricted net assets	108,573
UNRESTRICTED NET ASSETS, beginning of year	<u>4,033,538</u>
Unrestricted net assets, end of year	<u><u>\$ 4,142,111</u></u>

See accompanying notes to financial statements.

SOCIAL MODEL RECOVERY SYSTEMS, INC
(a Not-for-profit Corporation)

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2013

CASH FLOWS FROM OPERATING ACTIVITIES:

Increase in net assets	108,573
Adjustments to reconcile increase in net assets to net cash provided by operating activities --	
Bad debt provision	92,468
Depreciation	222,797
Changes in operating assets and liabilities --	
Contracts and accounts receivable	(352,401)
Prepaid expenses	(17,408)
Accounts payable and accrued expenses	53,975
Deferred Income	165,535
Net cash provided by operating activities	<u>273,539</u>

INVESTING ACTIVITIES:

Purchase of property and equipment	<u>(45,503)</u>
Net cash used in investing activities	<u>(45,503)</u>

FINANCING ACTIVITIES:

Increase in debt service reserve funds	(638)
Proceeds from long term debt	160,000
Payments on long term debt	<u>(282,710)</u>
Net cash used in financing activities	<u>(123,348)</u>
Net increase in cash	104,688

CASH AND CASH EQUIVALENTS, beginning of year 290,516

Cash and cash equivalents, end of year \$ 395,204

SUPPLEMENTAL DISCLOSURE OF CASH FLOWS INFORMATION:

Interest paid \$ 158,284

See accompanying notes to financial statements.

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2013

Note 1 – Summary of Significant Accounting Policies

Social Model Recovery Systems, Inc (the “Organization”) is a nonprofit California corporation whose mission “envisions a world where communities can pursue social, economic, educational, and spiritual wellness free from alcohol, other drug, and mental health problems.” The Organization is known for the development of innovative model programs which break new ground, serve new target groups, and demonstrate the effectiveness of new recovery service design. The Organization’s focus is on four major areas: (1) treatment and recovery services, (2) training and technical assistance to alcohol and other drug recovery facilities, (3) development of affordable alcohol and drug-free housing, and (4) public policy, systems change, and prevention of alcohol and other drug related problems. The Organization is supported by government contracts, research grants, resident fees, and corporate and philanthropic donations.

(a) **Basis of Accounting**

The accompanying financial statements of the Organization have been prepared on the accrual basis of accounting, and accordingly, reflect all significant receivables, payables, and other liabilities.

(b) **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles 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.

(c) **Income Taxes**

The Organization has been designated as tax exempt by the Internal Revenue Service under Section 501(c)(3) of the Internal Revenue Code and is also exempt from California state tax.

The Organization follows the provisions of uncertain tax positions as addressed in FASB Accounting Standards Codification 740-10-50-15. The Organization recognized no increase in the liability for unrecognized tax benefits. The Organization has no tax position at June 30, 2013 for which the ultimate deductibility is highly uncertain and for which there is uncertainty about the timing of such deductibility. The Organization recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. No such interest or penalties were recognized during the year ended June 30, 2013.

The Organization’s Federal and State exempt organization returns for the years ended June 30, 2009 and before, are closed. Management continually evaluates expiring statutes of limitations, audits, proposed settlements, changes in tax law and new authoritative rulings.

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2013

Note 1 -- Summary of Significant Accounting Policies (Continued)

(d) **Cash and Cash Equivalents**

The Organization considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

(e) **Land, Buildings, and Equipment**

Land, buildings, and equipment are recorded at cost, if purchased, or at fair value if donated. Federal funding sources may maintain equitable interest in the property purchased with grant monies as well as the right to determine the use of any proceeds from the sale of these assets. The Federal Agencies have a reversionary interest in those assets purchased with its funds which have a cost of \$5,000 or more and an estimated useful life of at least two years. Assets purchased based on specific contracts are expensed or capitalized as required by those specific contracts.

Depreciation is computed using the straight-line method, based on the estimated useful lives of the various classes of assets, ranging from 3 to 40 years. Depreciation and amortization expense for the year ended June 30, 2013 was \$222,797.

(f) **Revenue Recognition**

Public support and revenue are recorded using the accrual method. All gifts, bequests, and other public support are included in unrestricted net assets unless specifically restricted by the donor, the terms of the gift, or grant instrument. The Organization reports gifts of cash and other assets that are received with donor restrictions that limit their use or require the passage of time as either temporarily or permanently restricted. Gifts permanently restricted by the donor, such as endowments whereby the donor has prohibited the use of the corpus, are recorded as permanently restricted net assets with earnings included as unrestricted net assets, unless specifically restricted by the donor.

(g) **Net Assets**

i **Unrestricted Net Assets**

The unrestricted net assets are utilized to record contributions, investment income, and other forms of unrestricted revenue and expenditures related to general operations of the Organization.

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2013

Note 1 – Summary of Significant Accounting Policies (Continued)

ii **Temporary Restricted Net Assets**

The temporary restricted net assets are utilized to record resources received that are temporary restricted as to the use by donor. When the restricted use has been fulfilled or expired with passage of time, the net assets of this fund are reclassified to unrestricted net assets. There were no temporarily restricted net assets at June 30, 2013.

iii **Permanently Restricted Net Assets**

The permanently restricted net assets are utilized to record resources whose use by the Organization is limited by donor-imposed stipulations that neither expires by the passage of time nor can be fulfilled or otherwise removed by actions of the Organization. There were no permanently restricted net assets at June 30, 2013.

(h) **Management Review**

The Organization evaluated subsequent events through October 30, 2013, the date which the financial statements were available to be issued.

Note 2 – Government grant receivable

The Organization participates in federal and local government grant programs to help support the services provided by the Organization. As of June 30, 2013, the amounts due from these programs were \$1,157,218.

Note 3 – Land, Buildings, and Equipment

Land, buildings, and equipment consist of the following at June 30, 2013:

Land and development cost	\$ 3,538,822
Buildings and improvements	3,438,049
Furniture, fixtures, and equipment	404,413
Automotive equipment	<u>158,153</u>
	7,539,437
Less accumulated depreciation	<u>(2,223,062)</u>
Total	<u>\$ 5,316,375</u>

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2013

Note 4 – Long-Term Debt

Long-term debt consists of the following:

(a) Loan payable to a state public instrumentality, proceeds from Bonds issued by the instrumentality were loaned to the Organization for the acquisition, improvement and furnishing of a facility. The terms of the loan call for repayment methods as if the Organization was paying the Bonds itself. The loan is secured by a deed of trust on the facility. The Bonds have interest rates ranging from 2.9% to 5.4%, commencing November 30, 2001 and extending through May 31, 2026. The Organization is required to pay into a debt service reserve fund at a monthly rate of approximately \$11,426.	\$ 1,245,000
(b) Loan payable to a state public instrumentality, proceeds from Bonds issued by the instrumentality were loaned to the Organization for the acquisition, improvement and furnishing of a facility. The terms of the loan call for repayment methods as if the Organization was paying the Bonds itself. The loan is secured by a deed of trust on the facility. The Bonds have interest rates ranging from 3.0% to 5.0%, commencing April 1, 2005 and extending through March 31, 2022. The Organization is required to pay into a debt service reserve fund at a monthly rate of approximately \$6,931.	590,000
(c) Note payable, secured by real estate, interest at 5.59% with monthly payments of principal and interest of \$15,113, maturing February, 2019.	879,079
(d) Note payable, secured by personal property, and other assets; monthly payments of \$2,995 including principal and interest at 4.60%, maturing in December 2017.	145,530
(e) Note payable to finance equipment, interest at 6.643%, monthly payments of principal and interest of \$1,228, maturing November, 2014.	<u>18,792</u>
	2,878,401
Less current portion	<u>(304,260)</u>
	<u>\$ 2,574,141</u>

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2013

Note 4 – Long-Term Debt (continued)

Aggregate principal maturities for the five years after June 30, 2013 are as follows:

Years Ending <u>June 30,</u>	
2014	\$ 304,260
2015	304,513
2016	319,336
2017	334,600
2018	337,285

Monthly payments in debt service reserve fund accounts with the Trustee (Notes 4(a) and 4(b), which are used to meet current and future bond maturities. Total monthly payments on these bonds for the five years after June 30, 2013 are as follows:

Years Ending <u>June 30,</u>	
2014	\$ 219,444
2015	213,924
2016	218,258
2017	216,395
2018	219,115

The Organization had entered into two loan agreements (herein referred to as the “Agreement(s)”) with the California Health Facilities Financing Authority (the “Authority”). Under these Agreements the Organization applied for financial assistance of the Authority to provide the refunding of the portion of the Authority’s Insured Health Facility Revenue Bond (the “Bond”) allocable to the Organization. Terms of the Agreements are set forth in the Indenture by and between the Authority and the U.S. Bank National Association (herein referred as the “Trustee”). Pursuant to the Indentures, the Authority has authorized the issuance of the Bonds in the aggregate amounts of \$22,545,000 and \$6,085,000, of which the portions allocated to the Organization were \$955,000 and \$1,890,000, respectively.

The Agreement for the \$955,000 loan requires the Organization to comply with certain covenants, which include the maintenance of certain financial ratios and benchmarks. The Agreement also provides for an event of default if a determination is made by the Authority or the Trustee that the Organization’s financial condition is unsatisfactory. For the year ended June 30, 2013, the Organization had complied with significantly all the terms of the Agreement, including its monthly obligations for debt service which requires it to maintain a defined debt service coverage ratio.

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2013

Note 5 – Concentrations of Credit Risk Arising from Cash Deposits in Excess of Insured Limits

The Organization maintains its cash balances at financial institutions located in Southern California. The balances are insured by the Federal Deposit Insurance Corporation up to \$250,000. At June 30, 2013, there were no uninsured cash balances.

Note 6 – Retirement Plan

The Organization maintains a 401(k) profit sharing plan. Full-time employees and regular part-time employees are eligible to participate in the Plan from date of hire. The Plan provides for voluntary contributions by employees and voluntary employer contributions for employees attaining one year of employment. The Organization contributed \$52,500 on behalf of its eligible employees during the year ended June 30, 2013.

Note 7 -- Commitments

The Organization has entered into several non-cancellable operating lease arrangements for facilities and equipment. The Organization also has a number of month-month leases for various properties.

Future minimum payments for the leases:

Year Ended <u>June 30,</u>	
2014	\$ 139,574
2015	141,024
2016	142,505
2017	142,430
2018	59,692

Rent expense for the year ended June 30, 2012 was \$304,285.

Note 8 – Related Party Transactions

Effective April 1, 2013, the Organization entered into an agreement to provide management, accounting, and human resources services to a related non-profit organization. The agreement has an initial term of one year and thereafter will be on a monthly basis, with either party having the option to terminate the agreement if at least 30 days written notice is given. The Organization received \$63,485 in management fees during the year ended June 30, 2013. In addition, the related non-profit organization prepaid its obligation under the contract for the next fiscal year in the amount of \$165,535, which is shown as deferred income, included with current liabilities, on the statement of financial position at June 30, 2013.

SOCIAL MODEL RECOVERY SYSTEMS, INC.

(a Not-for-Profit Corporation)

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2013

<u>Federal Grantor/Pass-Through Grantor/ Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Entity Identifying Number</u>	<u>Federal Expenditures</u>
Department of Health and Human Services Pass-Through Programs from:			
<i>Mental Health Cluster</i>			
State of California / County of Orange	93.959	CT-042 10010206	<u>\$ 644,758</u>
<i>Drug & Alcohol Cluster</i>			
State of California / County of Los Angeles - Prevention	93.959	PH-002275	941,031
State of California / County of Los Angeles - Prevention	93.959	PH-002028	200,000
State of California / County of Los Angeles - Prevention	93.959	PH-002386	100,000
State of California / County of Los Angeles - Outpatient	93.558	PH-1827A	46,704
State of California / County of Los Angeles - Outpatient	93.959	PH-1235A	82,491
State of California / County of Los Angeles - Outpatient	93.959	PH-1235B	19,063
State of California / County of Los Angeles - Outpatient	93.558	PH-1235A-1	4,374
State of California / County of Los Angeles - Outpatient	93.558	PH-001216	2,427
			<u>1,396,090</u>
Total Department of Health and Human Services			<u><u>2,040,848</u></u>
Total Expenditures of Federal Awards			<u><u>\$ 2,040,848</u></u>

See accompanying notes to schedule.

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2013

Note 1 – Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the “Schedule”) includes the federal grant activities of the Organization and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profits Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Note 2 – Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through entity identifying numbers are presented where available.

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

SINGLE AUDIT REPORTS

FOR THE YEAR ENDED JUNE 30, 2013

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

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DILLON & AVEDESIAN/ACCOUNTANCY CORPORATION

CERTIFIED PUBLIC ACCOUNTANTS

260 S. LOS ROBLES, SUITE 218
PASADENA, CA 91101

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors,

Social Model Recovery Systems, Inc.
Covina, California

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Social Model Recovery Systems, Inc. (a nonprofit corporation), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 30, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Social Model Recovery Systems, Inc.'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Social Model Recovery Systems, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

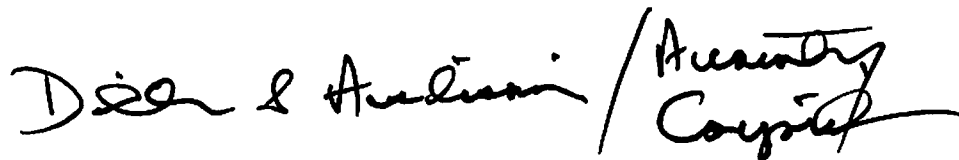
INDEPENDENT AUDITORS' REPORT (continued)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Social Model Recovery Systems, Inc.'s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Organization's internal control or on compliance. This report is an integral part of an audit performed with in accordance with *Government Auditing Standards* in considering the Organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink, reading "Dier & Audiman / Accountants & Counselors". The signature is written in a cursive style and is positioned above the date and location information.

October 30, 2013

Pasadena, California

DILLON & AVEDISSIAN/ACCOUNTANCY CORPORATION

CERTIFIED PUBLIC ACCOUNTANTS

260 S. LOS ROBLES, SUITE 218
PASADENA, CA 91101

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REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

INDEPENDENT AUDITORS' REPORT

To the Board of Directors,

Social Model Recovery Systems, Inc.
Covina, California

Report on Compliance for Each Major Federal Program

We have audited Social Model Recovery Systems, Inc.'s compliance with the types of compliance requirements described in *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Social Model Recovery Systems, Inc.'s major federal programs for the year ended June 30, 2013. Social Model Recovery Systems, Inc.'s major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Social Model Recovery Systems, Inc.'s major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Social Model Recovery Systems, Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Social Model Recovery Systems, Inc.'s compliance.

INDEPENDENT AUDITORS' REPORT (continued)

Opinion on Each Major Federal Program

In our opinion, Social Model Recovery Systems, Inc. complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

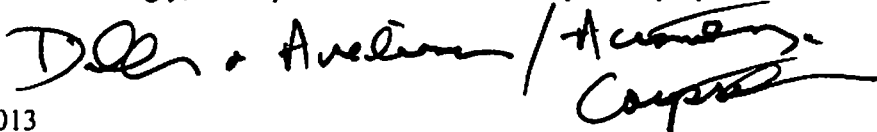
Report on Internal Control Over Compliance

Management of Social Model Recovery Systems, Inc. is responsible for establishing and maintaining effective internal control over compliance and the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Social Model Recovery Systems, Inc.'s internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Social Model Recovery Systems, Inc.'s internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

This purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.



October 30, 2013

Pasadena, California

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2013

SECTION I – SUMMARY OF AUDITOR’S RESULTS

Financial Statements

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? No
- Significant deficiencies identified that are not considered to be material weakness(es)? No

Noncompliance material to financial statements noted? No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? No
- Significant deficiencies identified that are not considered to be material weakness(es)? No

Type of auditor’s report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? No

Identification of major programs:

- CFDA No. 93.959 – CT-042 10010206 – Mental Health Services
- CFDA No 93.959 – PH-002275 - Prevention
- CFDA No. 93959 – PH-002386 - Prevention
- CFDA No. 93.959 – PH-002028 – Prevention
- CFDA No. 93.959 – PH-1235A & B - Outpatient

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? Yes

SOCIAL MODEL RECOVERY SYSTEMS, INC.
(a Not-for-Profit Corporation)

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)

YEAR ENDED JUNE 30, 2013

SECTION II – FINANCIAL STATEMENT FINDINGS – CURRENT YEAR

There were no federal award findings.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS – CURRENT YEAR

There were no federal award findings or questioned costs.

SECTION IV – FINANCIAL STATEMENT FINDINGS – PRIOR YEAR

There were no federal award findings.

SECTION V – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS – PRIOR YEAR

There were no federal award findings or questioned costs.

APPENDIX C

FINANCIAL REPORTS OF THE CONFIRMING BANK

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**Federal Home Loan Bank of San Francisco
Statements of Condition**

(In millions-except par value)	December 31, 2013	December 31, 2012
Assets:		
Cash and due from banks	\$ 4,906	\$ 104
Securities purchased under agreements to resell	—	1,500
Federal funds sold	7,498	10,857
Trading securities ^(a)	3,208	3,191
Available-for-sale securities ^(a)	7,047	7,604
Held-to-maturity securities (fair values were \$17,352 and \$17,584, respectively) ^(b)	17,507	17,376
Advances (includes \$7,069 and \$7,390 at fair value under the fair value option, respectively)	44,395	43,750
Mortgage loans held for portfolio, net of allowance for credit losses of \$2 and \$3, respectively	905	1,289
Accrued interest receivable	81	101
Premises, software, and equipment, net	25	26
Derivative assets, net	116	529
Other assets	86	94
Total Assets	\$ 85,774	\$ 86,421
Liabilities:		
Deposits	\$ 193	\$ 227
Consolidated obligations:		
Bonds (includes \$10,115 and \$27,884 at fair value under the fair value option, respectively)	53,207	70,310
Discount notes	24,194	5,209
Total consolidated obligations	77,401	75,519
Mandatorily redeemable capital stock	2,071	4,343
Accrued interest payable	95	175
Affordable Housing Program payable	151	144
Derivative liabilities, net	47	23
Other liabilities	107	377
Total Liabilities	80,065	80,808
Commitments and Contingencies (Note 21)		
Capital:		
Capital stock—Class B—Putable (\$100 par value) issued and outstanding:		
35 shares and 42 shares, respectively	3,460	4,160
Unrestricted retained earnings	317	246
Restricted retained earnings	2,077	2,001
Total Retained Earnings	2,394	2,247
Accumulated other comprehensive income/(loss)	(145)	(794)
Total Capital	5,709	5,613
Total Liabilities and Capital	\$ 85,774	\$ 86,421

(a) At December 31, 2013, and December 31, 2012, none of these securities were pledged as collateral that may be repledged.

(b) At December 31, 2013, none of these securities were pledged as collateral that may be repledged. At December 31, 2012, \$2 of these securities were pledged as collateral that may be repledged.

The accompanying notes are an integral part of these financial statements.

**Federal Home Loan Bank of San Francisco
Statements of Income**

(In millions)	For the Years Ended December 31,		
	2013	2012	2011
Interest Income:			
Advances	\$ 340	\$ 520	\$ 692
Prepayment fees on advances, net	5	65	17
Securities purchased under agreements to resell	1	5	—
Federal funds sold	15	12	22
Trading securities	7	22	25
Available-for-sale securities	276	317	238
Held-to-maturity securities	392	476	679
Mortgage loans held for portfolio	50	77	113
Total Interest Income	1,086	1,494	1,786
Interest Expense:			
Consolidated obligations:			
Bonds	432	574	707
Discount notes	17	21	34
Mandatorily redeemable capital stock	155	51	12
Total Interest Expense	604	646	753
Net Interest Income	482	848	1,033
Provision for/(reversal of) credit losses on mortgage loans	(1)	(1)	4
Net Interest Income After Mortgage Loan Loss Provision	483	849	1,029
Other Income/(Loss):			
Net gain/(loss) on trading securities	2	(11)	(7)
Total other-than-temporary impairment (OTTI) loss	(14)	(55)	(437)
Net amount of OTTI loss reclassified to/(from) accumulated other comprehensive income/(loss)	7	11	24
Net OTTI loss, credit-related	(7)	(44)	(413)
Net gain/(loss) on advances and consolidated obligation bonds held under fair value option	(23)	(15)	25
Net gain/(loss) on derivatives and hedging activities	26	(101)	(256)
Other	7	7	6
Total Other Income/(Loss)	5	(164)	(645)
Other Expense:			
Compensation and benefits	63	63	61
Other operating expense	53	52	46
Federal Housing Finance Agency	7	12	10
Office of Finance	5	5	6
Other	—	2	3
Total Other Expense	128	134	126
Income/(Loss) Before Assessments	360	551	258
REFCORP	—	—	17
Affordable Housing Program	52	60	25
Total Assessments	52	60	42
Net Income/(Loss)	\$ 308	\$ 491	\$ 216

The accompanying notes are an integral part of these financial statements.

**Federal Home Loan Bank of San Francisco
Statements of Comprehensive Income**

(In millions)	For the Years Ended December 31,		
	2013	2012	2011
Net Income/(Loss)	\$ 308	\$ 491	\$ 216
Other Comprehensive Income/(Loss):			
Net change in pension and postretirement benefits	5	—	(5)
Net unrealized gain/(loss) on available-for-sale securities	—	(1)	3
Net non-credit-related OTTI loss on available-for-sale securities:			
Non-credit-related OTTI loss transferred from held-to-maturity securities	(4)	(28)	(2,672)
Net change in fair value of other-than-temporarily impaired securities	644	1,102	810
Reclassification of non-credit-related OTTI loss included in net income/(loss)	(3)	14	26
Total net non-credit-related OTTI loss on available-for-sale securities	637	1,088	(1,836)
Net non-credit-related OTTI loss on held-to-maturity securities:			
Non-credit-related OTTI loss	(4)	(25)	(207)
Reclassification of non-credit-related OTTI loss transferred to available-for-sale securities	—	—	157
Accretion of non-credit-related OTTI loss	7	9	266
Non-credit-related OTTI loss transferred to available-for-sale securities	4	28	2,672
Total net non-credit-related OTTI loss on held-to-maturity securities	7	12	2,888
Total other comprehensive income/(loss)	649	1,099	1,050
Total Comprehensive Income/(Loss)	\$ 957	\$ 1,590	\$ 1,266

The accompanying notes are an integral part of these financial statements.

Federal Home Loan Bank of San Francisco
Statements of Capital Accounts

(In millions)	Capital Stock Class B—Putable		Retained Earnings			Accumulated Other Comprehensive Income/(Loss)	Total Capital
	Shares	Par Value	Restricted	Unrestricted	Total		
Balance, December 31, 2010	83	\$ 8,282	\$ 1,609	\$ —	\$ 1,609	\$ (2,943)	\$ 6,948
Issuance of capital stock	2	244					244
Repurchase of capital stock	(10)	(1,043)					(1,043)
Capital stock reclassified from/(to) mandatorily redeemable capital stock, net	(27)	(2,688)					(2,688)
Comprehensive income/(loss)			194	22	216	1,050	1,266
Cash dividends paid on capital stock (0.29%)				(22)	(22)		(22)
Balance, December 31, 2011	48	\$ 4,795	\$ 1,803	\$ —	\$ 1,803	\$ (1,893)	\$ 4,705
Issuance of capital stock	3	266					266
Repurchase of capital stock	(9)	(864)					(864)
Capital stock reclassified from/(to) mandatorily redeemable capital stock, net	—	(37)					(37)
Comprehensive income/(loss)			198	293	491	1,099	1,590
Cash dividends paid on capital stock (0.97%)				(47)	(47)		(47)
Balance, December 31, 2012	42	\$ 4,160	\$ 2,001	\$ 246	\$ 2,247	\$ (794)	\$ 5,613
Issuance of capital stock	5	530					530
Repurchase of capital stock	(12)	(1,226)					(1,226)
Capital stock reclassified from/(to) mandatorily redeemable capital stock, net	—	(4)					(4)
Comprehensive income/(loss)			76	232	308	649	957
Cash dividends paid on capital stock (3.99%)				(161)	(161)		(161)
Balance, December 31, 2013	35	\$ 3,460	\$ 2,077	\$ 317	\$ 2,394	\$ (145)	\$ 5,709

The accompanying notes are an integral part of these financial statements.

Federal Home Loan Bank of San Francisco
Statements of Cash Flows

(In millions)	For the Years Ended December 31,		
	2013	2012	2011
Cash Flows from Operating Activities:			
Net Income/(Loss)	\$ 308	\$ 491	\$ 216
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:			
Depreciation and amortization	(68)	(32)	(76)
Provision for/(reversal of) credit losses on mortgage loans	(1)	(1)	4
Change in net fair value adjustment on trading securities	(2)	11	7
Change in net fair value adjustment on advances and consolidated obligation bonds held under the fair value option	23	15	(25)
Change in net derivatives and hedging activities	7	42	269
Net OTTI loss, credit-related	7	44	413
Other adjustments	—	—	(3)
Net change in:			
Accrued interest receivable	21	86	59
Other assets	(8)	(10)	26
Accrued interest payable	(85)	(66)	(231)
Other liabilities	18	2	(77)
Total adjustments	(88)	91	366
Net cash provided by/(used in) operating activities	220	582	582
Cash Flows from Investing Activities:			
Net change in:			
Interest-bearing deposits	(128)	28	—
Securities purchased under agreements to resell	1,500	(1,500)	—
Federal funds sold	3,359	(5,491)	10,946
Premises, software, and equipment	(8)	(7)	(12)
Trading securities:			
Proceeds from maturities of long-term	236	2,548	864
Purchases of long-term	(525)	(2,666)	(1,160)
Available-for-sale securities:			
Proceeds from maturities of long-term	1,283	3,208	836
Held-to-maturity securities:			
Net (increase)/decrease in short-term	79	3,602	3,999
Proceeds from maturities of long-term	3,927	4,397	4,580
Purchases of long-term	(4,193)	(4,014)	(6,145)
Advances:			
Principal collected	529,782	361,716	255,620
Made to members	(530,789)	(337,460)	(228,146)
Mortgage loans held for portfolio:			
Principal collected	379	540	555
Proceeds from sales of foreclosed assets	4	3	—
Net cash provided by/(used in) investing activities	4,906	24,904	41,937

**Federal Home Loan Bank of San Francisco
Statements of Cash Flows (continued)**

(In millions)	For the Years Ended December 31,		
	2013	2012	2011
Cash Flows from Financing Activities:			
Net change in:			
Deposits	273	(360)	(312)
Net (payments)/proceeds on derivative contracts with financing elements	66	48	60
Net proceeds from issuance of consolidated obligations:			
Bonds	29,195	53,478	56,156
Discount notes	107,252	49,244	56,361
Bonds transferred from another Federal Home Loan Bank	122	—	15
Payments for matured and retired consolidated obligations:			
Bonds	(45,827)	(66,189)	(93,645)
Discount notes	(88,272)	(63,180)	(56,735)
Proceeds from issuance of capital stock	530	266	244
Payments for repurchase/redemption of mandatorily redeemable capital stock	(2,276)	(1,272)	(859)
Payments for repurchase of capital stock	(1,226)	(864)	(1,043)
Cash dividends paid	(161)	(47)	(22)
Net cash provided by/(used in) financing activities	(324)	(28,876)	(39,780)
Net increase/(decrease) in cash and due from banks	4,802	(3,390)	2,739
Cash and due from banks at beginning of the period	104	3,494	755
Cash and due from banks at end of the period	\$ 4,906	\$ 104	\$ 3,494
Supplemental Disclosures:			
Interest paid	\$ 520	\$ 627	\$ 935
Affordable Housing Program payments	45	66	49
REFCORP payments	—	—	54
Supplemental Disclosures of Noncash Investing Activities:			
Transfers of mortgage loans to real estate owned	4	5	5
Transfers of other-than-temporarily impaired held-to-maturity securities to available-for-sale securities	72	140	7,940

The accompanying notes are an integral part of these financial statements.

Federal Home Loan Bank of San Francisco
Notes to Financial Statements
(Unaudited)

(Dollars in millions except per share amounts)

Background Information

The Federal Home Loan Bank of San Francisco (Bank), a federally chartered corporation exempt from ordinary federal, state, and local taxation except real property taxes, is one of 12 District Federal Home Loan Banks (FHLBanks). The FHLBanks are government-sponsored enterprises (GSEs) that serve the public by enhancing the availability of credit for residential mortgages and targeted community development by providing a readily available, competitively priced source of funds to their member institutions. Each FHLBank is operated as a separate entity with its own management, employees, and board of directors. The Bank does not have any special purpose entities or any other type of off-balance sheet conduits. The Bank has a cooperative ownership structure. To access the Bank's products and services, a financial institution must be approved for membership and purchase capital stock in the Bank. The member's capital stock requirement is generally based on its use of Bank products, subject to a minimum asset-based membership requirement that is intended to reflect the value to the member of having ready access to the Bank as a reliable source of competitively priced funds. Bank capital stock is issued, transferred, redeemed, and repurchased at its par value of \$100 per share, subject to certain regulatory and statutory limits. It is not publicly traded. All shareholders may receive dividends on their capital stock, to the extent declared by the Bank's Board of Directors. Regulated financial depositories and insurance companies engaged in residential housing finance, with principal places of business located in Arizona, California, and Nevada, are eligible to apply for membership. In addition, authorized community development financial institutions are eligible to be members of the Bank. All members are required to purchase capital stock in the Bank. State and local housing authorities that meet certain statutory criteria may also borrow from the Bank. While eligible to borrow, these housing authorities are not members of the Bank, and, as such, are not required to hold capital stock.

The Bank conducts business with members in the normal course of business. See Note 22 – Transactions with Certain Members, Certain Nonmembers, and Other FHLBanks for more information.

The Federal Housing Finance Agency (Finance Agency), an independent federal agency in the executive branch of the United States government, supervises and regulates the FHLBanks and the FHLBanks' Office of Finance.

The Office of Finance is a joint office of the FHLBanks that facilitates the issuance and servicing of the debt instruments (consolidated obligations) of the FHLBanks and prepares the combined quarterly and annual financial reports of all 12 FHLBanks.

The primary source of funds for the FHLBanks is the proceeds from the sale to the public of the FHLBanks' consolidated obligations through the Office of Finance using authorized securities dealers. As provided by the Federal Home Loan Bank Act of 1932, as amended (FHLBank Act), or regulations governing the operations of the FHLBanks, all the FHLBanks have joint and several liability for all FHLBank consolidated obligations. Other funds are provided by deposits, other borrowings, and the issuance of capital stock to members. The Bank primarily uses these funds to provide advances to members.

Note 1 — Summary of Significant Accounting Policies

Use of Estimates. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make a number of judgments, estimates, and assumptions that may affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of income, expenses, gains, and losses during the reporting period. The most significant of these estimates include estimating the allowance for credit losses on the advances and mortgage loan portfolios; accounting for derivatives; estimating fair values of investments classified as trading and available-for-sale, derivatives and associated hedged items carried at fair value in accordance with the accounting for derivative instruments and associated hedging activities, and financial instruments carried at fair

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

value under the fair value option, and accounting for other-than-temporary impairment for investment securities; and estimating the prepayment speeds on mortgage-backed securities (MBS) and mortgage loans for the accounting of amortization of premiums and accretion of discounts on MBS and mortgage loans. Actual results could differ significantly from these estimates.

Estimated Fair Values. Many of the Bank's financial instruments lack an available liquid trading market as characterized by frequent exchange transactions between a willing buyer and willing seller. Therefore, the Bank uses financial models employing significant assumptions and present value calculations for the purpose of determining estimated fair values. Thus, the fair values may not represent the actual values of the financial instruments that could have been realized as of yearend or that will be realized in the future.

Fair values for certain financial instruments are based on quoted prices, market rates, or replacement rates for similar financial instruments as of the last business day of the year. The estimated fair values of the Bank's financial instruments and related assumptions are detailed in Note 20 – Fair Value.

Securities Purchased under Agreements to Resell. These investments provide short-term liquidity and are carried at cost. The Bank treats securities purchased under agreements to resell as collateralized financing arrangements because they effectively represent short-term loans with investment-grade counterparties, which are classified as assets in the Statements of Condition. Securities purchased under agreements to resell are held in safekeeping in the name of the Bank by third-party custodians approved by the Bank. In accordance with the terms of these loans, if the fair value of the underlying securities decreases below the fair value required as collateral, the counterparty must place an equivalent amount of additional securities as collateral or remit an equivalent amount of cash. If an agreement to resell is deemed to be impaired, the difference between the fair value of the collateral and the amortized cost of the agreement is charged to earnings.

Federal Funds Sold. These investments provide short-term liquidity and are carried at cost. The Bank invests in Federal funds sold with highly rated counterparties, and such investments are only evaluated for purposes of an allowance for credit losses if the investment is not paid when due. All investments in Federal funds sold as of December 31, 2013 and 2012, were repaid according to the contractual terms.

Investment Securities. The Bank classifies investments as trading, available-for-sale (AFS), or held-to-maturity (HTM) at the date of acquisition. Purchases and sales of securities are recorded on a trade date basis.

The Bank classifies certain investments as trading. These securities are held for liquidity purposes and carried at fair value with changes in the fair value of these investments recorded in other income. The Bank does not participate in speculative trading practices and holds these investments indefinitely as the Bank periodically evaluates its liquidity needs.

The Bank classifies certain securities as AFS and carries these securities at their fair value. Unrealized gains and losses on these securities are recognized in accumulated other comprehensive income (AOCI).

HTM securities are carried at cost, adjusted for periodic principal repayments; amortization of premiums and accretion of discounts; and previous OTTI recognized in net income and AOCI. The Bank classifies these investments as HTM securities because the Bank has the positive intent and ability to hold these securities until maturity.

Certain changes in circumstances may cause the Bank to change its intent to hold a certain security to maturity without calling into question its intent to hold other debt securities to maturity in the future. Thus, the sale or transfer of an HTM security because of certain changes in circumstances, such as evidence of significant deterioration in the issuer's creditworthiness or changes in regulatory requirements, is not considered to be inconsistent with its original classification. Other events that are isolated, nonrecurring, and unusual for the Bank that could not have been reasonably anticipated may cause the Bank to sell or transfer an HTM security without

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

necessarily calling into question its intent to hold other debt securities to maturity. In addition, sales of debt securities that meet either of the following two conditions may be considered as maturities for purposes of the classification of securities: (i) the sale occurs near enough to its maturity date (or call date if exercise of the call is probable) that interest rate risk is substantially eliminated as a pricing factor and changes in market interest rates would not have a significant effect on the security's fair value, or (ii) the sale occurs after the Bank has already collected a substantial portion (at least 85%) of the principal outstanding at acquisition because of prepayments on the debt security or scheduled payments on a debt security payable in equal installments (both principal and interest) over its term.

The Bank calculates the amortization of purchased premiums and accretion of purchased discounts on investments using the level-yield method on a retrospective basis over the estimated life of the securities. This method requires a retrospective adjustment of the effective yield each time the Bank changes the estimated life as if the new estimate had been known since the original acquisition date of the securities. The Bank uses nationally recognized, market-based, third-party prepayment models to project estimated lives.

On a quarterly basis, the Bank evaluates its individual AFS and HTM investment securities in an unrealized loss position for OTTI. A security is considered impaired when its fair value is less than its amortized cost basis. For impaired debt securities, an entity is required to assess whether: (i) it has the intent to sell the debt security; (ii) it is more likely than not that it will be required to sell the debt security before its anticipated recovery of the remaining amortized cost basis of the security; or (iii) it does not expect to recover the entire amortized cost basis of the impaired debt security. If any of these conditions is met, an OTTI on the security must be recognized.

With respect to any debt security, a credit loss is defined as the amount by which the amortized cost basis exceeds the present value of the cash flows expected to be collected. If a credit loss exists but the entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before the anticipated recovery of its remaining amortized cost basis (the amortized cost basis less any current-period credit loss), the carrying value of the debt security is adjusted to its fair value. However, instead of recognizing the entire difference between the amortized cost basis and fair value in earnings, only the amount of the impairment representing the credit loss is recognized in earnings, while the amount of non-credit-related impairment is recognized in AOCI. The total OTTI is presented in the Statements of Income with an offset for the amount of the total OTTI that is recognized in AOCI. This presentation provides additional information about the amounts that the entity does not expect to collect related to a debt security. The credit loss on a debt security is limited to the amount of that security's unrealized losses.

For subsequent accounting of other-than-temporarily impaired securities, if the present value of cash flows expected to be collected is less than the amortized cost basis, the Bank records an additional OTTI. The amount of total OTTI for a security that was previously impaired is calculated as the difference between its amortized cost less the amount of OTTI recognized in AOCI prior to the determination of OTTI and its fair value. For an other-than-temporarily impaired security that was previously impaired and has subsequently incurred an additional OTTI related to credit loss (limited to that security's unrealized losses), this additional credit-related OTTI, up to the amount in AOCI, would be reclassified out of non-credit-related OTTI in AOCI and charged to earnings. Any credit loss in excess of the related AOCI is charged to earnings.

Subsequent related increases and decreases (if not an OTTI) in the fair value of AFS securities will be netted against the non-credit component of OTTI previously recognized in AOCI.

For securities classified as HTM, the OTTI recognized in AOCI is accreted to the carrying value of each security on a prospective basis, based on the amount and timing of future estimated cash flows (with no effect on earnings unless the security is subsequently sold or there are additional decreases in cash flows expected to be collected). For securities classified as AFS, the Bank does not accrete the OTTI recognized in AOCI to the carrying value because the subsequent measurement basis for these securities is fair value.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

For securities previously identified as other-than-temporarily impaired, the Bank updates its estimate of future estimated cash flows on a regular basis. If there is no additional impairment on the security, the yield of the security is adjusted on a prospective basis when there is a significant increase in the expected cash flows. This accretion is included in net interest income in the Statements of Income.

Financial Instruments Meeting Netting Requirements. The Bank presents certain financial instruments, including derivative instruments and securities purchased under agreements to resell, on a net basis when they have a legal right of offset and all other requirements for netting are met (collectively referred to as the netting requirements). The Bank has elected to offset its derivative asset and liability positions, as well as cash collateral received or pledged, when the netting requirements are met. The Bank did not have any offsetting liabilities related to its securities purchased under agreements to resell for the periods presented.

The net exposure for these financial instruments can change on a daily basis; therefore, there may be a delay between the time this exposure change is identified and additional collateral is requested, and the time this collateral is received or pledged. Likewise, there may be a delay for excess collateral to be returned. For derivative instruments that meet the netting requirements, any excess cash collateral received or pledged is recognized as a derivative liability or derivative asset. Additional information regarding these agreements is provided in Note 19 – Derivatives and Hedging Activities. Based on the fair value of the related collateral held, the securities purchased under agreements to resell were fully collateralized for the periods presented.

Variable Interest Entities. The Bank's investments in variable interest entities (VIEs) are limited to private-label residential mortgage-backed securities (PLRMBS). On an ongoing basis, the Bank performs a quarterly evaluation to determine whether it is the primary beneficiary in any VIE. The Bank evaluated its investments in VIEs as of December 31, 2013, to determine whether it is a primary beneficiary of any of these investments. The primary beneficiary is required to consolidate a VIE. The Bank determined that consolidation accounting is not required because the Bank is not the primary beneficiary of these VIEs for the periods presented. The Bank does not have the power to significantly affect the economic performance of any of these investments because it does not act as a key decision maker nor does it have the unilateral ability to replace a key decision maker. In addition, the Bank does not design, sponsor, transfer, service, or provide credit or liquidity support in any of its investments in VIEs. The Bank's maximum loss exposure for these investments is limited to the carrying value.

Advances. The Bank reports advances (loans to members, former members or their successors, or housing associates) either at amortized cost or at fair value when the fair value option is elected. Advances carried at amortized cost are reported net of premiums, discounts (including discounts related to the Affordable Housing Program), and hedging adjustments. The Bank amortizes premiums and accretes discounts and recognizes hedging adjustments resulting from the discontinuation of a hedging relationship to interest income using a level-yield methodology. Interest on advances is credited to income as earned. For advances carried at fair value, the Bank recognizes contractual interest in interest income.

Advance Modifications. In cases in which the Bank funds an advance concurrent with or within a short period of time before or after the prepayment of a previous advance to the same member, the Bank evaluates whether the subsequent advance meets the accounting criteria to qualify as a modification of an existing advance or whether it constitutes a new advance. The Bank compares the present value of the cash flows on the subsequent advance to the present value of the cash flows remaining on the previous advance. If there is at least a 10 percent difference in the present value of the cash flows or if the Bank concludes that the difference between the advances is more than minor based on a qualitative assessment of the modifications made to the previous advance's contractual terms, then the subsequent advance is accounted for as a new advance. In all other instances, the subsequent advance is accounted for as a modification.

Prepayment Fees. When a borrower prepays certain advances prior to the original maturity, the Bank may charge the borrower a prepayment fee. For certain advances with partial prepayment symmetry, the Bank may charge the

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

borrower a prepayment fee or pay the borrower a prepayment credit, depending on certain circumstances, such as movements in interest rates, when the advance is prepaid.

For prepaid advances that are hedged and meet the hedge accounting requirements, the Bank terminates the hedging relationship upon prepayment and records the associated fair value gains and losses, adjusted for the prepayment fees, in interest income. If a new advance represents a modification of an original hedged advance, the fair value gains or losses on the advance and the prepayment fees are included in the carrying amount of the modified advance, and gains or losses and prepayment fees are amortized in interest income over the life of the modified advance using the level-yield method. If the modified advance is also hedged and the hedge meets the hedge accounting requirements, the modified advance is marked to fair value after the modification, and subsequent fair value changes are recorded in other income. If the prepayment represents an extinguishment of the original hedged advance, the prepayment fee and any fair value gain or loss are immediately recognized in interest income.

For prepaid advances that are not hedged or that are hedged but do not meet the hedge accounting requirements, the Bank records prepayment fees in interest income unless the Bank determines that the new advance represents a modification of the original advance. If the new advance represents a modification of the original advance, the prepayment fee on the original advance is deferred, recorded in the basis of the modified advance, and amortized over the life of the modified advance using the level-yield method. This amortization is recorded in interest income.

Mortgage Loans Held in Portfolio. Under the Mortgage Partnership Finance® (MPF®) Program, the Bank purchased conventional conforming fixed rate residential mortgage loans from its participating members. (“Mortgage Partnership Finance” and “MPF” are registered trademarks of the FHLBank of Chicago.) Participating members originated or purchased the mortgage loans, credit-enhanced them and sold them to the Bank, and generally retained the servicing of the loans. The Bank manages the interest rate risk, prepayment risk, and liquidity risk of each loan in its portfolio. The Bank and the participating institution (either the original participating member that sold the loans to the Bank or a successor to that member) share in the credit risk of the loans, with the Bank assuming the first loss obligation limited by the first loss account, and the participating institution assuming credit losses in excess of the first loss account, up to the amount of the credit enhancement obligation specified in the master agreement. The amount of the credit enhancement was originally calculated so that any Bank credit losses (excluding special hazard losses) in excess of the first loss account were limited to those that would be expected from an equivalent investment with a long-term credit rating of AA.

For taking on the credit enhancement obligation, the Bank pays the participating institution a credit enhancement fee, which is calculated on the remaining unpaid principal balance of the mortgage loans. Depending on the specific MPF product, all or a portion of the credit enhancement fee is paid monthly beginning with the month after each delivery of loans. The MPF Plus product also provides for a performance-based credit enhancement fee, which accrues monthly, beginning with the month after each delivery of loans, and is paid to the participating institution beginning 12 months later. The performance-based credit enhancement fee will be reduced by an amount equivalent to loan losses up to the amount of the first loss account established for each master commitment. The participating institutions obtained supplemental mortgage insurance (SMI) to cover their credit enhancement obligations under this product. If the SMI provider's claims-paying ability rating falls below a specified level, the participating institution has six months to either replace the SMI policy or assume the credit enhancement obligation and fully collateralize the obligation; otherwise the Bank may choose not to pay the participating institution its performance-based credit enhancement fee.

The Bank classifies mortgage loans as held for investment and, accordingly, reports them at their principal amount outstanding net of unamortized premiums, discounts, and unrealized gains and losses from loans initially classified as mortgage loan commitments. The Bank defers and amortizes these amounts as interest income using the level-yield method on a retrospective basis over the estimated life of the related mortgage loan. Actual prepayment experience and estimates of future principal prepayments are used in calculating the estimated life of the mortgage loans. The Bank aggregates the mortgage loans by similar characteristics (type, maturity, note rate, and acquisition date) in determining prepayment estimates. A retrospective adjustment is required each time the Bank changes the

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

estimated amounts as if the new estimate had been known since the original acquisition date of the assets. The Bank uses nationally recognized, market-based, third-party prepayment models to project estimated lives.

The Bank records credit enhancement fees as a reduction to interest income.

Allowance for Credit Losses. An allowance for credit losses is a valuation allowance separately established for each identified portfolio segment, if it is probable that impairment has occurred in the Bank's portfolio as of the Statements of Condition date and the amount of loss can be reasonably estimated. To the extent necessary, an allowance for credit losses for off-balance sheet credit exposures is recorded as a liability.

Portfolio Segments. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. The Bank has developed and documented a systematic methodology for determining an allowance for credit losses for each applicable portfolio segment. See Note 10 - Allowance for Credit Losses for more information.

Allowance for Credit Losses on Credit Products. Following the requirements of the FHLBank Act, the Bank obtains sufficient collateral for credit products to protect the Bank from credit losses. Under the FHLBank Act, collateral eligible to secure credit products includes certain investment securities, residential mortgage loans, cash or deposits with the Bank, and other eligible real estate-related assets. As more fully discussed in Note 10 – Allowance for Credit Losses, the Bank may also accept secured small business, small farm, and small agribusiness loans, and securities representing a whole interest in such secured loans, as collateral from members that are community financial institutions. The Housing and Economic Recovery Act of 2008 (Housing Act) defines community financial institutions as Federal Deposit Insurance Corporation (FDIC)-insured depository institutions with average total assets over the preceding three-year period of \$1,000 or less, to be adjusted for inflation annually by the Finance Agency. The average total asset cap for 2013 was \$1,095. The Bank has never experienced any credit losses on any of its credit products. The Bank evaluates the creditworthiness of its members and nonmember borrowers on an ongoing basis.

The Bank classifies as impaired any advance with respect to which the Bank believes it is probable that all principal and interest due will not be collected according to its contractual terms. Impaired advances are valued using the present value of expected future cash flows discounted at the advance's effective interest rate, the advance's observable market price or, if collateral-dependent, the fair value of the advance's underlying collateral. When an advance is classified as impaired, the accrual of interest is discontinued and unpaid accrued interest is reversed. Advances do not return to accrual status until they are brought current with respect to both principal and interest and until the Bank believes future principal payments are no longer in doubt. No advances were classified as impaired during the periods presented.

Based on the collateral pledged as security, the Bank's credit analyses of members' financial condition, and the Bank's credit extension and collateral policies as of December 31, 2013, the Bank expects to collect all amounts due according to the contractual terms. Therefore, no allowance for losses on credit products was deemed necessary by the Bank. The Bank has never experienced any credit losses on its credit products.

Allowance for Credit Losses on Mortgage Loans. The Bank bases the allowance for credit losses on mortgage loans on its estimate of probable credit losses in the Bank's mortgage loan portfolio as of the date of the Statements of Condition. The Bank performs periodic reviews of its portfolio to identify the probable losses in the portfolio and to determine the likelihood of collection of the portfolio. The overall allowance is determined by an analysis that includes delinquency statistics, past performance, current performance, loan portfolio characteristics, collateral valuations, industry data, collectability of credit enhancements from members or from mortgage insurers, and prevailing economic conditions.

Impairment Methodology on Mortgage Loans. A mortgage loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Loans that are on non-accrual status and that are considered collateral-dependent are measured for impairment based on the fair value of the underlying property less estimated selling costs. Loans are considered collateral-dependent if repayment is expected to be provided solely by the sale of the underlying property, that is, there is no other available and reliable source of repayment. Collateral-dependent loans are impaired if the fair value of the underlying collateral less estimated selling costs is insufficient to recover the unpaid principal balance on the loan. Interest income on impaired loans is recognized in the same manner as interest income on non-accrual loans noted below.

The Bank places a mortgage loan on nonaccrual status when the collection of the contractual principal or interest from the participating institution is reported 90 days or more past due. When a mortgage loan is placed on nonaccrual status, accrued but uncollected interest is reversed against interest income. The Bank records cash payments received on nonaccrual loans first as interest income and then as a reduction of principal as specified in the contractual agreement, unless the collection of the remaining principal amount due is considered doubtful. If the collection of the remaining principal amount due is considered doubtful, then cash payments received would be applied first solely to principal until the remaining principal amount due is expected to be collected and then as a recovery of any charge-off, if applicable, followed by recording interest income. A loan on non-accrual status may be restored to accrual when (1) none of its contractual principal and interest is due and unpaid, and the Bank expects repayment of the remaining contractual interest and principal, or (2) it otherwise becomes well secured and in the process of collection.

Real Estate Owned. Real estate owned (REO) includes assets that have been received in satisfaction of debt through foreclosures. REO is initially recorded at fair value less estimated selling costs and is subsequently carried at the lower of that amount or current fair value less estimated selling costs. The Bank recognizes a charge-off to the allowance for credit losses if the fair value of the REO less estimated selling costs is less than the recorded investment in the loan at the date of transfer from loans to REO. Any subsequent realized gains, realized or unrealized losses, and carrying costs are included in other non-interest expense in the Statements of Income. REO is recorded in "Other assets" in the Statements of Condition. At December 31, 2013, the Bank's other assets included \$3 of REO resulting from foreclosure of 27 mortgage loans held by the Bank. At December 31, 2012, the Bank's other assets included \$3 of REO resulting from foreclosure of 30 mortgage loans held by the Bank.

Other Fees. Letter of credit fees are recorded as other income over the term of the letter of credit.

Derivatives. All derivatives are recognized on the Statements of Condition at their fair value. The Bank has elected to report derivative assets and derivative liabilities net of cash collateral, including initial and variation margin, and accrued interest received from or pledged to futures commission merchants (clearing agents) or counterparties. The fair values of derivatives are netted by clearing agent or counterparty when the netting requirements have been met. If these netted amounts are positive, they are classified as an asset, and if negative, they are classified as a liability. Cash flows associated with derivatives are reflected as cash flows from operating activities in the Statements of Cash Flows unless the derivative meets the criteria to be a financing derivative.

Each derivative is designated as one of the following:

- (1) a qualifying hedge of the change in fair value of (i) a recognized asset or liability or (ii) an unrecognized firm commitment (a fair value hedge);
- (2) a qualifying hedge of (i) a forecasted transaction or (ii) the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge);
- (3) a non-qualifying hedge of an asset or liability for asset-liability management purposes or of certain advances and consolidated obligation bonds for which the Bank elected the fair value option (an economic hedge); or
- (4) a non-qualifying hedge of another derivative that is offered as a product to members or used to offset other derivatives with nonmember counterparties (an intermediation hedge).

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

If hedging relationships meet certain criteria, including but not limited to formal documentation of the hedging relationship and an expectation to be hedge effective, they are eligible for hedge accounting, and the offsetting changes in fair value of the hedged items attributable to the hedged risk may be recorded in earnings. The application of hedge accounting generally requires the Bank to evaluate the effectiveness of the hedging relationships at inception and on an ongoing basis and to calculate the changes in fair value of the derivatives and the related hedged items independently. This is known as the “long-haul” method of hedge accounting. Transactions that meet certain criteria qualify for the “short-cut” method of hedge accounting, in which an assumption can be made that the change in the fair value of a hedged item, because of changes in the benchmark rate, exactly offsets the change in the value of the related derivative. Under the shortcut method, the entire change in fair value of the interest rate swap is considered to be effective at achieving offsetting changes in fair values or cash flows of the hedged asset or liability.

Derivatives are typically executed at the same time as the hedged item, and the Bank designates the hedged item in a qualifying hedge relationship as of the trade date. In many hedging relationships, the Bank may designate the hedging relationship upon its commitment to disburse an advance or trade a consolidated obligation in which settlement occurs within the shortest period of time possible for the type of instrument based on market settlement conventions. The Bank records the changes in the fair value of the derivatives and the hedged item beginning on the trade date.

Changes in the fair value of a derivative that qualifies as a fair value hedge and is designated as a fair value hedge, along with changes in the fair value of the hedged asset or liability (hedged item) that are attributable to the hedged risk (including changes that reflect losses or gains on firm commitments), are recorded in other income as “Net gain/(loss) on derivatives and hedging activities.”

Changes in the fair value of a derivative that qualifies as a cash flow hedge and is designated as a cash flow hedge, to the extent that the hedge is effective, are recorded in AOCI, a component of capital, until earnings are affected by the variability of the cash flows of the hedged transaction (until the periodic recognition of interest on a variable rate asset or liability is recorded in earnings).

For both fair value and cash flow hedges, any hedge ineffectiveness (which represents the amount by which the change in the fair value of the derivative differs from the change in the fair value of the hedged item or the variability in the cash flows of the forecasted transaction) is recorded in other income as “Net gain/(loss) on derivatives and hedging activities.”

Changes in the fair value of a derivative designated as an economic hedge or an intermediation hedge are recorded in current period earnings with no fair value adjustment to an asset or liability. An economic hedge is defined as a derivative hedging certain advances and consolidated obligation bonds for which the Bank elected the fair value option, or hedging specific or non-specific underlying assets, liabilities, or firm commitments, that does not qualify or was not designated for fair value or cash flow hedge accounting, but is an acceptable hedging strategy under the Bank's risk management program. These economic hedging strategies also comply with Finance Agency regulatory requirements prohibiting speculative hedge transactions. An economic hedge introduces the potential for earnings variability caused by the changes in fair value of the derivatives that are recorded in the Bank's income but are not offset by corresponding changes in the value of the economically hedged assets, liabilities, or firm commitments. The derivatives used in intermediary activities do not qualify for hedge accounting treatment and are separately marked to market through earnings. The net result of the accounting for these derivatives does not significantly affect the operating results of the Bank. Changes in the fair value of these non-qualifying hedges are recorded in other income as “Net gain/(loss) on derivatives and hedging activities.” In addition, the interest income and interest expense associated with these non-qualifying hedges are recorded in other income as “Net gain/(loss) on derivatives and hedging activities.” Cash flows associated with these stand-alone derivatives are reflected as cash flows from operating activities in the Statements of Cash Flows unless the derivative meets the criteria to be designated as a financing derivative.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

The differences between accruals of interest receivables and payables on derivatives designated as fair value or cash flow hedges are recognized as adjustments to the interest income or interest expense of the designated underlying hedged item. The differences between accruals of interest receivables and payables on intermediated derivatives for members and other economic hedges are recognized in other income as “Net gain/(loss) on derivatives and hedging activities.”

The Bank discontinues hedge accounting prospectively when: (i) it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (ii) the derivative and/or the hedged item expires or is sold, terminated, or exercised; (iii) it is no longer probable that the forecasted transaction will occur in the originally expected period; (iv) a hedged firm commitment no longer meets the definition of a firm commitment; (v) it determines that designating the derivative as a hedging instrument is no longer appropriate; or (vi) it decides to use the derivative to offset changes in the fair value of other derivatives or instruments carried at fair value.

When hedge accounting is discontinued, the Bank either terminates the derivative or continues to carry the derivative on the Statements of Condition at its fair value, ceases to adjust the hedged asset or liability for changes in fair value, and amortizes the cumulative basis adjustment on the hedged item into earnings over the remaining life of the hedged item using a level-yield methodology.

When hedge accounting is discontinued because the Bank determines that the derivative no longer qualifies as an effective cashflow hedge of an existing hedged item, the Bank continues to carry the derivative on the Statements of Condition at its fair value and reclassifies the AOCI adjustment into earnings when earnings are affected by the existing hedged item (the original forecasted transaction).

Under limited circumstances, when the Bank discontinues cashflow hedge accounting because it is no longer probable that the forecasted transaction will occur by the end of the originally specified time period, or within the following two months, but it is probable the transaction will still occur in the future, the gain or loss on the derivative remains in AOCI and is recognized in earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within the following two months, the gains and losses that were recorded in AOCI are recognized immediately in earnings.

When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Bank continues to carry the derivative on the Statements of Condition at its fair value, removing from the Statements of Condition any asset or liability that was recorded to recognize the firm commitment and recording it as a gain or loss in current period earnings.

The Bank may be the primary obligor on consolidated obligations and may make advances in which derivative instruments are embedded. Upon execution of these transactions, the Bank assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the remaining component of the advance or debt (the host contract) and whether a separate, non-embedded instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that: (i) the embedded derivative has economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, and (ii) a separate, stand-alone instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and designated as a stand-alone derivative instrument equivalent to an economic hedge. However, the entire contract is carried on the Statements of Condition at fair value and no portion of the contract is designated as a hedging instrument if the entire contract (the host contract and the embedded derivative) is to be measured at fair value, with changes in fair value reported in current period earnings (such as an investment security classified as trading, as well as hybrid financial instruments that are eligible for the fair value option), or if the Bank cannot reliably identify and measure the embedded derivative for purposes of separating the derivative from its host contract.

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

Mandatorily Redeemable Capital Stock. The Bank reclassifies the capital stock subject to redemption from capital to a liability after a member provides the Bank with a written notice of redemption; gives notice of intention to withdraw from membership; or attains nonmember status by merger or acquisition, charter termination, or other involuntary membership termination; or after a receiver or other liquidating agent for a member transfers the member's Bank capital stock to a nonmember entity, resulting in the member's shares then meeting the definition of a mandatorily redeemable financial instrument. Shares meeting this definition are reclassified to a liability at fair value. Dividends declared on shares classified as a liability are accrued at the expected dividend rate and reflected as interest expense in the Statements of Income. The repayment of these mandatorily redeemable financial instruments (by repurchase or redemption of the shares) is reflected as a financing cash outflow in the Statements of Cash Flows once settled. See Note 16 – Capital for more information.

If a member cancels its written notice of redemption or notice of withdrawal or if the Bank allows the transfer of mandatorily redeemable capital stock to a member, the Bank reclassifies mandatorily redeemable capital stock from a liability to capital. After the reclassification, dividends on the capital stock are no longer classified as interest expense.

Premises, Software, and Equipment. The Bank records premises, software, and equipment at cost less accumulated depreciation and amortization. The Bank's accumulated depreciation and amortization related to premises, software, and equipment totaled \$67 and \$58 at December 31, 2013 and 2012, respectively. Improvements and major renewals are capitalized; ordinary maintenance and repairs are expensed as incurred. Depreciation is computed on the straight-line method over the estimated useful lives of assets ranging from 3 to 10 years, and leasehold improvements are amortized on the straight-line method over the estimated useful life of the improvement or the remaining term of the lease, whichever is shorter. Depreciation and amortization expense was \$9 for 2013, \$10 for 2012, and \$7 for 2011. The Bank includes gains and losses on disposal of premises, software, and equipment in other income. The net realized gain on disposal of premises, software, and equipment, primarily related to the 1999 sale of the Bank's building, was \$1, \$1, and \$1 in 2013, 2012, and 2011, respectively.

The cost of computer software developed or obtained for internal use is capitalized and depreciated over future periods. At December 31, 2013 and 2012, the Bank had \$20 and \$21 in unamortized computer software costs respectively. Depreciation of computer software costs charged to expense was \$7, \$9, and \$5 in 2013, 2012, and 2011, respectively.

Consolidated Obligations. Consolidated obligations are recorded at amortized cost unless the Bank has elected the fair value option, in which case the consolidated obligations are carried at fair value.

Concessions on Consolidated Obligations. Concessions are paid to dealers in connection with the issuance of consolidated obligations for which the Bank is the primary obligor. The amount of the concession is allocated to the Bank by the Office of Finance based on the percentage of the debt issued for which the Bank is the primary obligor. Concessions paid on consolidated obligations designated under the fair value option are expensed as incurred. Concessions paid on consolidated obligations not designated under the fair value option are deferred and amortized to expense using the level-yield method over the remaining contractual life or on a retrospective basis over the estimated life of the consolidated obligations. Unamortized concessions were \$14 and \$16 at December 31, 2013 and 2012, respectively, and are included in "Other assets." Amortization of concessions is included in consolidated obligation interest expense and totaled \$7, \$22, and \$25, in 2013, 2012, and 2011, respectively.

Discounts and Premiums on Consolidated Obligations. The discounts on consolidated obligation discount notes for which the Bank is the primary obligor are amortized to expense using the level-yield method over the term to maturity. The discounts and premiums on consolidated obligation bonds for which the Bank is the primary obligor are amortized to expense using the level-yield method over the remaining contractual life or on a retrospective basis over the estimated life of the consolidated obligation bonds.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Finance Agency Expenses. The FHLBanks fund a portion of the costs of operating the Finance Agency, and each FHLBank is assessed a proportionate share of those costs. The Finance Agency allocates its expenses and working capital fund among the FHLBanks based on the ratio between each FHLBank's minimum required regulatory capital and the aggregate minimum required regulatory capital of all the FHLBanks.

Office of Finance Expenses. Each FHLBank is assessed a proportionate share of the cost of operating the Office of Finance, which facilitates the issuance and servicing of consolidated obligations. The Office of Finance allocates its operating and capital expenditures among the FHLBanks as follows: (1) two-thirds of the assessment is based on each FHLBank's share of total consolidated obligations outstanding, and (2) one-third of the assessment is based on an equal pro rata allocation.

Affordable Housing Program. As more fully discussed in Note 13 – Affordable Housing Program, the FHLBank Act requires each FHLBank to establish and fund an Affordable Housing Program (AHP). The Bank charges the required funding for the AHP to earnings and establishes a liability. The AHP funds provide subsidies to members to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Subsidies may be in the form of direct grants or below-market interest rate advances.

Resolution Funding Corporation Assessments. Although the FHLBanks are exempt from ordinary federal, state, and local taxation except real property taxes, they were required to make quarterly payments to the Resolution Funding Corporation (REFCORP) toward the interest on bonds issued by REFCORP through the second quarter of 2011. REFCORP was established by Congress in 1989 under 12 U.S.C. Section 1441b as a means of funding the Resolution Trust Corporation, a federal instrumentality established to provide funding for the resolution and disposition of insolvent savings institutions. Officers, employees, and agents of the Office of Finance are authorized to act for and on the behalf of REFCORP to carry out the functions of REFCORP. See Note 14 – Resolution Funding Corporation Assessments for more information.

Note 2 — Recently Issued and Adopted Accounting Guidance

Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. On January 17, 2014, the Financial Accounting Standards Board (FASB) issued guidance clarifying when consumer mortgage loans collateralized by real estate should be reclassified to REO. Specifically, such collateralized mortgage loans should be reclassified to REO when either the creditor obtains legal title to the residential real estate property upon completion of a foreclosure or the borrower conveys all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The guidance is effective for interim and annual periods beginning on or after December 15, 2014, and may be adopted under either the modified retrospective transition method or the prospective transition method. The Bank is in the process of evaluating the effect of this guidance on the Bank's financial condition, results of operations, and cash flows, but it is not expected to be material.

Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. On July 17, 2013, the FASB amended existing guidance to include the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate (OIS)) as a U.S. benchmark interest rate for hedge accounting purposes. Including OIS as an acceptable U.S. benchmark interest rate, in addition to U.S. Treasuries and London Interbank Offered Rate (LIBOR), provides a more comprehensive spectrum of interest rate resets to use as the designated benchmark interest rate risk component under the hedge accounting guidance. The amendments also remove the restriction on using different benchmark interest rates for similar hedges. The amendments apply to all entities that elect to apply hedge accounting of the benchmark interest rate and were effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this guidance did not affect the Bank's financial statement disclosures, financial condition, results of operations, or cash flows.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Joint and Several Liability Arrangements. On February 28, 2013, the FASB issued guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date. The guidance requires an entity to measure these obligations as the sum of (1) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and (2) any additional amount the reporting entity expects to pay on behalf of its co-obligors. In addition, the guidance requires an entity to disclose the nature and amount of the obligations as well as other information about the obligations. The guidance is effective for interim and annual periods beginning on or after December 15, 2013, and is to be applied retrospectively to obligations with joint and several liabilities existing at the beginning of an entity's fiscal year of adoption. The adoption of this guidance is not expected to affect the Bank's financial condition, results of operations, or cash flows.

Disclosures about Offsetting Assets and Liabilities. On December 16, 2011, the FASB and the International Accounting Standards Board issued common disclosure requirements intended to help investors and other financial statement users better assess the effect or potential effect of offsetting arrangements on a company's financial position, whether a company's financial statements are prepared on the basis of GAAP or International Financial Reporting Standards. The guidance was amended on January 31, 2013, to clarify that its scope includes only certain financial instruments that are either offset on the balance sheet or are subject to an enforceable master netting arrangement or similar agreement. The Bank is required to disclose both gross and net information about derivatives, repurchase, and security lending instruments that meet these criteria. The guidance, as amended, became effective for the Bank for interim and annual periods beginning on January 1, 2013, and was applied retrospectively for all comparative periods presented. The adoption of this guidance resulted in additional financial statement disclosures, but did not affect the Bank's financial condition, results of operations, or cash flows.

Presentation of Comprehensive Income. On February 5, 2013, the FASB issued guidance to improve the transparency of reporting reclassifications out of accumulated other comprehensive income/(loss) (AOCI). The guidance does not change the current requirements for reporting net income or comprehensive income in financial statements. However, it requires the Bank to provide information about the amounts reclassified out of AOCI by component. In addition, the Bank is required to present significant amounts reclassified out of AOCI, either on the face of the financial statement where net income is presented or in the footnotes. These amounts are presented based on the respective lines of net income only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, the Bank is required to cross-reference to other required disclosures that provide additional detail about these other amounts. The guidance became effective for the Bank for interim and annual periods beginning on January 1, 2013, and was applied prospectively. The adoption of this guidance resulted in additional financial statement disclosures, but did not affect the Bank's financial condition, results of operations, or cash flows.

Recently Issued Regulatory Guidance

Framework for Adversely Classifying Loans, Other Real Estate Owned, and Other Assets and Listing Assets for Special Mention. On April 9, 2012, the Federal Housing Finance Agency (Finance Agency) issued Advisory Bulletin 2012-02, *Framework for Adversely Classifying Loans, Other Real Estate Owned, and Other Assets and Listing Assets for Special Mention* (AB 2012-02). The guidance establishes a standard and uniform methodology for classifying loans, other real estate owned, and certain other assets (excluding investment securities) and prescribes the timing of asset charge-offs based on these classifications. The guidance is generally consistent with the *Uniform Retail Credit Classification and Account Management Policy* issued by the federal banking regulators in June 2000. AB 2012-02 was effective upon issuance. However, the Finance Agency issued additional guidance extending the effective date of the advisory bulletin. The Bank implemented the asset classification provisions as of January 1, 2014. The charge-off provisions are to be implemented no later than January 1, 2015. The adoption of the accounting guidance in AB 2012-02 is not expected to have a significant impact on the Bank's financial condition, results of operations, or cash flows.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Note 3 — Cash and Due from Banks

Compensating Balances. The Bank maintains collected cash balances with commercial banks in consideration for certain services. There are no legal restrictions under these agreements on the withdrawal of these funds. The average collected cash balances were approximately \$1 for 2013 and \$1 for 2012.

Effective July 12, 2012, the Federal Reserve eliminated its Contractual Clearing Balance Program. Prior to July 12, 2012, the Bank maintained average required balances with the Federal Reserve Bank of San Francisco for this program.

Note 4 — Trading Securities

The estimated fair value of trading securities as of December 31, 2013 and 2012, was as follows:

	2013	2012
Government-sponsored enterprises (GSEs) – Federal Farm Credit Bank (FFCB) bonds	\$ 3,194	\$ 3,175
MBS – Other U.S. obligations – Ginnie Mae	14	16
Total	\$ 3,208	\$ 3,191

Redemption Terms. The estimated fair value of non-mortgage-backed securities (non-MBS) by contractual maturity (based on contractual final principal payment) and of mortgage-backed securities (MBS) as of December 31, 2013 and 2012, is shown below. Expected maturities of MBS will differ from contractual maturities because borrowers generally have the right to prepay the underlying obligations without prepayment fees.

Year of Contractual Maturity	2013	2012
Trading securities other than MBS:		
Due in 1 year or less	\$ 580	\$ 234
Due after 1 year through 5 years	2,614	2,941
Subtotal	3,194	3,175
MBS – Other U.S. obligations – Ginnie Mae	14	16
Total	\$ 3,208	\$ 3,191

Interest Rate Payment Terms. Interest rate payment terms for trading securities at December 31, 2013 and 2012, are detailed in the following table:

	2013	2012
Estimated fair value of trading securities other than MBS:		
Adjustable rate	\$ 3,194	\$ 3,175
Estimated fair value of trading MBS:		
Passthrough securities – Adjustable rate	14	16
Total	\$ 3,208	\$ 3,191

The net unrealized gain/(loss) on trading securities was \$2, \$(11), and \$(7) for the years ended December 31, 2013, 2012, and 2011, respectively. These amounts represent the changes in the fair value of the securities during the reported periods.

Note 5 — Available-for-Sale Securities

Available-for-sale securities by major security type as of December 31, 2013 and 2012, were as follows:

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

December 31, 2013

	Amortized Cost ⁽¹⁾	OTTI Recognized in AOCI	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
PLRMBS:					
Prime	\$ 661	\$ (11)	\$ 27	\$ —	\$ 677
Alt-A, option ARM	1,122	(74)	51	—	1,099
Alt-A, other	5,376	(239)	142	(8)	5,271
Total	\$ 7,159	\$ (324)	\$ 220	\$ (8)	\$ 7,047

December 31, 2012

	Amortized Cost ⁽¹⁾	OTTI Recognized in AOCI	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
PLRMBS:					
Prime	\$ 832	\$ (46)	14	\$ —	\$ 800
Alt-A, option ARM	1,227	(219)	2	—	1,010
Alt-A, other	6,293	(539)	40	—	5,794
Total	\$ 8,352	\$ (804)	\$ 56	\$ —	\$ 7,604

(1) Amortized cost includes unpaid principal balance, unamortized premiums and discounts, and previous other-than-temporary impairments recognized in earnings.

Redemption Terms. Expected maturities of PLRMBS will differ from contractual maturities because borrowers generally have the right to prepay the underlying obligations without prepayment fees.

At December 31, 2013, the amortized cost of the Bank's PLRMBS classified as AFS included credit-related OTTI of \$1,312 (including interest accretion adjustments of \$40). At December 31, 2012, the amortized cost of the Bank's PLRMBS classified as AFS included credit-related OTTI of \$1,427 (including interest accretion adjustments of \$61).

Securities Transferred. Beginning in the first quarter of 2011, the Bank elected to transfer any PLRMBS that incurred a credit-related OTTI charge during the applicable period from the Bank's HTM portfolio to its AFS portfolio at their fair values. These transfers allow the Bank the option to divest these securities prior to maturity in view of changes in interest rates, changes in prepayment risk, or other factors, while acknowledging its intent to hold these securities for an indefinite period of time. For additional information on the transferred securities, see Note 7 – Other-Than-Temporary Impairment Analysis.

The following table summarizes the AFS securities with unrealized losses as of December 31, 2013 and 2012. The unrealized losses are aggregated by major security type and the length of time that individual securities have been in a continuous unrealized loss position. Total unrealized losses in the following table will not agree to the total gross unrealized losses in the table above. The unrealized losses in the following table also include non-credit-related OTTI losses recognized in AOCI net of subsequent unrealized gains, up to the amount of non-credit-related OTTI in AOCI. For OTTI analysis of AFS securities, see Note 7 – Other-Than-Temporary Impairment Analysis.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

December 31, 2013

	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
PLRMBS:						
Prime	\$ 28	\$ —	\$ 287	\$ 11	\$ 315	\$ 11
Alt-A, option ARM	—	—	674	74	674	74
Alt-A, other	677	10	2,351	237	3,028	247
Total	\$ 705	\$ 10	\$ 3,312	\$ 322	\$ 4,017	\$ 332

December 31, 2012

	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
PLRMBS:						
Prime	\$ —	\$ —	\$ 547	\$ 46	\$ 547	\$ 46
Alt-A, option ARM	6	—	973	219	979	219
Alt-A, other	187	1	4,208	538	4,395	539
Total	\$ 193	\$ 1	\$ 5,728	\$ 803	\$ 5,921	\$ 804

As indicated in the tables above, as of December 31, 2013, the Bank's investments classified as AFS had gross unrealized losses related to PLRMBS, which were primarily due to illiquidity in the MBS market, uncertainty about the future condition of the housing and mortgage markets and the economy, and market expectations of the credit performance of loan collateral underlying these securities, which caused these assets to be valued at discounts to their acquisition cost.

Interest Rate Payment Terms. Interest rate payment terms for AFS securities at December 31, 2013 and 2012, are shown in the following table:

	2013	2012
Amortized cost of AFS PLRMBS:		
Collateralized mortgage obligations:		
Fixed rate	\$ 2,450	\$ 3,055
Adjustable rate	4,709	5,297
Total	\$ 7,159	\$ 8,352

Certain MBS classified as fixed rate collateralized mortgage obligations have an initial fixed interest rate that subsequently converts to an adjustable interest rate on a specified date as follows:

	2013	2012
Collateralized mortgage obligations:		
Converts in 1 year or less	\$ 191	\$ 59
Converts after 1 year through 5 years	364	703
Total	\$ 555	\$ 762

Note 6 — Held-to-Maturity Securities

The Bank classifies the following securities as HTM because the Bank has the positive intent and ability to hold these securities to maturity:

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

December 31, 2013

	Amortized Cost ⁽¹⁾	OTTI Recognized in AOCI ⁽¹⁾	Carrying Value ⁽¹⁾	Gross Unrecognized Holding Gains ⁽²⁾	Gross Unrecognized Holding Losses ⁽²⁾	Estimated Fair Value
Certificates of deposit	\$ 1,660	\$ —	\$ 1,660	\$ —	\$ —	\$ 1,660
Housing finance agency bonds:						
California Housing Finance Agency (CalHFA) bonds	416	—	416	—	(100)	316
Subtotal	2,076	—	2,076	—	(100)	1,976
MBS:						
Other U.S. obligations – Ginnie Mae	1,575	—	1,575	3	(45)	1,533
GSEs:						
Freddie Mac	5,250	—	5,250	53	(90)	5,213
Fannie Mae	6,331	—	6,331	109	(45)	6,395
Subtotal GSEs	11,581	—	11,581	162	(135)	11,608
PLRMBS:						
Prime	1,380	—	1,380	1	(37)	1,344
Alt-A, option ARM	16	—	16	—	(2)	14
Alt-A, other	906	(27)	879	24	(26)	877
Subtotal PLRMBS	2,302	(27)	2,275	25	(65)	2,235
Total MBS	15,458	(27)	15,431	190	(245)	15,376
Total	\$ 17,534	\$ (27)	\$ 17,507	\$ 190	\$ (345)	\$ 17,352

December 31, 2012

	Amortized Cost ⁽¹⁾	OTTI Recognized in AOCI ⁽¹⁾	Carrying Value ⁽¹⁾	Gross Unrecognized Holding Gains ⁽²⁾	Gross Unrecognized Holding Losses ⁽²⁾	Estimated Fair Value
Certificates of deposit	\$ 1,739	\$ —	\$ 1,739	\$ —	\$ —	\$ 1,739
Housing finance agency bonds:						
CalHFA bonds	535	—	535	—	(114)	421
Subtotal	2,274	—	2,274	—	(114)	2,160
MBS:						
Other U.S. obligations – Ginnie Mae	340	—	340	8	—	348
GSEs:						
Freddie Mac	4,828	—	4,828	162	(1)	4,989
Fannie Mae	7,020	—	7,020	247	(5)	7,262
Subtotal GSEs	11,848	—	11,848	409	(6)	12,251
PLRMBS:						
Prime	1,749	—	1,749	3	(57)	1,695
Alt-A, option ARM	41	—	41	—	(7)	34
Alt-A, other	1,158	(34)	1,124	23	(51)	1,096
Subtotal PLRMBS	2,948	(34)	2,914	26	(115)	2,825
Total MBS	15,136	(34)	15,102	443	(121)	15,424
Total	\$ 17,410	\$ (34)	\$ 17,376	\$ 443	\$ (235)	\$ 17,584

- (1) Amortized cost includes unpaid principal balance, unamortized premiums and discounts, and previous OTTI recognized in earnings. The carrying value of HTM securities represents amortized cost after adjustment for non-credit-related OTTI recognized in AOCI.
- (2) Gross unrecognized holding gains/(losses) represent the difference between estimated fair value and carrying value.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

At December 31, 2013, the amortized cost of the Bank’s MBS classified as HTM included premiums of \$71, discounts of \$70, and credit-related OTTI of \$6 (including interest accretion adjustments of \$5). At December 31, 2012, the amortized cost of the Bank’s MBS classified as HTM included premiums of \$67, discounts of \$36, and credit-related OTTI of \$6 (including interest accretion adjustments of \$5).

Securities Transferred. Beginning in the first quarter of 2011, the Bank elected to transfer any PLRMBS that incurred a credit-related OTTI charge during the applicable period from the Bank’s HTM portfolio to its AFS portfolio at their fair values. These transfers allow the Bank the option to divest these securities prior to maturity in view of changes in interest rates, changes in prepayment risk, or other factors, while acknowledging its intent to hold these securities for an indefinite period of time. For additional information on the transferred securities, see Note 5 – Available-for-Sale Securities and Note 7 – Other-Than-Temporary Impairment Analysis.

The following tables summarize the HTM securities with unrealized losses as of December 31, 2013 and 2012. The unrealized losses are aggregated by major security type and the length of time that individual securities have been in a continuous unrealized loss position. Total unrealized losses in the following table will not agree to the total gross unrecognized losses in the table above. The unrealized losses in the following table also include non-credit-related OTTI losses recognized in AOCI. For OTTI analysis of HTM securities, see Note 7 – Other-Than-Temporary Impairment Analysis.

December 31, 2013

	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Housing finance agency bonds:						
CalHFA bonds	\$ —	\$ —	\$ 316	\$ 100	\$ 316	\$ 100
MBS:						
Other U.S. obligations – Ginnie Mae	1,187	45	2	—	1,189	45
GSEs:						
Freddie Mac	2,918	89	66	1	2,984	90
Fannie Mae	2,069	40	126	5	2,195	45
Subtotal GSEs	4,987	129	192	6	5,179	135
PLRMBS:						
Prime	481	5	693	32	1,174	37
Alt-A, option ARM	—	—	14	2	14	2
Alt-A, other	159	2	688	51	847	53
Subtotal PLRMBS	640	7	1,395	85	2,035	92
Total MBS	6,814	181	1,589	91	8,403	272
Total	\$ 6,814	\$ 181	\$ 1,905	\$ 191	\$ 8,719	\$ 372

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

December 31, 2012

	Less Than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Housing finance agency bonds:						
CalHFA bonds	\$ —	\$ —	\$ 421	\$ 114	\$ 421	\$ 114
MBS:						
Other U.S. obligations – Ginnie Mae	—	—	3	—	3	—
GSEs:						
Freddie Mac	314	1	13	—	327	1
Fannie Mae	56	1	270	4	326	5
Subtotal GSEs	370	2	283	4	653	6
PLRMBS:						
Prime	83	2	1,197	55	1,280	57
Alt-A, option ARM	—	—	34	7	34	7
Alt-A, other	—	—	1,043	85	1,043	85
Subtotal PLRMBS	83	2	2,274	147	2,357	149
Total MBS	453	4	2,560	151	3,013	155
Total	\$ 453	\$ 4	\$ 2,981	\$ 265	\$ 3,434	\$ 269

As indicated in the tables above, the Bank's investments classified as HTM had gross unrealized losses primarily related to CalHFA bonds and PLRMBS. The gross unrealized losses associated with the CalHFA bonds were mainly due to an illiquid market, credit concerns regarding the underlying mortgage collateral, and credit concerns regarding the monoline insurance providers, causing these investments to be valued at a discount to their acquisition cost. The gross unrealized losses associated with the PLRMBS were primarily due to illiquidity in the MBS market, uncertainty about the future condition of the housing and mortgage markets and the economy, and market expectations of the credit performance of the loan collateral underlying these securities, which caused these assets to be valued at discounts to their acquisition cost.

Redemption Terms. The amortized cost, carrying value, and estimated fair value of non-MBS securities by contractual maturity (based on contractual final principal payment) and of MBS as of December 31, 2013 and 2012, are shown below. Expected maturities of MBS will differ from contractual maturities because borrowers generally have the right to prepay the underlying obligations without prepayment fees.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

December 31, 2013

Year of Contractual Maturity	Amortized Cost ⁽¹⁾	Carrying Value ⁽¹⁾	Estimated Fair Value
HTM securities other than MBS:			
Due in 1 year or less	\$ 1,660	\$ 1,660	\$ 1,660
Due after 1 year through 5 years	—	—	—
Due after 5 years through 10 years	62	62	49
Due after 10 years	354	354	267
Subtotal	2,076	2,076	1,976
MBS:			
Other U.S. obligations – Ginnie Mae	1,575	1,575	1,533
GSEs:			
Freddie Mac	5,250	5,250	5,213
Fannie Mae	6,331	6,331	6,395
Subtotal GSEs	11,581	11,581	11,608
PLRMBS:			
Prime	1,380	1,380	1,344
Alt-A, option ARM	16	16	14
Alt-A, other	906	879	877
Subtotal PLRMBS	2,302	2,275	2,235
Total MBS	15,458	15,431	15,376
Total	\$ 17,534	\$ 17,507	\$ 17,352

December 31, 2012

Year of Contractual Maturity	Amortized Cost ⁽¹⁾	Carrying Value ⁽¹⁾	Estimated Fair Value
HTM securities other than MBS:			
Due in 1 year or less	\$ 1,739	\$ 1,739	\$ 1,739
Due after 1 year through 5 years	18	18	17
Due after 5 years through 10 years	46	46	39
Due after 10 years	471	471	365
Subtotal	2,274	2,274	2,160
MBS:			
Other U.S. obligations – Ginnie Mae	340	340	348
GSEs:			
Freddie Mac	4,828	4,828	4,989
Fannie Mae	7,020	7,020	7,262
Subtotal GSEs	11,848	11,848	12,251
PLRMBS:			
Prime	1,749	1,749	1,695
Alt-A, option ARM	41	41	34
Alt-A, other	1,158	1,124	1,096
Subtotal PLRMBS	2,948	2,914	2,825
Total MBS	15,136	15,102	15,424
Total	\$ 17,410	\$ 17,376	\$ 17,584

(1) Amortized cost includes unpaid principal balance, unamortized premiums and discounts, and previous OTTI recognized in earnings. The carrying value of HTM securities represents amortized cost after adjustment for non-credit-related OTTI recognized in AOCI.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Interest Rate Payment Terms. Interest rate payment terms for HTM securities at December 31, 2013 and 2012, are detailed in the following table:

	2013	2012
Amortized cost of HTM securities other than MBS:		
Fixed rate	\$ 1,660	\$ 1,739
Adjustable rate	416	535
Subtotal	2,076	2,274
Amortized cost of HTM MBS:		
Passthrough securities:		
Fixed rate	461	821
Adjustable rate	430	467
Collateralized mortgage obligations:		
Fixed rate	10,820	9,096
Adjustable rate	3,747	4,752
Subtotal	15,458	15,136
Total	\$ 17,534	\$ 17,410

Certain MBS classified as fixed rate passthrough securities and fixed rate collateralized mortgage obligations have an initial fixed interest rate that subsequently converts to an adjustable interest rate on a specified date as follows:

	2013	2012
Passthrough securities:		
Converts in 1 year or less	\$ 62	\$ 76
Converts after 1 year through 5 years	316	614
Converts after 5 years through 10 years	72	116
Total	\$ 450	\$ 806
Collateralized mortgage obligations:		
Converts in 1 year or less	\$ 185	\$ 26
Converts after 1 year through 5 years	133	506
Total	\$ 318	\$ 532

Note 7 — Other-Than-Temporary Impairment Analysis

On a quarterly basis, the Bank evaluates its individual AFS and HTM investment securities in an unrealized loss position for OTTI. As part of this evaluation, the Bank considers whether it intends to sell each debt security and whether it is more likely than not that it will be required to sell the debt security before its anticipated recovery of the amortized cost basis. If either of these conditions is met, the Bank recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the statement of condition date. For securities in an unrealized loss position that meet neither of these conditions, the Bank considers whether it expects to recover the entire amortized cost basis of the security by comparing its best estimate of the present value of the cash flows expected to be collected from the security with the amortized cost basis of the security. If the Bank's best estimate of the present value of the cash flows expected to be collected is less than the amortized cost basis, the difference is considered the credit loss.

PLRMBS. To assess whether it expects to recover the entire amortized cost basis of its PLRMBS, the Bank performed a cash flow analysis for all of its PLRMBS as of December 31, 2013, using two third-party models. The first model projects prepayments, default rates, and loss severities on the underlying loan collateral based on

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

borrower characteristics and the particular attributes of the loans underlying the Bank's securities, in conjunction with assumptions related primarily to future changes in home prices and interest rates. A significant input to the first model is the forecast of future housing price changes for the relevant states and core-based statistical areas (CBSAs), which are based on an assessment of the regional housing markets. CBSA refers collectively to metropolitan and micropolitan statistical areas as defined by the United States Office of Management and Budget. As currently defined, a CBSA must contain at least one urban area with a population of 10,000 or more people. The FHLBanks' OTTI Governance Committee developed a short-term housing price forecast with projected changes ranging from a decrease of 5.0% to an increase of 7.0% over the 12-month period beginning October 1, 2013. For the vast majority of markets, the projected short-term housing price changes range from an increase of 1.0% to an increase of 5.0%. Thereafter, home prices were projected to recover using one of five different recovery paths. The table below presents the ranges of the annualized projected home price recovery rates at December 31, 2013.

Months	December 31, 2013
1 - 6	0.0% - 3.0%
7 - 12	1.0% - 4.0%
13 - 18	2.0% - 4.0%
19 - 30	2.0% - 5.0%
31 - 54	2.0% - 6.0%
Thereafter	2.3% - 5.6%

The month-by-month projections of future loan performance derived from the first model, which reflect projected prepayments, default rates, and loss severities, are then input into a second model that allocates the projected loan level cash flows and losses to the various security classes in each securitization structure in accordance with the structure's prescribed cash flow and loss allocation rules. When the credit enhancement for the senior securities in a securitization is derived from the presence of subordinated securities, losses are generally allocated first to the subordinated securities until their principal balance is reduced to zero. The projected cash flows are based on a number of assumptions and expectations, and the results of these models can vary significantly with changes in assumptions and expectations. The scenario of cash flows determined based on the model approach described above reflects a best-estimate scenario and includes a base case housing price forecast that reflects the expectations for near- and long-term housing price behavior.

At each quarter end, the Bank compares the present value of the cash flows expected to be collected on its PLRMBS to the amortized cost basis of the securities to determine whether a credit loss exists. For the Bank's variable rate and hybrid PLRMBS, the Bank uses the effective interest rate derived from a variable rate index (for example, one-month LIBOR) plus the contractual spread, plus or minus a fixed spread adjustment when there is an existing discount or premium on the security. As the implied forward rates of the index change over time, the effective interest rates derived from that index will also change over time. The Bank then uses the effective interest rate for the security prior to impairment for determining the present value of the future estimated cash flows. For all securities, including securities previously identified as other-than-temporarily impaired, the Bank updates its estimate of future estimated cash flows on a quarterly basis.

For all the PLRMBS in its AFS and HTM portfolios, the Bank does not intend to sell any security and it is not more likely than not that the Bank will be required to sell any security before its anticipated recovery of the remaining amortized cost basis.

For securities determined to be other-than-temporarily impaired as of December 31, 2013 (securities for which the Bank determined that it does not expect to recover the entire amortized cost basis), the following table presents a summary of the significant inputs used in measuring the amount of credit loss recognized in earnings during the year ended December 31, 2013, and the related current credit enhancement for the Bank.

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Notes to Financial Statements (continued)

December 31, 2013

Year of Securitization	Significant Inputs for Other-Than-Temporarily Impaired PLRMBS			Current
	Prepayment Rates	Default Rates	Loss Severities	Credit Enhancement
	Weighted Average %	Weighted Average %	Weighted Average %	Weighted Average %
Prime				
2007	10.1	5.6	31.0	19.4
2006	10.8	18.6	42.1	—
Total Prime	10.1	5.8	31.2	19.1
Alt-A, other				
2007	8.8	38.9	46.0	6.9
2005	7.2	21.4	43.6	15.3
2004 and earlier	12.1	9.9	33.6	15.5
Total Alt-A, other	8.6	31.2	44.2	10.1
Alt-A, option ARM				
2005	5.6	19.5	36.3	30.1
Total Alt-A, option ARM	5.6	19.5	36.3	30.1
Total	8.6	30.4	43.7	10.8

Credit enhancement is defined as the percentage of subordinated tranches, excess spread, and over-collateralization, if any, in a security structure that will generally absorb losses before the Bank will experience a loss on the security. The calculated averages represent the dollar-weighted averages of all the PLRMBS investments in each category shown. The classification (Prime; Alt-A, option ARM; and Alt-A, other) is based on the model used to run the estimated cash flows for the CUSIP, which may not necessarily be the same as the classification at the time of origination.

For each security classified as HTM, the estimated non-credit-related OTTI is accreted prospectively, based on the amount and timing of future estimated cash flows, over the remaining life of the security as an increase in the carrying value of the security (with no effect on earnings unless the security is subsequently sold or there are additional decreases in the cash flows expected to be collected). The Bank accreted \$7 and \$9 from AOCI to increase the carrying value of the respective PLRMBS classified as HTM for the years ended December 31, 2013 and 2012, respectively. The Bank does not intend to sell these securities and it is not more likely than not that the Bank will be required to sell these securities before its anticipated recovery of the remaining amortized cost basis.

The following table presents the credit-related OTTI, which is recognized in earnings, for the years ended December 31, 2013, 2012, and 2011.

	2013	2012	2011
Balance, beginning of the year	\$ 1,397	\$ 1,362	\$ 952
Charges on securities for which OTTI was not previously recognized	—	—	16
Additional charges on securities for which OTTI was previously recognized ⁽¹⁾	7	44	397
Increases in cash flows expected to be collected that are recognized over the remaining life of the securities	(26)	(9)	(3)
Balance, end of the year	\$ 1,378	\$ 1,397	\$ 1,362

(1) For the year ended December 31, 2013, “securities for which OTTI was previously recognized” represents all securities that were also other-than-temporarily impaired prior to January 1, 2013. For the year ended December 31, 2012, “securities for which OTTI was previously recognized” represents all securities that were also previously other-than-temporarily impaired prior to January 1, 2012. For the year ended December 31, 2011, “securities for which OTTI was previously recognized” represents all securities that were also previously other-than-temporarily impaired prior to January 1, 2011.

Changes in circumstances may cause the Bank to change its intent to hold a certain security to maturity without calling into question its intent to hold other debt securities to maturity in the future. The sale or transfer of an HTM

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

security because of certain changes in circumstances, such as evidence of significant deterioration in the issuers' creditworthiness, is not considered to be inconsistent with its original classification. In addition, other events that are isolated, nonrecurring, or unusual for the Bank that could not have been reasonably anticipated may cause the Bank to sell or transfer an HTM security without necessarily calling into question its intent to hold other debt securities to maturity.

Beginning in the first quarter of 2011, the Bank elected to transfer any PLRMBS that incurred a credit-related OTTI charge during the applicable period from the Bank's HTM portfolio to its AFS portfolio at their fair values. The Bank recognized an OTTI credit loss on these HTM PLRMBS, which the Bank believes is evidence of a significant decline in the issuers' creditworthiness. The decline in the issuers' creditworthiness is the basis for the transfers to the AFS portfolio. These transfers allow the Bank the option to sell these securities prior to maturity in view of changes in interest rates, changes in prepayment risk, or other factors, while recognizing the Bank's intent to hold these securities for an indefinite period of time. The Bank does not intend to sell its other-than-temporarily impaired securities and it is not more likely than not that the Bank will be required to sell any security before its anticipated recovery of the remaining amortized cost basis.

The following table summarizes the PLRMBS transferred from the Bank's HTM portfolio to its AFS portfolio during the years ended December 31, 2013 and 2012. The amounts shown represent the values when the securities were transferred from the HTM portfolio to the AFS portfolio.

	2013				2012			
	Amortized Cost	OTTI Recognized in AOCI	Gross Unrecognized Holding Gains	Estimated Fair Value	Amortized Cost	OTTI Recognized in AOCI	Gross Unrecognized Holding Gains	Estimated Fair Value
Other-than-temporarily impaired PLRMBS backed by loans classified at origination as:								
Prime	\$ —	\$ —	\$ —	\$ —	\$ 22	\$ (2)	\$ —	\$ 20
Alt-A, option ARM	22	(3)	—	19	—	—	—	—
Alt-A, other	54	(1)	—	53	146	(26)	—	120
Total	\$ 76	\$ (4)	\$ —	\$ 72	\$ 168	\$ (28)	\$ —	\$ 140

The following tables present the Bank's other-than-temporarily impaired PLRMBS that incurred OTTI charges anytime during the life of the securities at December 31, 2013 and 2012, by loan collateral type:

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Notes to Financial Statements (continued)

December 31, 2013

	Available-for-Sale Securities			Held-to-Maturity Securities			
	Unpaid Principal Balance	Amortized Cost	Estimated Fair Value	Unpaid Principal Balance	Amortized Cost	Carrying Value	Estimated Fair Value
Other-than-temporarily impaired PLRMBS backed by loans classified at origination as:							
Prime	\$ 795	\$ 661	\$ 677	\$ —	\$ —	\$ —	\$ —
Alt-A, option ARM	1,516	1,122	1,099	—	—	—	—
Alt-A, other	6,151	5,376	5,271	150	147	120	144
Total	\$ 8,462	\$ 7,159	\$ 7,047	\$ 150	\$ 147	\$ 120	\$ 144

December 31, 2012

	Available-for-Sale Securities			Held-to-Maturity Securities			
	Unpaid Principal Balance	Amortized Cost	Estimated Fair Value	Unpaid Principal Balance	Amortized Cost	Carrying Value	Estimated Fair Value
Other-than-temporarily impaired PLRMBS backed by loans classified at origination as:							
Prime	\$ 976	\$ 832	\$ 800	\$ —	\$ —	\$ —	\$ —
Alt-A, option ARM	1,641	1,227	1,010	—	—	—	—
Alt-A, other	7,153	6,293	5,794	173	171	136	159
Total	\$ 9,770	\$ 8,352	\$ 7,604	\$ 173	\$ 171	\$ 136	\$ 159

For the Bank's PLRMBS that were not other-than-temporarily impaired as of December 31, 2013, the Bank has experienced net unrealized losses primarily because of illiquidity in the PLRMBS market, uncertainty about the future condition of the housing and mortgage markets and the economy, and market expectations of the credit performance of loan collateral underlying these securities, which caused these assets to be valued at discounts to their acquisition cost. The Bank does not intend to sell these securities, it is not more likely than not that the Bank will be required to sell these securities before its anticipated recovery of the remaining amortized cost basis, and the Bank expects to recover the entire amortized cost basis of these securities. As a result, the Bank determined that, as of December 31, 2013, the gross unrealized losses on these PLRMBS are temporary. These securities were included in the securities that the Bank reviewed and analyzed for OTTI as discussed above, and the analyses performed indicated that these securities were not other-than-temporarily impaired.

All Other Available-for-Sale and Held-to-Maturity Investments. As of December 31, 2013, the Bank's investments in housing finance agency bonds, which were issued by CalHFA, had gross unrealized losses totaling \$100. These gross unrealized losses were mainly due to an illiquid market, credit concerns regarding the underlying mortgage collateral, and credit concerns regarding the monoline insurance providers, causing these investments to be valued at a discount to their acquisition cost. The Bank independently modeled cash flows for the underlying collateral, using assumptions for default rates and loss severity that a market participant would deem reasonable, and concluded that the available credit support within the CalHFA structure more than offset the projected underlying collateral losses. The Bank determined that, as of December 31, 2013, all of the gross unrealized losses on the bonds are temporary because the underlying collateral and credit enhancements were sufficient to protect the Bank from losses. As a result, the Bank expects to recover the entire amortized cost basis of these securities.

For its agency MBS, the Bank expects to recover the entire amortized cost basis of these securities because the Bank determined that the strength of the issuers' guarantees through direct obligations or support from the U.S. government is sufficient to protect the Bank from losses. As a result, the Bank determined that, as of December 31, 2013, all of the gross unrealized losses on its agency MBS are temporary.

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

Note 8 — Advances

The Bank offers a wide range of fixed and adjustable rate advance products with different maturities, interest rates, payment characteristics, and option features. Fixed rate advances generally have maturities ranging from one day to 30 years. Adjustable rate advances generally have maturities ranging from less than 30 days to 10 years, with the interest rates resetting periodically at a fixed spread to LIBOR or to another specified index.

Redemption Terms. The Bank had advances outstanding, excluding overdrawn demand deposit accounts, at interest rates ranging from 0.06% to 8.57% at December 31, 2013, and 0.09% to 8.57% at December 31, 2012, as summarized below.

Contractual Maturity	2013		2012	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Within 1 year	\$ 22,556	0.50%	\$ 19,565	0.61%
After 1 year through 2 years	6,838	1.48	5,957	1.47
After 2 years through 3 years	6,754	1.24	6,352	1.59
After 3 years through 4 years	3,208	1.43	5,869	1.35
After 4 years through 5 years	2,825	1.79	2,772	1.51
After 5 years	2,006	2.41	2,665	2.43
Total par value	44,187	1.00%	43,180	1.14%
Valuation adjustments for hedging activities	95		282	
Valuation adjustments under fair value option	113		288	
Total	\$ 44,395		\$ 43,750	

Many of the Bank's advances are prepayable at the member's option. However, when advances are prepaid, the member is generally charged a prepayment fee intended to make the Bank financially indifferent to the prepayment. In addition, for certain advances with partial prepayment symmetry, the Bank may charge the member a prepayment fee or pay the member a prepayment credit depending on certain circumstances, such as movements in interest rates, when the advance is prepaid. The Bank had advances with partial prepayment symmetry outstanding totaling \$6,833 at December 31, 2013, and \$6,867 at December 31, 2012. Some advances may be repaid on pertinent call dates without prepayment fees (callable advances). The Bank had callable advances outstanding totaling \$235 at December 31, 2013, and \$73 at December 31, 2012.

The Bank's advances at December 31, 2013 and 2012, included \$182 and \$197, respectively, of puttable advances. At the Bank's discretion, the Bank may terminate these advances on predetermined exercise dates and offer replacement funding at prevailing market rates, subject to certain conditions. The Bank would typically exercise such termination rights when interest rates increase.

The following table summarizes advances at December 31, 2013 and 2012, by the earlier of the year of contractual maturity or next call date for callable advances and by the earlier of the year of contractual maturity or next put date for puttable advances.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

	Earlier of Contractual Maturity or Next Call Date		Earlier of Contractual Maturity or Next Put Date	
	2013	2012	2013	2012
Within 1 year	\$ 22,609	\$ 19,633	\$ 22,696	\$ 19,747
After 1 year through 2 years	6,843	5,952	6,838	5,915
After 2 years through 3 years	6,850	6,357	6,754	6,352
After 3 years through 4 years	3,208	5,869	3,108	5,869
After 4 years through 5 years	2,901	2,762	2,785	2,672
After 5 years	1,776	2,607	2,006	2,625
Total par value	\$ 44,187	\$ 43,180	\$ 44,187	\$ 43,180

Credit and Concentration Risk. The following tables present the concentration in advances to the top five borrowers and their affiliates at December 31, 2013 and 2012. The tables also present the interest income from these advances before the impact of interest rate exchange agreements associated with these advances for the years ended December 31, 2013 and 2012.

December 31, 2013

Name of Borrower	Advances Outstanding ⁽¹⁾	Percentage of Total Advances Outstanding	Interest Income from Advances ⁽²⁾	Percentage of Total Interest Income from Advances
Bank of America California, N.A.	\$ 7,750	18%	\$ 15	3%
JPMorgan Chase & Co.:				
JPMorgan Bank & Trust Company, National Association	5,125	11	76	16
JPMorgan Chase Bank, National Association ⁽³⁾	835	2	8	2
Subtotal JPMorgan Chase & Co.	5,960	13	84	18
First Republic Bank	5,150	12	70	15
Bank of the West	4,933	11	30	6
One West Bank, FSB	4,501	10	41	9
Subtotal	28,294	64	240	51
Others	15,893	36	234	49
Total	\$ 44,187	100%	\$ 474	100%

December 31, 2012

Name of Borrower	Advances Outstanding ⁽¹⁾	Percentage of Total Advances Outstanding	Interest Income from Advances ⁽²⁾	Percentage of Total Interest Income from Advances
JPMorgan Chase & Co.:				
JPMorgan Bank & Trust Company, National Association	\$ 7,850	18%	\$ 105	15%
JPMorgan Chase Bank, National Association ⁽³⁾	1,542	4	14	2
Subtotal JPMorgan Chase & Co.	9,392	22	119	17
Citibank, N.A. ⁽³⁾	8,285	19	44	6
Bank of the West	2,920	7	93	14
OneWest Bank, FSB	3,651	9	55	8
First Republic Bank	3,225	7	55	8
Subtotal	27,473	64	366	53
Others	15,707	36	313	47
Total	\$ 43,180	100%	\$ 679	100%

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

- (1) Borrower advance amounts and total advance amounts are at par value, and total advance amounts will not agree to carrying value amounts shown in the Statements of Condition. The differences between the par and carrying value amounts primarily relate to unrealized gains or losses associated with hedged advances resulting from valuation adjustments related to hedging activities and under the fair value option.
- (2) Interest income amounts exclude the interest effect of interest rate exchange agreements with derivative counterparties; as a result, the total interest income amounts will not agree to the Statements of Income. The amount of interest income from advances can vary depending on the amount outstanding, terms to maturity, interest rates, and repricing characteristics.
- (3) Nonmember institution.

The Bank held a security interest in collateral from each of the top five advances borrowers and their affiliates sufficient to support their respective advances outstanding, and the Bank does not expect to incur any credit losses on these advances. As of December 31, 2013, two of the advances borrowers and their affiliates (JPMorgan Chase & Co. and Citibank, N.A.) each owned more than 10% of the Bank’s outstanding capital stock, including mandatorily redeemable capital stock.

For information related to the Bank’s credit risk on advances and allowance methodology for credit losses, see Note 10 – Allowance for Credit Losses.

Interest Rate Payment Terms. Interest rate payment terms for advances at December 31, 2013 and 2012, are detailed below:

	2013	2012
Par value of advances:		
Fixed rate:		
Due within 1 year	\$ 17,998	\$ 5,397
Due after 1 year	16,453	17,563
Total fixed rate	34,451	22,960
Adjustable rate:		
Due within 1 year	4,558	14,168
Due after 1 year	5,178	6,052
Total adjustable rate	9,736	20,220
Total par value	\$ 44,187	\$ 43,180

The Bank may use derivatives to adjust the repricing and/or options characteristics of advances to more closely match the characteristics of the Bank’s funding liabilities. In general, whenever a member executes a fixed rate advance or a variable rate advance with embedded options, the Bank will simultaneously execute an interest rate exchange agreement with terms that offset the terms and embedded options, if any, in the advance. The combination of the advance and the interest rate exchange agreement effectively creates a variable rate asset. This type of hedge is treated as a fair value hedge. In addition, for certain advances for which the Bank has elected the fair value option, the Bank will simultaneously execute an interest rate exchange agreement with terms that economically offset the terms of the advance. However, this type of hedge is treated as an economic hedge because these combinations generally do not meet the requirements for fair value hedge accounting treatment. For more information, see Note 19 – Derivatives and Hedging Activities and Note 20 – Fair Value.

The Bank did not have any advances with embedded features that met the requirements to separate the embedded feature from the host contract and designate the embedded feature as a stand-alone derivative at December 31, 2013 and 2012.

Prepayment Fees, Net. The Bank charges borrowers prepayment fees or pays borrowers prepayment credits when the principal on certain advances is paid prior to original maturity. The Bank records prepayment fees net of any associated fair value adjustments related to prepaid advances that were hedged. The net amount of prepayment fees is reflected as interest income in the Statements of Income for the years ended December 31, 2013, 2012, and 2011, as follows:

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

	2013	2012	2011
Prepayment fees received	\$ 14	\$ 211	\$ 103
Fair value adjustments	(9)	(146)	(86)
Total prepayment fees, net	\$ 5	\$ 65	\$ 17
Advance principal prepaid	\$ 365	\$ 9,858	\$ 5,217

Note 9 — Mortgage Loans Held for Portfolio

Under the MPF Program, the Bank purchased conventional conforming fixed rate residential mortgage loans directly from its participating members from May 2002 through October 2006. Participating members originated or purchased the mortgage loans, credit-enhanced them and sold them to the Bank, and generally retained the servicing of the loans.

On October 2, 2013, the Bank announced its renewed participation in the MPF Program. In 2014, the Bank plans to begin purchasing conventional conforming fixed rate mortgage loans and FHA/VA-insured mortgage loans from members for the Bank’s own portfolio under the MPF Original and MPF Government products. The Bank also plans to facilitate the purchase of fixed rate mortgage loans from members for concurrent sale to Fannie Mae under the MPF Xtra® product. (“MPF Xtra” is a registered trademark of the FHLBank of Chicago.)

The Bank plans to begin with a small number of participating members, then add other members that are active mortgage originators and servicers later in 2014 or in 2015. The Bank previously purchased conventional conforming fixed rate residential mortgage loans from participating members from May 2002 to October 2006.

The following table presents information as of December 31, 2013 and 2012, on mortgage loans, all of which are secured by one- to four-unit residential properties and single-unit second homes.

	2013	2012
Fixed rate medium-term mortgage loans	\$ 238	\$ 359
Fixed rate long-term mortgage loans	675	937
Subtotal	913	1,296
Unamortized premiums	10	10
Unamortized discounts	(16)	(14)
Mortgage loans held for portfolio	907	1,292
Less: Allowance for credit losses	(2)	(3)
Total mortgage loans held for portfolio, net	\$ 905	\$ 1,289

Medium-term loans have original contractual terms of 15 years or less, and long-term loans have contractual terms of more than 15 years.

The participating member and the Bank share the risk of credit losses on conventional MPF loan products by structuring potential losses on conventional MPF loans into layers with respect to each master commitment. After any primary mortgage insurance, the Bank is obligated to incur the first layer or portion of credit losses not absorbed by the liquidation value of the real property securing the loan. Under the MPF Program, the participating member's credit enhancement protection consists of the credit enhancement amount, which may be a direct obligation of the participating member or may be a supplemental mortgage insurance policy paid for by the participating member, and may include a contingent performance-based credit enhancement fee payable to the participating member. The participating member is required to pledge collateral to secure any portion of its credit enhancement amount that is a direct obligation.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

For taking on the credit enhancement obligation, the Bank pays the participating member or any successor a credit enhancement fee, which is calculated on the remaining unpaid principal balance of the mortgage loans. The Bank records credit enhancement fees as a reduction to interest income. The Bank reduced net interest income for credit enhancement fees totaling \$1 in 2013, \$1 in 2012, and \$1 in 2011.

Concentration Risk. The Bank had the following concentration in MPF loans with institutions whose outstanding total of mortgage loans sold to the Bank represented 10% or more of the Bank’s total outstanding mortgage loans at December 31, 2013 and 2012.

December 31, 2013

Name of Institution	Mortgage Loan Balances Outstanding	Percentage of Total Mortgage Loan Balances Outstanding	Number of Mortgage Loans Outstanding	Percentage of Total Number of Mortgage Loans Outstanding
JPMorgan Chase Bank, National Association ⁽¹⁾	\$ 715	78%	7,355	69%
OneWest Bank, FSB	120	13	2,510	23
Subtotal	835	91	9,865	92
Others	78	9	883	8
Total	\$ 913	100%	10,748	100%

December 31, 2012

Name of Institution	Mortgage Loan Balances Outstanding	Percentage of Total Mortgage Loan Balances Outstanding	Number of Mortgage Loans Outstanding	Percentage of Total Number of Mortgage Loans Outstanding
JPMorgan Chase Bank, National Association ⁽¹⁾	\$ 1,015	79%	9,638	70%
OneWest Bank, FSB	173	13	3,064	22
Subtotal	1,188	92	12,702	92
Others	108	8	1,136	8
Total	\$ 1,296	100%	13,838	100%

(1) Nonmember institution.

For information related to the Bank’s credit risk on mortgage loans and allowance methodology for credit losses, see Note 10 – Allowance for Credit Losses.

Note 10 — Allowance for Credit Losses

An allowance for credit losses is a valuation allowance separately established for each identified portfolio segment, if it is probable that impairment has occurred in the Bank's portfolio as of the Statements of Condition date and the amount of loss can be reasonably estimated. To the extent necessary, an allowance for credit losses for off-balance sheet credit exposures is recorded as a liability.

Portfolio Segments. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. The Bank has developed and documented a systematic methodology for determining an allowance for credit losses for each of the following portfolio segments:

- advances, letters of credit, and other extensions of credit to members, collectively referred to as “credit products,”
- MPF loans held for portfolio,
- term securities purchased under agreements to resell, and
- term Federal funds sold.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Classes of Financing Receivables. Classes of financing receivables generally are a disaggregation of a portfolio segment to the extent needed to understand the exposure to credit risk arising from these financing receivables. The Bank determined that no further disaggregation of the portfolio segments identified above is needed because the credit risk arising from these financing receivables is assessed and measured by the Bank at the portfolio segment level.

Credit Products. The Bank lends to member financial institutions that have a principal place of business in Arizona, California, or Nevada. Under the FHLBank Act, the Bank is required to obtain sufficient collateral for credit products to protect the Bank from credit losses. Collateral eligible to secure credit products includes certain investment securities, residential mortgage loans, cash or deposits with the Bank, and other eligible real estate-related assets. The capital stock of the Bank owned by each borrowing member is pledged as additional collateral for the member's indebtedness to the Bank. The Bank may also accept secured small business, small farm, and small agribusiness loans, and securities representing a whole interest in such secured loans, as collateral from members that are community financial institutions. The Housing Act added secured loans for community development activities as collateral that the Bank may accept from community financial institutions. In addition, the Bank has advances outstanding to former members and member successors, which are also subject to these security terms.

The Bank requires each borrowing member to execute a written Advances and Security Agreement, which describes the lending relationship between the Bank and the borrower. At December 31, 2013 and 2012, the Bank had a perfected security interest in collateral pledged by each borrowing member, or by the member's affiliate on behalf of the member, and by each nonmember borrower, with an estimated value in excess of the outstanding credit products for that borrower. Based on the financial condition of the borrower, the Bank may either (i) allow the borrower or the pledging affiliate to retain physical possession of loan collateral pledged to the Bank, provided that the borrower or the pledging affiliate agree to hold the collateral for the benefit of the Bank, or (ii) require the borrower or the pledging affiliate to deliver physical possession of loan collateral to the Bank or its custodial agent. All securities collateral is required to be delivered to the Bank's custodial agent. All loan collateral pledged to the Bank is subject to a UCC-1 financing statement.

Section 10(e) of the FHLBank Act affords any security interest granted to the Bank by a member or any affiliate of the member or any nonmember borrower priority over claims or rights of any other party, except claims or rights that (i) would be entitled to priority under otherwise applicable law and (ii) are held by bona fide purchasers for value or secured parties with perfected security interests.

The Bank classifies as impaired any advance with respect to which it is probable that all principal and interest due will not be collected according to its contractual terms. Impaired advances are valued using the present value of expected future cash flows discounted at the advance's effective interest rate, the advance's observable market price or, if collateral-dependent, the fair value of the advance's underlying collateral. When an advance is classified as impaired, the accrual of interest is discontinued and unpaid accrued interest is reversed. Advances do not return to accrual status until they are brought current with respect to both principal and interest and until the future principal payments are no longer in doubt. No advances were classified as impaired during the periods presented.

The Bank manages its credit exposure relating to credit products through an integrated approach that generally provides for a credit limit to be established for each borrower, includes an ongoing review of each borrower's financial condition, and is coupled with conservative collateral and lending policies to limit the risk of loss while taking into account borrowers' needs for a reliable funding source. At December 31, 2013 and 2012, none of the Bank's credit products were past due, on nonaccrual status, or considered impaired. There were no troubled debt restructurings related to credit products during 2013 and 2012.

Based on the collateral pledged as security for advances, the Bank's credit analyses of borrowers' financial condition, and the Bank's credit extension and collateral policies as of December 31, 2013, the Bank expects to collect all amounts due according to the contractual terms. Therefore, no allowance for losses on credit products was deemed necessary by the Bank. The Bank has never experienced any credit losses on its credit products.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

During 2013, three member institutions were placed into receivership. These institutions had no advances outstanding at the time they were placed into receivership.

From January 1, 2014, to February 28, 2014, no member institutions were placed into receivership.

Mortgage Loans Held for Portfolio. A mortgage loan is considered to be impaired when it is reported 90 days or more past due (nonaccrual) or when it is probable, based on current information and events, that the Bank will be unable to collect all principal and interest amounts due according to the contractual terms of the mortgage loan agreement.

Loans that are on nonaccrual status and that are considered collateral-dependent are measured for impairment based on the fair value of the underlying property less estimated selling costs. Loans are considered collateral-dependent if repayment is expected to be provided solely by the sale of the underlying property, that is, if it is considered likely that the borrower will default and there is no credit enhancement to offset losses under the master commitment, or the collectability or availability of credit enhancement is deemed to be uncertain. Collateral-dependent loans are impaired if the fair value of the underlying collateral less estimated selling costs is insufficient to recover the unpaid principal balance on the loan. Interest income on impaired loans is recognized in the same manner as interest income on nonaccrual loans, as noted below.

The Bank places a mortgage loan on nonaccrual status when the collection of the contractual principal or interest from the participating institution is reported 90 days or more past due or when the loan is in foreclosure. When a mortgage loan is placed on nonaccrual status, accrued but uncollected interest is reversed against interest income. The Bank records cash payments received on nonaccrual loans first as interest income and then as a reduction of principal as specified in the contractual agreement, unless the collection of the remaining principal amount due is considered doubtful.

The following table presents information on delinquent mortgage loans as of December 31, 2013 and 2012.

	2013	2012
	Recorded Investment ⁽¹⁾	Recorded Investment ⁽¹⁾
30 – 59 days delinquent	\$ 14	\$ 18
60 – 89 days delinquent	7	7
90 days or more delinquent	27	32
Total past due	48	57
Total current loans	863	1,241
Total mortgage loans	\$ 911	\$ 1,298
In process of foreclosure, included above ⁽²⁾	\$ 17	\$ 20
Nonaccrual loans	\$ 27	\$ 32
Loans past due 90 days or more and still accruing interest	\$ —	\$ —
Serious delinquencies as a percentage of total mortgage loans outstanding ⁽³⁾	3.00%	2.45%

- (1) The recorded investment in a loan is the unpaid principal balance of the loan, adjusted for accrued interest, net deferred loan fees or costs, unamortized premiums or discounts, and direct write-downs. The recorded investment is not net of any valuation allowance.
- (2) Includes loans for which the servicer has reported a decision to foreclose or to pursue a similar alternative, such as deed-in-lieu. Loans in process of foreclosure are included in past due or current loans depending on their delinquency status.
- (3) Represents loans that are 90 days or more past due or in the process of foreclosure as a percentage of the recorded investment of total mortgage loans outstanding. The ratio increased primarily because of the decline in the recorded investment of the Bank's mortgage loans.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Mortgage Loans Evaluated at the Individual Master Commitment Level – The credit risk analysis of all conventional MPF loans is performed at the individual master commitment level to determine the credit enhancements available to recover losses on MPF loans under each individual master commitment.

Individually Evaluated Mortgage Loans – Certain conventional mortgage loans, primarily impaired mortgage loans that are considered collateral-dependent, may be specifically identified for purposes of calculating the allowance for credit losses. The estimated credit losses on impaired collateral-dependent loans may be separately determined because sufficient information exists to make a reasonable estimate of the inherent loss on those loans on an individual loan basis. The Bank estimates the fair value of collateral using real estate broker price opinions or automated valuation models (AVMs) based on property characteristics as well as recent market sales and current listings. The resulting incurred loss, if any, is equal to the difference between the carrying value of the loan and the estimated fair value of the collateral less estimated selling costs.

Collectively Evaluated Mortgage Loans – The credit risk analysis of conventional loans collectively evaluated for impairment considers loan pool-specific attribute data, applies estimated loss severities, and considers the associated credit enhancements to determine the Bank's best estimate of probable incurred losses. The analysis includes estimating projected cash flows that the Bank is likely to collect based on an assessment of all available information, including prepayment speeds, default rates, and loss severity for the mortgage loans based on underlying loan-level borrower and loan characteristics; expected housing price changes; and interest rate assumptions. In performing a detailed cash flow analysis, the Bank develops its best estimate of the cash flows expected to be collected using a third-party model to project prepayments, default rates, and loss severities based on borrower characteristics and the particular attributes of the mortgage loans, in conjunction with assumptions related primarily to future changes in home prices and interest rates. The assumptions used as inputs to the model, including the forecast of future housing price changes, are consistent with assumptions used for the Bank's evaluation of its PLRMBS for OTTI.

The allowance for credit losses on the mortgage loan portfolio was as follows:

	2013	2012	2011
Balance, beginning of the year	\$ 3	\$ 6	\$ 3
Charge-offs – transferred to real estate owned (REO)	—	(2)	(1)
Provision for/(reversal of) credit losses	(1)	(1)	4
Balance, end of the year	\$ 2	\$ 3	\$ 6
Ratio of net charge-offs during the period to average loans outstanding during the year	(0.07)%	(0.08)%	(0.07)%

The allowance for credit losses and recorded investment by impairment methodology for individually and collectively evaluated impaired loans are as follows:

	2013	2012
Allowance for credit losses, end of the year		
Individually evaluated for impairment	\$ 2	\$ 3
Collectively evaluated for impairment	—	—
Total allowance for credit losses	\$ 2	\$ 3
Recorded investment, end of the year		
Individually evaluated for impairment	\$ 27	\$ 31
Collectively evaluated for impairment	884	1,267
Total recorded investment	\$ 911	\$ 1,298

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

The recorded investment, unpaid principal balance, and related allowance of impaired loans individually evaluated for impairment as of December 31, 2013 and 2012, are as follows:

	2013			2012		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance	\$ 20	\$ 20	\$ —	\$ 19	\$ 19	\$ —
With an allowance	7	7	2	12	12	3
Total	\$ 27	\$ 27	\$ 2	\$ 31	\$ 31	\$ 3

The average recorded investment on impaired loans individually evaluated for impairment is as follows:

	2013	2012
With no related allowance	\$ 19	\$ 19
With an allowance	11	16
Total	\$ 30	\$ 35

The Bank and any participating institution share in the credit risk of the loans sold by that institution as specified in a master agreement. Loans purchased under the MPF Program generally had a credit risk exposure at the time of purchase equivalent to AA-rated assets taking into consideration the credit risk sharing structure mandated by the Finance Agency’s acquired member assets (AMA) regulation. The Bank holds additional risk-based capital when it determines that purchased loans do not have a credit risk exposure equivalent to AA-rated assets. The MPF Program structures potential credit losses on conventional MPF loans into layers with respect to each pool of loans purchased by the Bank under a single master commitment for the member selling the loans, as follows:

1. The first layer of protection against loss is the liquidation value of the real property securing the loan.
2. The next layer of protection comes from the primary mortgage insurance that is required for loans with a loan-to-value ratio greater than 80%, if still in place.
3. Losses that exceed the liquidation value of the real property and any primary mortgage insurance, up to an agreed-upon amount called the first loss account for each master commitment, are incurred by the Bank.
4. Losses in excess of the first loss account for each master commitment, up to an agreed-upon amount called the “credit enhancement amount,” are covered by the participating institution’s credit enhancement obligation at the time losses are incurred.
5. Losses in excess of the first loss account and the participating institution’s remaining credit enhancement for the master commitment, if any, are incurred by the Bank.

The Bank calculates its estimated allowance for credit losses on mortgage loans acquired under its two MPF products, Original MPF and MPF Plus, as described below.

Allowance for Credit Losses on MPF Loans – The Bank evaluates the allowance for credit losses on MPF mortgage loans based on two components. The first component applies to each individual loan that is specifically identified as impaired. The Bank evaluates the exposure on these loans by considering the first layer of loss protection (the liquidation value of the real property securing the loan) and the availability and collectability of credit enhancements under the terms of each master commitment and records a provision for credit losses. For this component, the Bank established an allowance for credit losses for Original MPF loans totaling de minimis amounts as of December 31, 2013 and 2012, and for MPF Plus loans totaling \$2 as of December 31, 2013, and \$3 as of December 31, 2012.

The second component applies to loans that are not specifically identified as impaired and is based on the Bank’s estimate of probable credit losses on those loans as of the financial statement date. The Bank evaluates the credit

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

loss exposure on a loan pool basis considering various observable data, such as delinquency statistics, past performance, current performance, loan portfolio characteristics, collateral valuations, industry data, and prevailing economic conditions. The Bank also considers the availability and collectability of credit enhancements from institutions or from mortgage insurers under the terms of each master commitment. For this component, the Bank established an allowance for credit losses for Original MPF loans totaling de minimis amounts as of December 31, 2013 and 2012, and for MPF Plus loans totaling de minimis amounts as of December 31, 2013 and 2012.

Troubled Debt Restructurings – Troubled debt restructuring (TDR) is considered to have occurred when a concession is granted to the debtor for economic or legal reasons related to the debtor's financial difficulties and that concession would not have been considered otherwise. An MPF loan considered a TDR is individually evaluated for impairment when determining its related allowance for credit losses. Credit loss is measured by factoring in expected cashflow shortfalls incurred as of the reporting date as well as the economic loss attributable to delaying the original contractual principal and interest due dates, if applicable.

The Bank's TDRs of MPF loans primarily involve modifying the borrower's monthly payment for a period of up to 36 months to reflect a housing expense ratio that is no more than 31% of the borrower's qualifying monthly income. The outstanding principal balance is re-amortized to reflect a principal and interest payment for a term not to exceed 40 years from the original note date and a housing expense ratio not to exceed 31%. This would result in a balloon payment at the original maturity date of the loan because the maturity date and number of remaining monthly payments are not adjusted. If the 31% ratio is still not achieved through re-amortization, the interest rate is reduced in 0.125% increments below the original note rate, to a floor rate of 3.00%, resulting in reduced principal and interest payments, for the temporary payment modification period of up to 36 months, until the 31% housing expense ratio is met.

The recorded investment of the Bank's nonperforming MPF loans classified as TDRs totaled \$0.8 as of December 31, 2013 and 2012. During 2013 and 2012, the amount of the pre- and post-modification recorded investment in TDRs that occurred during the year was equal because there were no write-offs resulting from either principal forgiveness or direct write-offs. None of the MPF loans classified as TDRs within the previous 12 months experienced a payment default.

Term Securities Purchased Under Agreements to Resell. Securities purchased under agreements to resell are considered collateralized financing arrangements and effectively represent short-term loans with investment-grade counterparties, which are classified as assets in the Statements of Condition. Securities purchased under agreements to resell are held in safekeeping in the name of the Bank by third-party custodians approved by the Bank. In accordance with the terms of these loans, if the market value of the underlying securities decreases below the market value required as collateral, the counterparty must place an equivalent amount of additional securities as collateral or remit an equivalent amount of cash. If an agreement to resell is deemed to be impaired, the difference between the fair value of the collateral and the amortized cost of the agreement is charged to earnings. Based upon the collateral held as security, the Bank determined that no allowance for credit losses was needed for the securities purchased under agreements to resell at December 31, 2012. The Bank did not have any term securities purchased under agreements to resell at December 31, 2013.

Term Federal Funds Sold. The Bank invests in Federal funds sold with highly rated counterparties, and these investments are evaluated for purposes of an allowance for credit losses if the investment is not paid when due. All investments in Federal funds sold as of December 31, 2013 and 2012, were repaid or are expected to be repaid according to the contractual terms.

Note 11 — Deposits

The Bank maintains demand deposit accounts that are directly related to the extension of credit to members and offers short-term deposit programs to members and qualifying nonmembers. In addition, a member that services mortgage loans may deposit in the Bank funds collected in connection with the mortgage loans, pending

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

disbursement of these funds to the owners of the mortgage loans. The Bank classifies these types of deposits as non-interest-bearing deposits.

Deposits as of December 31, 2013 and 2012, were as follows:

	2013	2012
Interest-bearing deposits:		
Demand and overnight	\$ 190	\$ 224
Term	1	2
Other	1	—
Total interest-bearing deposits	192	226
Non-interest-bearing deposits	1	1
Total	\$ 193	\$ 227

Interest Rate Payment Terms. Deposits classified as demand, overnight, and other pay interest based on a daily interest rate. Term deposits pay interest based on a fixed rate determined at the issuance of the deposit. Interest rate payment terms for deposits at December 31, 2013 and 2012, are detailed in the following table:

	2013		2012	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Interest-bearing deposits:				
Fixed rate	\$ 1	0.01%	\$ 2	0.03%
Adjustable rate	191	0.01	224	0.01
Total interest-bearing deposits	192	0.01	226	0.01
Non-interest-bearing deposits	1	—	1	—
Total	\$ 193	0.01%	\$ 227	0.01%

The aggregate amount of time deposits with a denomination of \$0.1 or more was \$1 at December 31, 2013, and \$2 at December 31, 2012. These time deposits were scheduled to mature within three months.

Note 12 — Consolidated Obligations

Consolidated obligations, consisting of consolidated obligation bonds and discount notes, are jointly issued by the FHLBanks through the Office of Finance, which serves as the FHLBanks' agent. As provided by the FHLBank Act or by regulations governing the operations of the FHLBanks, all FHLBanks have joint and several liability for all FHLBank consolidated obligations. For a discussion of the joint and several liability regulation, see Note 21 – Commitments and Contingencies. In connection with each issuance of consolidated obligations, each FHLBank specifies the type, term, and amount of debt it requests to have issued on its behalf. The Office of Finance tracks the amount of debt issued on behalf of each FHLBank. In addition, the Bank separately tracks and records as a liability its specific portion of the consolidated obligations issued and is the primary obligor for that portion of the consolidated obligations issued. The Finance Agency and the U.S. Secretary of the Treasury have oversight over the issuance of FHLBank debt through the Office of Finance.

Consolidated obligation bonds are issued primarily to raise intermediate- and long-term funds for the FHLBanks. The maturity of consolidated obligation bonds generally ranges from 1 to 15 years, but the maturity is not subject to any statutory or regulatory limits. Consolidated obligation discount notes are primarily used to raise short-term funds. These notes are issued at less than their face amount and redeemed at par value when they mature.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

The par value of the outstanding consolidated obligations of all 12 FHLBanks was \$766,837 at December 31, 2013, and \$687,902 at December 31, 2012. Regulations require the FHLBanks to maintain, for the benefit of investors in consolidated obligations, in the aggregate, unpledged qualifying assets in an amount equal to the consolidated obligations outstanding. Qualifying assets are defined as cash; secured advances; assets with an assessment or credit rating at least equivalent to the current assessment or credit rating of the consolidated obligations; obligations, participations, mortgages, or other securities of or issued by the United States or an agency of the United States; and such securities as fiduciary and trust funds may invest in under the laws of the state in which the FHLBank is located. Any assets subject to a lien or pledge for the benefit of holders of any issue of consolidated obligations are treated as if they were free from lien or pledge for the purposes of compliance with these regulations. At December 31, 2013, the Bank had qualifying assets totaling \$85,547, and the Bank's participation in consolidated obligations outstanding was \$77,401.

General Terms. Consolidated obligations are generally issued with either fixed rate payment terms or adjustable rate payment terms, which use a variety of indices for interest rate resets, including LIBOR, the Federal funds effective rate, and others. In addition, to meet the specific needs of certain investors, fixed rate and adjustable rate consolidated obligation bonds may contain certain embedded features, such as call options and complex coupon payment terms. In general, when such consolidated obligation bonds are issued for which the Bank is the primary obligor, the Bank simultaneously enters into interest rate exchange agreements containing offsetting features to, in effect, convert the terms of the bond to the terms of a simple adjustable rate bond indexed to LIBOR.

In addition to having fixed rate or simple adjustable rate coupon payment terms, consolidated obligations may include:

- Callable bonds, which the Bank may call in whole or in part at its option on predetermined call dates according to the terms of the bond offerings;
- Step-up callable bonds, which pay interest at increasing fixed rates for specified intervals over the life of the bond and can generally be called at the Bank's option on the step-up dates according to the terms of the bond offerings;
- Step-down callable bonds, which pay interest at decreasing fixed rates for specified intervals over the life of the bond and can generally be called at the Bank's option on the step-down dates according to the terms of the bond offerings;
- Conversion bonds, which have coupon rates that convert from fixed to adjustable or from adjustable to fixed on predetermined dates according to the terms of the bond offerings.

Redemption Terms. The following is a summary of the Bank's participation in consolidated obligation bonds at December 31, 2013 and 2012.

Contractual Maturity	2013		2012	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Within 1 year	\$ 26,161	0.40%	\$ 40,714	1.25%
After 1 year through 2 years	7,101	0.80	9,661	0.87
After 2 years through 3 years	7,740	2.94	3,622	1.34
After 3 years through 4 years	1,963	2.50	6,406	3.45
After 4 years through 5 years	2,420	1.49	2,896	2.14
After 5 years	7,384	1.99	6,022	2.18
Total par value	52,769	1.17%	69,321	1.52%
Unamortized premiums	78		69	
Unamortized discounts	(16)		(22)	
Valuation adjustments for hedging activities	491		906	
Fair value option valuation adjustments	(115)		36	
Total	\$ 53,207		\$ 70,310	

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

The Bank's participation in consolidated obligation bonds outstanding includes callable bonds of \$13,042 at December 31, 2013, and \$8,778 at December 31, 2012. When a callable bond for which the Bank is the primary obligor is issued, the Bank may simultaneously enter into an interest rate swap (in which the Bank pays a variable rate and receives a fixed rate) with a call feature that mirrors the call option embedded in the bond (a sold callable swap). The Bank had notional amounts of interest rate exchange agreements hedging callable bonds of \$9,997 at December 31, 2013, and \$4,233 at December 31, 2012. The combined sold callable swaps and callable bonds enable the Bank to meet its funding needs at costs not otherwise directly attainable solely through the issuance of non-callable debt, while effectively converting the Bank's net payment to an adjustable rate.

The Bank's participation in consolidated obligation bonds at December 31, 2013 and 2012, was as follows:

	2013	2012
Par value of consolidated obligation bonds:		
Non-callable	\$ 39,727	\$ 60,543
Callable	13,042	8,778
Total par value	\$ 52,769	\$ 69,321

The following is a summary of the Bank's participation in consolidated obligation bonds outstanding at December 31, 2013 and 2012, by the earlier of the year of contractual maturity or next call date.

Earlier of Contractual Maturity or Next Call Date	2013	2012
Within 1 year	\$ 36,093	\$ 48,712
After 1 year through 2 years	6,046	9,271
After 2 years through 3 years	7,550	3,547
After 3 years through 4 years	1,478	6,131
After 4 years through 5 years	830	1,093
After 5 years	772	567
Total par value	\$ 52,769	\$ 69,321

Consolidated obligation discount notes are consolidated obligations issued to raise short-term funds. These notes are issued at less than their face value and redeemed at par value when they mature. The Bank's participation in consolidated obligation discount notes, at December 31, 2013 and 2012, all of which are due within one year, was as follows:

	2013		2012	
	Amount Outstanding	Weighted Average Interest Rate	Amount Outstanding	Weighted Average Interest Rate
Par value	\$ 24,199	0.10%	\$ 5,211	0.15%
Unamortized discounts	(5)		(2)	
Total	\$ 24,194		\$ 5,209	

Interest Rate Payment Terms. Interest rate payment terms for consolidated obligations at December 31, 2013 and 2012, are detailed in the following table.

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

	2013	2012
Par value of consolidated obligations:		
Bonds:		
Fixed rate	\$ 38,489	\$ 40,823
Adjustable rate	11,218	26,918
Step-up	2,460	1,345
Step-down	340	165
Fixed rate that converts to adjustable rate	262	70
Total bonds, par	52,769	69,321
Discount notes, par	24,199	5,211
Total consolidated obligations, par	\$ 76,968	\$ 74,532

Consolidated obligation bonds are structured to meet the Bank's and/or investors' needs. Common structures include fixed rate bonds with or without call options and adjustable rate bonds with or without embedded options. In general, when bonds with these structures are issued, the Bank will simultaneously execute an interest rate exchange agreement with terms that offset the terms and embedded options, if any, of the consolidated obligation bond. This combination of the consolidated obligation bond and the interest rate exchange agreement effectively creates an adjustable rate bond. The cost of this funding combination is generally lower than the cost that would be available through the issuance of an adjustable rate bond alone. These transactions generally receive fair value hedge accounting treatment. In addition, for certain consolidated obligation bonds for which the Bank has elected the fair value option, the Bank will simultaneously execute an interest rate exchange agreement with terms that economically offset the terms of the consolidated obligation bond. However, this type of hedge is treated as an economic hedge because these combinations generally do not meet the requirements for fair value hedge accounting treatment. For more information, see Note 19 – Derivatives and Hedging Activities and Note 20 – Fair Value.

The Bank did not have any bonds with embedded features that met the requirements to separate the embedded feature from the host contract and designate the embedded feature as a stand-alone derivative at December 31, 2013 and 2012. In general, the Bank has elected to account for bonds with embedded features under the fair value option, and these bonds are carried at fair value on the Statements of Condition. For more information, see Note 20 – Fair Value.

Note 13 — Affordable Housing Program

The FHLBank Act requires each FHLBank to establish an Affordable Housing Program (AHP). Each FHLBank provides subsidies to members, which use the funds to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Subsidies may be in the form of direct grants or below-market interest rate advances. Annually, the FHLBanks must set aside for their AHPs, in the aggregate, the greater of \$100 or 10% of the current year's net earnings (income before interest expense related to mandatorily redeemable capital stock and the assessment for AHP, but after the assessment for REFCORP before the REFCORP obligation was fully satisfied). The exclusion of interest expense related to mandatorily redeemable capital stock is based on an advisory bulletin issued by the Finance Board. The FHLBanks fully satisfied their REFCORP obligation with their payment made on July 15, 2011. For more information, see Note 14 – Resolution Funding Corporation Assessments.

The Bank accrues its AHP assessment monthly based on its net earnings. If the Bank experienced a net loss during a quarter but still had net earnings for the year, the Bank's obligation to the AHP would be calculated based on the Bank's year-to-date net earnings. If the Bank had net earnings in subsequent quarters, it would be required to contribute additional amounts to meet its calculated annual obligation. If the Bank experienced a net loss for a full year, the amount of the AHP liability would be equal to zero, since each FHLBank's required annual AHP contribution is limited to its annual net earnings. However, if the result of the aggregate 10% calculation is less than \$100 for all 12 FHLBanks, then the FHLBank Act requires that each FHLBank contribute such prorated sums as

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

may be required to ensure that the aggregate contribution of the FHLBanks equals \$100. The proration would be made on the basis of an FHLBank's income in relation to the income of all the FHLBanks for the previous year. There was no AHP shortfall, as described above, in 2013, 2012, or 2011. If an FHLBank finds that its required AHP assessments are contributing to the financial instability of that FHLBank, it may apply to the Finance Agency for a temporary suspension of its contributions. The Bank did not make such an application in 2013, 2012, or 2011.

The Bank's total AHP assessments equaled \$52, \$60, and \$25 during 2013, 2012, and 2011, respectively. These amounts were charged to earnings each year and recognized as a liability. As subsidies are disbursed, the AHP liability is reduced. The AHP liability was as follows:

	2013	2012	2011
Balance, beginning of the year	\$ 144	\$ 150	\$ 174
AHP assessments	52	60	25
AHP grant payments	(45)	(66)	(49)
Balance, end of the year	\$ 151	\$ 144	\$ 150

All subsidies were distributed in the form of direct grants in 2013, 2012, and 2011.

Note 14 — Resolution Funding Corporation Assessments

The FHLBanks were required to make payments to REFCORP from 1990 to 2011. REFCORP was established in 1989 under 12 U.S.C. Section 1441b as a means of funding the Resolution Trust Corporation, a federal instrumentality established to provide funding for the resolution and disposition of insolvent savings institutions. Each FHLBank was required to pay 20% of income calculated in accordance with U.S. GAAP after the assessment for AHP, but before the assessment for REFCORP. The AHP and REFCORP assessments were calculated simultaneously because of their interdependence. Calculation of the AHP assessment is discussed in Note 13 – Affordable Housing Program.

On August 5, 2011, the Finance Agency certified that the FHLBanks had fully satisfied their REFCORP obligation with their payment made on July 15, 2011. During 2011, the FHLBanks entered into a Joint Capital Enhancement Agreement, as amended (Agreement), that requires each FHLBank to allocate 20% of its net income to a separate restricted retained earnings account at that FHLBank until the balance of the account equals at least 1% of that FHLBank's average balance of outstanding consolidated obligations for the previous quarter. The FHLBanks began allocating 20% of net income to their new restricted retained earnings accounts in the third quarter of 2011. Under the Agreement, these restricted retained earnings will not be available to pay dividends. For more information, see Note 16 – Capital.

Because the REFCORP obligation was fully satisfied by the FHLBanks' payment for the second quarter of 2011, the Bank did not record a REFCORP assessment for the years ended December 31, 2013 and 2012, and in each of the last two quarters of 2011. The Bank's total REFCORP assessments equaled \$17 in 2011.

Changes in the Bank's REFCORP (asset)/liability were as follows:

	2011
Balance, beginning of the year	\$ 37
REFCORP assessments	17
REFCORP payments	(54)
Balance, end of the year	\$ —

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

Note 15 — Accumulated Other Comprehensive Income/(Loss)

The following table summarizes the changes in accumulated other comprehensive income/(loss) for the years ended December 31, 2013, 2012, and 2011:

	Net Unrealized Gain/(Loss) on AFS Securities	Net Non-Credit- Related OTTI Loss on AFS Securities	Net Non-Credit- Related OTTI Loss on HTM Securities	Pension and Postretirement Benefits	Total Accumulated Other Comprehensive Income/(Loss)
Balance, December 31, 2010	\$ (2)	\$ —	\$ (2,934)	\$ (7)	\$ (2,943)
Other comprehensive income/(loss) before reclassifications:					
Net change in pension and postretirement benefits				(5)	(5)
Non-credit-related OTTI loss			(207)		(207)
Non-credit-related OTTI loss transferred		(2,672)	2,672		—
Net change in fair value	3	810			813
Accretion of non-credit-related OTTI loss			266		266
Reclassification from other comprehensive income/(loss) to net income/(loss):					
Non-credit-related OTTI to credit-related OTTI		26	157		183
Net current period other comprehensive income/(loss)	3	(1,836)	2,888	(5)	1,050
Balance, December 31, 2011	1	(1,836)	(46)	(12)	(1,893)
Other comprehensive income/(loss) before reclassifications:					
Non-credit-related OTTI loss			(25)		(25)
Non-credit-related OTTI loss transferred		(28)	28		—
Net change in fair value	(1)	1,102			1,101
Accretion of non-credit-related OTTI loss			9		9
Reclassification from other comprehensive income/(loss) to net income/(loss):					
Non-credit-related OTTI to credit-related OTTI		14	—		14
Net current period other comprehensive income/(loss)	(1)	1,088	12	—	1,099
Balance, December 31, 2012	—	(748)	(34)	(12)	(794)
Other comprehensive income/(loss) before reclassifications:					
Net change in pension and postretirement benefits				5	5
Non-credit-related OTTI loss			(4)		(4)
Non-credit-related OTTI loss transferred		(4)	4		—
Net change in fair value		644			644
Accretion of non-credit-related OTTI loss			7		7
Reclassification from other comprehensive income/(loss) to net income/(loss):					
Non-credit-related OTTI to credit-related OTTI		(3)	—		(3)
Net current period other comprehensive income/(loss)	—	637	7	5	649
Balance, December 31, 2013	\$ —	\$ (111)	\$ (27)	\$ (7)	\$ (145)

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Note 16 — Capital

Capital Requirements. The Bank issues only one class of capital stock, Class B stock, with a par value of one hundred dollars per share, which may be redeemed (subject to certain conditions) upon five years' notice by the member to the Bank. In addition, at its discretion, under certain conditions, the Bank may repurchase excess capital stock at any time. (See "Excess Capital Stock" below for more information.) The capital stock may be issued, redeemed, and repurchased only at its stated par value, subject to certain statutory and regulatory requirements. The Bank may only redeem or repurchase capital stock from a shareholder if, following the redemption or repurchase, the shareholder will continue to meet its minimum capital stock requirement and the Bank will continue to meet its regulatory requirements for total capital, leverage capital, and risk-based capital.

Under the Housing Act, the Director of the Finance Agency is responsible for setting the risk-based capital standards for the FHLBanks. The FHLBank Act and regulations governing the operations of the FHLBanks require that the Bank's minimum capital stock requirement for shareholders must be sufficient to enable the Bank to meet its regulatory requirements for total capital, leverage capital, and risk-based capital. The Bank must maintain: (i) total regulatory capital in an amount equal to at least 4% of its total assets, (ii) leverage capital in an amount equal to at least 5% of its total assets, and (iii) permanent capital in an amount at least equal to its risk-based capital requirement. Because the Bank issues only Class B stock, regulatory capital and permanent capital for the Bank are both composed of retained earnings and Class B stock, including mandatorily redeemable capital stock (which is classified as a liability for financial reporting purposes). Regulatory capital and permanent capital do not include AOCI. Leverage capital is defined as the sum of permanent capital, weighted by a 1.5 multiplier, plus non-permanent capital.

The Bank's permanent capital must be greater than or equal to its risk-based capital requirement, which is equal to the sum of the Bank's credit risk, market risk, and operations risk capital requirements, all of which are calculated in accordance with the rules and regulations of the Finance Agency. The Finance Agency may require an FHLBank to maintain a greater amount of permanent capital than is required by the risk-based capital requirement as defined.

As of December 31, 2013 and 2012, the Bank was in compliance with these capital rules and requirements as shown in the following table.

	2013		2012	
	Required	Actual	Required	Actual
Risk-based capital	\$ 3,912	\$ 7,925	\$ 4,073	\$ 10,750
Total regulatory capital	\$ 3,431	\$ 7,925	\$ 3,457	\$ 10,750
Total regulatory capital ratio	4.00%	9.24%	4.00%	12.44%
Leverage capital	\$ 4,289	\$ 11,888	\$ 4,321	\$ 16,125
Leverage ratio	5.00%	13.86%	5.00%	18.66%

The Bank's capital plan requires each member to own capital stock in an amount equal to the greater of its membership capital stock requirement or its activity-based capital stock requirement. The Bank may adjust these requirements from time to time within limits established in the capital plan. Any changes to the capital plan must be approved by the Bank's Board of Directors and the Finance Agency.

A member's membership capital stock requirement is 1.0% of its membership asset value. The membership capital stock requirement for a member is capped at \$25. The Bank may adjust the membership capital stock requirement for all members within a range of 0.5% to 1.5% of a member's membership asset value and may adjust the cap for all members within an authorized range of \$10 to \$50. A member's membership asset value is determined by multiplying the amount of the member's membership assets by the applicable membership asset factors. Membership assets are those assets (other than Bank capital stock) of a type that could qualify as collateral to secure a member's indebtedness to the Bank under applicable law, whether or not the assets are pledged to the Bank or

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Notes to Financial Statements (continued)**

accepted by the Bank as eligible collateral. The membership asset factors were initially based on the typical borrowing capacity percentages generally assigned by the Bank to the same types of assets when pledged to the Bank (although the factors may differ from the actual borrowing capacities, if any, assigned to particular assets pledged by a specific member at any point in time).

A member's activity-based capital stock requirement is the sum of 4.7% of the member's outstanding advances plus 5.0% of any portion of any mortgage loan sold by the member and owned by the Bank. The Bank may adjust the activity-based capital stock requirement for all members within a range of 4.4% to 5.0% of the member's outstanding advances and a range of 5.0% to 5.7% of any portion of any mortgage loan sold by the member and owned by the Bank.

The Gramm-Leach-Bliley Act (GLB Act) established voluntary membership for all members. Any member may withdraw from membership and, subject to certain statutory and regulatory restrictions, have its capital stock redeemed after giving the required notice. Members that withdraw from membership may not reapply for membership for five years, in accordance with Finance Agency rules.

Mandatorily Redeemable Capital Stock. The Bank reclassifies the capital stock subject to redemption from capital to a liability after a member provides the Bank with a written notice of redemption; gives notice of intention to withdraw from membership; or attains nonmember status by merger or acquisition, charter termination, or other involuntary membership termination; or after a receiver or other liquidating agent for a member transfers the member's Bank capital stock to a nonmember entity, resulting in the member's shares then meeting the definition of a mandatorily redeemable financial instrument. Shares meeting this definition are reclassified to a liability at fair value. Dividends declared on shares classified as a liability are accrued at the expected dividend rate and reflected as interest expense in the Statements of Income. The repayment of these mandatorily redeemable financial instruments (by repurchase or redemption of the shares) is reflected as a financing cash outflow in the Statements of Cash Flows once settled.

The Bank has a cooperative ownership structure under which members, former members, and certain other nonmembers own the Bank's capital stock. Former members and certain other nonmembers are required to maintain their investment in the Bank's capital stock until their outstanding transactions are paid off or until their capital stock is redeemed following the relevant five-year redemption period for capital stock or is repurchased by the Bank, in accordance with the Bank's capital requirements. Capital stock cannot be issued, repurchased, redeemed, or transferred except between the Bank and its members (or their affiliates and successors) at the capital stock's par value of one hundred dollars per share. If a member cancels its written notice of redemption or notice of withdrawal or if the Bank allows the transfer of mandatorily redeemable capital stock to a member, the Bank reclassifies mandatorily redeemable capital stock from a liability to capital. After the reclassification, dividends on the capital stock are no longer classified as interest expense.

The Bank will not redeem or repurchase capital stock required to meet the minimum capital stock requirement until five years after the member's membership is terminated or after the Bank receives notice of the member's withdrawal, and the Bank will redeem or repurchase only the amounts that are in excess of the capital stock required to support activity (advances and mortgage loans) that may remain outstanding after the five-year redemption period has expired. The Bank will not redeem or repurchase activity-based capital stock as long as the activity remains outstanding, even after the expiration of the five-year redemption period. In both cases, the Bank will only redeem or repurchase capital stock if certain statutory and regulatory conditions are met. In accordance with the Bank's current practice, if activity-based capital stock becomes excess capital stock because an activity no longer remains outstanding, the Bank may repurchase the excess activity-based capital stock at its discretion, subject to certain statutory and regulatory conditions, on a scheduled quarterly basis.

The Bank had mandatorily redeemable capital stock totaling \$2,071 outstanding to 44 institutions at December 31, 2013, and \$4,343 outstanding to 53 institutions at December 31, 2012. The change in mandatorily redeemable capital stock for the years ended December 31, 2013, 2012, and 2011 was as follows:

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Notes to Financial Statements (continued)**

	2013	2012	2011
Balance at the beginning of the year	\$ 4,343	\$ 5,578	\$ 3,749
Reclassified from/(to) capital during the period:			
Merger with or acquisition by nonmember institution	4	30	19
Withdrawal from membership	—	3	—
Termination of membership ⁽¹⁾	—	4	3,169
Acquired by/transferred to members ⁽²⁾	—	—	(500)
Redemption of mandatorily redeemable capital stock	(502)	(43)	(57)
Repurchase of excess mandatorily redeemable capital stock	(1,774)	(1,229)	(802)
Balance at the end of the year	\$ 2,071	\$ 4,343	\$ 5,578

- (1) The Bank reclassified \$3,165 of capital stock to mandatorily redeemable capital stock (a liability) on June 28, 2011, as a result of the membership termination of Citibank, N.A., which became ineligible for membership in the Bank when it became a member of another FHLBank in connection with its merger with an affiliate outside of the Bank's district.
- (2) During the first quarter of 2011, the Bank allowed the transfer of excess capital stock totaling \$500, from JPMorgan Chase Bank, National Association, to JPMorgan Bank and Trust Company, National Association, to enable JPMorgan Bank and Trust Company, National Association, to satisfy its activity-based capital stock requirement. The capital stock transferred is no longer classified as mandatorily redeemable capital stock (a liability). However, the capital stock remaining with JPMorgan Chase Bank, National Association, remains classified as mandatorily redeemable capital stock (a liability).

Cash dividends on mandatorily redeemable capital stock in the amount of \$155, \$51, and \$12 were recorded as interest expense in December 31, 2013, 2012, and 2011, respectively.

The following table presents mandatorily redeemable capital stock amounts by contractual redemption period at December 31, 2013 and 2012.

Contractual Redemption Period	2013	2012
Within 1 year	\$ 571	\$ 847
After 1 year through 2 years	111	1,003
After 2 years through 3 years	1,289	194
After 3 years through 4 years	20	2,263
After 4 years through 5 years	3	36
Past contractual redemption date because of remaining activity ⁽¹⁾	77	—
Total	\$ 2,071	\$ 4,343

- (1) Represents mandatorily redeemable capital stock that is past the end of the contractual redemption period because of outstanding activity.

A member may cancel its notice of redemption or notice of withdrawal from membership by providing written notice to the Bank prior to the end of the relevant five-year redemption period or the membership termination date. If the Bank receives the notice of cancellation within 30 months following the notice of redemption or notice of withdrawal, the member is charged a fee equal to fifty cents multiplied by the number of shares of capital stock affected. If the Bank receives the notice of cancellation more than 30 months following the notice of redemption or notice of withdrawal (or if the Bank does not redeem the member's capital stock because following the redemption the member would fail to meet its minimum capital stock requirement), the member is charged a fee equal to one dollar multiplied by the number of shares of capital stock affected. In certain cases the Board of Directors may waive a cancellation fee for bona fide business purposes.

The Bank's capital stock is considered putable by the shareholder. There are significant statutory and regulatory restrictions on the Bank's obligation or ability to redeem outstanding capital stock, which include the following:

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Notes to Financial Statements (continued)**

- The Bank may not redeem any capital stock if, following the redemption, the Bank would fail to meet its minimum capital requirements for total capital, leverage capital, and risk-based capital. All of the Bank's capital stock immediately becomes nonredeemable if the Bank fails to meet its minimum capital requirements.
- The Bank may not be able to redeem any capital stock if either its Board of Directors or the Finance Agency determines that it has incurred or is likely to incur losses resulting in or expected to result in a charge against capital that would have any of the following effects: cause the Bank not to comply with its regulatory capital requirements, result in negative retained earnings, or otherwise create an unsafe and unsound condition at the Bank.
- In addition to being able to prohibit capital stock redemptions, the Bank's Board of Directors has a right and an obligation to call for additional capital stock purchases by its members, as a condition of continuing membership, as needed for the Bank to satisfy its statutory and regulatory capital requirements.
- If, during the period between receipt of a capital stock redemption notice and the actual redemption (a period that could last indefinitely), the Bank becomes insolvent and is either liquidated or merged with another FHLBank, the redemption value of the capital stock will be established either through the liquidation or the merger process. If the Bank is liquidated, after satisfaction of the Bank's obligations to creditors and to the extent funds are then available, each shareholder will be entitled to receive the par value of its capital stock as well as any retained earnings in an amount proportional to the shareholder's share of the total shares of capital stock, subject to any limitations that may be imposed by the Finance Agency. In the event of a merger or consolidation, the Board of Directors will determine the rights and preferences of the Bank's shareholders, subject to any terms and conditions imposed by the Finance Agency.
- The Bank may not redeem any capital stock if the principal or interest due on any consolidated obligations issued by the Office of Finance has not been paid in full.
- The Bank may not redeem any capital stock if the Bank fails to provide the Finance Agency with the quarterly certification required by section 1270.10(b)(1) of the Finance Agency rules prior to declaring or paying dividends for a quarter.
- The Bank may not redeem any capital stock if the Bank is unable to provide the required quarterly certification, projects that it will fail to comply with statutory or regulatory liquidity requirements or will be unable to fully meet all of its obligations on a timely basis, actually fails to satisfy these requirements or obligations, or negotiates to enter or enters into an agreement with another FHLBank to obtain financial assistance to meet its current obligations.

Mandatorily redeemable capital stock is considered capital for determining the Bank's compliance with its regulatory capital requirements. Based on Finance Agency interpretation, the classification of certain shares of the Bank's capital stock as mandatorily redeemable does not affect the definition of total capital for purposes of: determining the Bank's compliance with its regulatory capital requirements, calculating its mortgage-backed securities investment authority (300% of total capital), calculating its unsecured credit exposure to other GSEs (limited to 100% of total capital), or calculating its unsecured credit limits to other counterparties (various percentages of total capital depending on the rating of the counterparty).

Excess Stock Repurchase, Retained Earnings, and Dividend Framework. By Finance Agency regulation, dividends may be paid only out of current net earnings or previously retained earnings. As required by the Finance Agency, the Bank's Excess Stock Repurchase, Retained Earnings, and Dividend Framework is reviewed at least annually by the Bank's Board of Directors. It summarizes the Bank's capital management principles, strategy, and objectives, as well as its policies, analysis, and practices with respect to retained earnings, dividend payments, and the repurchase of excess capital stock. The Board of Directors may amend the Excess Stock Repurchase, Retained Earnings, and Dividend Framework from time to time.

The Bank's Excess Stock Repurchase, Retained Earnings, and Dividend Framework establishes amounts to be retained in restricted retained earnings, which are not made available for dividends in the current dividend period. The Bank may be restricted from paying dividends if the Bank is not in compliance with any of its minimum capital requirements or if payment would cause the Bank to fail to meet any of its minimum capital requirements. In

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Notes to Financial Statements (continued)**

addition, the Bank may not pay dividends if any principal or interest due on any consolidated obligations has not been paid in full or is not expected to be paid in full by any FHLBank, or, under certain circumstances, if the Bank fails to satisfy certain liquidity requirements under applicable Finance Agency regulations.

The Bank's Risk Management Policy limits the payment of dividends based on the ratio of the Bank's estimated market value of total capital to par value of capital stock. If this ratio at the end of any quarter is less than 100% but greater than or equal to 70%, any dividend would be limited to an annualized rate no greater than the daily average of the three-month LIBOR for the applicable quarter (subject to certain conditions), and if this ratio is less than 70%, the Bank would be restricted from paying a dividend. The ratio of the Bank's estimated market value of total capital to par value of capital stock was 144.9% as of December 31, 2013.

Retained Earnings Related to Valuation Adjustments - In accordance with the Bank's Excess Stock Repurchase, Retained Earnings, and Dividend Framework, the Bank retains in restricted retained earnings any cumulative net gains in earnings (net of applicable assessments) resulting from gains or losses on derivatives and associated hedged items and financial instruments carried at fair value (valuation adjustments).

In general, the Bank's derivatives and hedged instruments, as well as certain assets and liabilities that are carried at fair value, are held to the maturity, call, or put date. For these financial instruments, net valuation gains or losses are primarily a matter of timing and will generally reverse through changes in future valuations and settlements of contractual interest cash flows over the remaining contractual terms to maturity, or by the exercised call or put dates. However, the Bank may have instances in which hedging relationships are terminated prior to maturity or prior to the call or put dates. Terminating the hedging relationship may result in a realized gain or loss. In addition, the Bank may have instances in which it may sell trading securities prior to maturity, which may also result in a realized gain or loss.

The purpose of retaining cumulative net gains in earnings resulting from valuation adjustments as restricted retained earnings is to provide sufficient retained earnings to offset future net losses that result from the reversal of cumulative net gains, so that potential dividend payouts in future periods are not necessarily affected by the reversals of these gains. Although restricting retained earnings in this way may preserve the Bank's ability to pay dividends, the reversal of the cumulative net gains in any given period may result in a net loss if the reversal exceeds net earnings before the impact of valuation adjustments for that period.

Other Retained Earnings – Targeted Buildup – In addition to any cumulative net gains resulting from valuation adjustments, the Bank holds an additional amount in restricted retained earnings intended to protect paid-in capital from the effects of an extremely adverse credit event, an extremely adverse operations risk event, a cumulative net loss related to the Bank's derivatives and associated hedged items and financial instruments carried at fair value, an extremely adverse change in the market value of the Bank's capital, a significant amount of additional credit-related OTTI on PLRMBS, or some combination of these effects, especially in periods of extremely low net income resulting from an adverse interest rate environment.

The Board of Directors has set the targeted amount of restricted retained earnings at \$1,800, and the Bank reached this target as of March 31, 2012. The Bank's retained earnings target may be changed at any time. The Board of Directors periodically reviews the applicable methodology and analysis to determine whether any adjustments are appropriate. As of December 31, 2013, the amount of restricted retained earnings in the Bank's targeted buildup account was \$1,800.

Joint Capital Enhancement Agreement – In 2011, the 12 FHLBanks entered into a Joint Capital Enhancement Agreement, as amended (Agreement), which is intended to enhance the capital position of each FHLBank by allocating that portion of each FHLBank's earnings historically paid to satisfy its Resolution Funding Corporation (REFCORP) obligation to a separate retained earnings account at that FHLBank.

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Notes to Financial Statements (continued)**

On August 5, 2011, the Finance Agency certified that the FHLBanks had fully satisfied their REFCORP obligation. In accordance with the Agreement, starting in the third quarter of 2011, each FHLBank is required to allocate 20% of its net income each quarter to a separate restricted retained earnings account until the balance of the account equals at least 1% of that FHLBank's average balance of outstanding consolidated obligations for the previous quarter. Under the Agreement, these restricted retained earnings will not be available to pay dividends.

The following table summarizes the activity related to restricted retained earnings for the years ended December 31, 2013 and 2012:

	2013				2012			
	Restricted Retained Earnings Related to:				Restricted Retained Earnings Related to:			
	Valuation Adjustments	Targeted Buildup	Joint Capital Enhancement Agreement	Total	Valuation Adjustments	Targeted Buildup	Joint Capital Enhancement Agreement	Total
Balance at the beginning of the year	\$ 73	\$ 1,800	\$ 128	\$ 2,001	\$ 79	\$ 1,695	\$ 29	\$ 1,803
Transfers to/(from) restricted retained earnings	15	—	61	76	(6)	105	99	198
Balance at the end of the year	\$ 88	\$ 1,800	\$ 189	\$ 2,077	\$ 73	\$ 1,800	\$ 128	\$ 2,001

Dividend Payments – Finance Agency rules state that FHLBanks may declare and pay dividends only from previously retained earnings or current net earnings, and may not declare or pay dividends based on projected or anticipated earnings. There is no requirement that the Board of Directors declare and pay any dividend. A decision by the Board of Directors to declare or not declare a dividend is a discretionary matter and is subject to the requirements and restrictions of the FHLBank Act and applicable requirements under the regulations governing the operations of the FHLBanks.

The Bank currently pays dividends in cash rather than capital stock to comply with Finance Agency rules, which do not permit the Bank to pay dividends in the form of capital stock if its excess capital stock exceeds 1% of its total assets. Excess capital stock is defined as the aggregate of the capital stock held by each shareholder in excess of its minimum capital stock requirement, as established by the Bank's capital plan. As of December 31, 2013, the Bank's excess capital stock totaled \$2,446, or 2.85% of total assets.

Dividends on capital stock are recognized as cash dividends on the Statements of Capital Accounts, and dividends on mandatorily redeemable capital stock are recognized as interest expense on the Statements of Income.

The Bank paid dividends (including dividends on mandatorily redeemable capital stock) totaling \$316 at an annualized rate of 3.99% in 2013 and \$98 at an annualized rate of 0.97% in 2012.

On February 20, 2014, the Bank's Board of Directors declared a cash dividend on the capital stock outstanding during the fourth quarter of 2013 at an annualized rate of 6.67%, totaling \$98, including \$59 in dividends on capital stock and \$39 in dividends on mandatorily redeemable capital stock. The Bank recorded the dividend on February 20, 2014, the day it was declared by the Board of Directors. The Bank expects to pay the dividend on or about March 20, 2014. Dividends on mandatorily redeemable capital stock will be recognized as interest expense in the first quarter of 2014.

The Bank will continue to monitor the condition of its PLRMBS portfolio, the ratio of the estimated market value of the Bank's capital to the par value of the Bank's capital stock, its overall financial performance and retained earnings, developments in the mortgage and credit markets, and other relevant information as the basis for determining the payment of dividends in future quarters.

Excess Capital Stock – The Bank may repurchase some or all of a shareholder's excess capital stock, including any excess mandatorily redeemable capital stock, at the Bank's discretion, subject to certain statutory and regulatory requirements. The Bank must give the shareholder 15 days' written notice; however, the shareholder may waive this

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

notice period. The Bank may also repurchase some or all of a shareholder's excess capital stock at the shareholder's request, at the Bank's discretion, subject to certain statutory and regulatory requirements. A shareholder's excess capital stock is defined as any capital stock holdings in excess of the shareholder's minimum capital stock requirement, as established by the Bank's capital plan.

On a quarterly basis, the Bank determines whether it will repurchase excess capital stock. The Bank repurchased \$3,000 and \$2,093 in excess capital stock during 2013 and 2012, respectively.

During 2013 and 2012, the five-year redemption period for \$502 and \$43, respectively, in mandatorily redeemable capital stock expired, and the Bank redeemed the capital stock at its \$100 par value on the relevant scheduled redemption dates.

On February 20, 2014, the Bank announced that it plans to repurchase \$750 in excess capital stock on March 21, 2014. The amount of excess capital stock to be repurchased from each shareholder will be based on the total amount of capital stock (including mandatorily redeemable capital stock) outstanding to all shareholders on the repurchase date. The Bank will repurchase an equal percentage of each shareholder's total capital stock to the extent that the shareholder has sufficient excess capital stock.

The Bank will continue to monitor the condition of its PLRMBS portfolio, the ratio of the estimated market value of the Bank's capital to the par value of the Bank's capital stock, its overall financial performance and retained earnings, developments in the mortgage and credit markets, and other relevant information as the basis for determining the repurchase of excess capital stock in future quarters.

Excess capital stock totaled \$2,446 as of December 31, 2013, and \$5,452 as of December 31, 2012.

Concentration. The following table presents the concentration in capital stock held by institutions whose capital stock ownership represented 10% or more of the Bank's outstanding capital stock, including mandatorily redeemable capital stock, as of December 31, 2013 and 2012.

Name of Institution	2013		2012	
	Capital Stock Outstanding	Percentage of Total Capital Stock Outstanding	Capital Stock Outstanding	Percentage of Total Capital Stock Outstanding
Citigroup Inc.:				
Citibank, N.A. ⁽¹⁾	\$ 1,279	23%	\$ 2,246	26%
Banamex USA	1	—	2	—
Subtotal Citigroup Inc.	1,280	23	2,248	26
JPMorgan Chase & Co.:				
JPMorgan Bank & Trust Company, National Association	594	11	1,044	13
JPMorgan Chase Bank, National Association ⁽¹⁾	77	1	695	8
Subtotal JPMorgan Chase & Co.	671	12	1,739	21
Wells Fargo & Company:				
Wells Fargo Bank, N.A. ⁽¹⁾	518	9	909	11
Wells Fargo Financial National Bank	5	—	3	—
Subtotal Wells Fargo & Company	523	9	912	11
Total capital stock ownership over 10%	2,474	44	4,899	58
Others	3,057	56	3,604	42
Total	\$ 5,531	100%	\$ 8,503	100%

(1) The capital stock held by these nonmember institutions is classified as mandatorily redeemable capital stock.

Note 17 — Employee Retirement Plans and Incentive Compensation Plans

Defined Benefit Plans

Qualified Defined Benefit Plan. The Bank provides retirement benefits through a Bank-sponsored Cash Balance Plan, a qualified defined benefit plan. The Cash Balance Plan is provided to all employees who have completed six months of Bank service. Under the plan, each eligible Bank employee accrues benefits annually equal to 6% of the employee's annual compensation, plus 6% interest on the benefits accrued to the employee through the prior yearend. The Cash Balance Plan is funded through a qualified trust established by the Bank.

Non-Qualified Defined Benefit Plans. The Bank sponsors the following non-qualified defined benefit retirement plans:

- Benefit Equalization Plan, a non-qualified retirement plan restoring benefits offered under the Cash Balance Plan that are limited by laws governing the plan. See below for further discussion of the defined contribution portion of the Benefit Equalization Plan.
- Supplemental Executive Retirement Plan (SERP), a non-qualified unfunded retirement benefit plan available to the Bank's eligible senior officers, which generally provides a service-linked supplemental cash balance annual contribution credit to SERP participants and an annual interest credit of 6% that is in addition to the contributions made to the Cash Balance Plan.
- Deferred Compensation Plan, a non-qualified retirement plan available to eligible Bank officers, which provides make-up pension benefits that would have been earned under the Cash Balance Plan had the compensation not been deferred. The make-up benefits vest according to the corresponding provisions of the Cash Balance Plan. See below for further discussion of the defined contribution portion of the Deferred Compensation Plan.

Postretirement Health Benefit Plan. The Bank provides a postretirement health benefit plan to employees hired before January 1, 2003. The Bank's costs are capped at 1998 health care premium amounts. As a result, changes in health care cost trend rates will have no effect on the Bank's accumulated postretirement benefit obligation or service and interest costs.

The following table summarizes the changes in the benefit obligations, plan assets, and funded status of the defined benefit Cash Balance Plan, non-qualified defined benefit plans, and postretirement health benefit plan for the years ended December 31, 2013 and 2012.

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Notes to Financial Statements (continued)**

	2013			2012		
	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan
Change in benefit obligation						
Benefit obligation, beginning of the year	\$ 36	\$ 18	\$ 2	\$ 31	\$ 16	\$ 2
Service cost	3	2	—	3	1	—
Interest cost	1	1	—	1	1	—
Amendments	—	1	—	—	—	—
Actuarial gain/(loss)	(2)	(1)	—	1	1	—
Benefits paid	(1)	—	—	—	(1)	—
Benefit obligation, end of the year	\$ 37	\$ 21	\$ 2	\$ 36	\$ 18	\$ 2
Change in plan assets						
Fair value of plan assets, beginning of the year	\$ 32	\$ —	\$ —	\$ 24	\$ —	\$ —
Actual return on plan assets	5	—	—	3	—	—
Employer contributions	2	—	—	5	1	—
Benefits paid	(1)	—	—	—	(1)	—
Fair value of plan assets, end of the year	\$ 38	\$ —	\$ —	\$ 32	\$ —	\$ —
Funded status at the end of the year	\$ 1	\$ (21)	\$ (2)	\$ (4)	\$ (18)	\$ (2)

Amounts recognized in the Statements of Condition at December 31, 2013 and 2012, consist of:

	2013			2012		
	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan
Other liabilities	\$ 1	\$ (21)	\$ (2)	\$ (4)	\$ (18)	\$ (2)

Amounts recognized in AOCI at December 31, 2013 and 2012, consist of:

	2013			2012		
	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan
Net loss/(gain)	\$ 5	\$ 3	\$ (2)	\$ 10	\$ 3	\$ (1)
Prior service cost	—	1	—	—	—	—
AOCI	\$ 5	\$ 4	\$ (2)	\$ 10	\$ 3	\$ (1)

The following table presents information for pension plans with benefit obligations in excess of plan assets at December 31, 2013 and 2012.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

	2013			2012		
	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan
Projected benefit obligation	\$ 37	\$ 21	\$ 2	\$ 36	\$ 18	\$ 2
Accumulated benefit obligation	36	20	2	34	17	2
Fair value of plan assets	38	—	—	32	—	—

Components of the net periodic benefit costs and other amounts recognized in other comprehensive income for the years ended December 31, 2013, 2012, and 2011, were as follows:

	2013			2012			2011		
	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan
Net periodic benefit cost/(income)									
Service cost	\$ 3	\$ 2	\$ —	\$ 3	\$ 1	\$ —	\$ 2	\$ 1	\$ —
Interest cost	1	1	—	1	1	—	1	1	—
Expected return on plan assets	(3)	—	—	(2)	—	—	(2)	—	—
Amortization of net loss/(gain)	1	—	—	1	—	—	—	—	—
Net periodic benefit cost	2	3	—	3	2	—	1	2	—
Other changes in plan assets and benefit obligations recognized in other comprehensive income									
Net loss/(gain)	(5)	—	(1)	(1)	—	—	4	2	(1)
Prior service cost	—	1	—	—	—	—	—	—	—
Total recognized in other comprehensive income	(5)	1	(1)	(1)	—	—	4	2	(1)
Total recognized in net periodic benefit cost and other comprehensive income	\$ (3)	\$ 4	\$ (1)	\$ 2	\$ 2	\$ —	\$ 5	\$ 4	\$ (1)

The amounts in AOCI expected to be recognized as components of net periodic benefit cost in 2014 are de minimis.

Weighted average assumptions used to determine the benefit obligations at December 31, 2013 and 2012, for the Cash Balance Plan, non-qualified defined benefit plans, and postretirement health benefit plan were as follows:

	2013			2012		
	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan
Discount rate	4.25%	4.25%	4.75%	3.25%	3.25%	3.75%
Rate of salary increase	3.00% through 2015 4.00% thereafter	3.00% through 2015 4.00% thereafter	—	3.00% through 2015 4.00% thereafter	3.00% through 2015 4.00% thereafter	—

Weighted average assumptions used to determine the net periodic benefit costs for the years ended December 31, 2013, 2012, and 2011, for the Cash Balance Plan, non-qualified defined benefit plans, and postretirement health benefit plan were as follows:

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

	2013			2012			2011		
	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Post-retirement Health Benefit Plan
Discount rate	3.25%	3.25%	3.75%	4.00%	4.00%	4.25%	5.00%	5.00%	5.50%
Rate of salary increase	3.00% through 2015 4.00% thereafter	3.00% through 2015 4.00% thereafter	—	4.00	4.00	—	4.00	4.00	—
Expected return on plan assets	8.00	—	—	8.00	—	—	8.00	—	—

The Bank uses a discount rate to determine the present value of its future benefit obligations. The discount rate was determined based on the Citigroup Pension Discount Curve at the measurement date. The Citigroup Pension Discount Curve is a yield curve that reflects the market-observed yields for high-quality fixed income securities for each maturity. The projected benefit payments for each year from the plan are discounted using the spot rates on the yield curve to derive a single equivalent discount rate. The discount rate is reset annually on the measurement date.

The expected return on plan assets was determined based on: (i) the historical returns for each asset class, (ii) the expected future long-term returns for these asset classes, and (iii) the plan's target asset allocation.

The table below presents the fair values of the Cash Balance Plan's assets as of December 31, 2013 and 2012, by asset category. See Note 20 – Fair Value for further information regarding the three levels of fair value measurement.

Asset Category	2013				2012			
	Fair Value Measurement Using:			Total	Fair Value Measurement Using:			Total
	Level 1	Level 2	Level 3		Level 1	Level 2	Level 3	
Cash and cash equivalents	\$ 1	\$ —	\$ —	\$ 1	\$ 1	\$ —	\$ —	\$ 1
Equity mutual funds	24	—	—	24	18	—	—	18
Fixed income mutual funds	12	—	—	12	11	—	—	11
Real estate mutual funds	1	—	—	1	1	—	—	1
Other mutual funds	—	—	—	—	1	—	—	1
Total	\$ 38	\$ —	\$ —	\$ 38	\$ 32	\$ —	\$ —	\$ 32

The Cash Balance Plan is administered by the Bank's Retirement Committee, which establishes the plan's Statement of Investment Policy and Objectives. The Retirement Committee has adopted a strategic asset allocation based on a stable distribution of assets among major asset classes. These asset classes include domestic large-, mid-, and small-capitalization equity investments; international equity investments; and fixed income investments. The Retirement Committee has set the Cash Balance Plan's target allocation percentages for a mix range of 50% to 70% equity and 30% to 50% fixed income. The Retirement Committee reviews the performance of the Cash Balance Plan on a regular basis.

The Cash Balance Plan's weighted average asset allocation at December 31, 2013 and 2012, by asset category was as follows:

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Asset Category	2013	2012
Cash and cash equivalents	2%	4%
Equity mutual funds	62	58
Fixed income mutual funds	32	34
Real estate mutual funds	2	2
Other mutual funds	2	2
Total	100%	100%

The Bank contributed \$2 in 2013 and expects to contribute \$2 in 2014 to the Cash Balance Plan. The Bank contributed a de minimis amount in 2013 and expects to contribute \$1 in 2014 to the non-qualified defined benefit plans and postretirement health benefit plan.

The following are the estimated future benefit payments, which reflect expected future service, as appropriate:

Year	Cash Balance Plan	Non-Qualified Defined Benefit Plans	Postretirement Health Benefit Plan
2014	\$ 2	\$ 1	\$ —
2015	3	3	—
2016	3	3	—
2017	3	2	—
2018	3	3	—
2019 – 2023	19	9	1

Defined Contribution Plans

Retirement Savings Plan. The Bank sponsors a qualified defined contribution retirement 401(k) savings plan, the Federal Home Loan Bank of San Francisco Savings Plan (Savings Plan). Contributions to the Savings Plan consist of elective participant contributions of up to 20% of each participant's base compensation and a Bank matching contribution of up to 6% of each participant's base compensation. The Bank contributed approximately \$2, \$2, and \$2 during the years ended December 31, 2013, 2012, and 2011, respectively.

Benefit Equalization Plan. The Bank sponsors a non-qualified retirement plan restoring benefits offered under the Savings Plan that have been limited by laws governing the plan. Contributions made during the years ended December 31, 2013, 2012, and 2011, were de minimis.

Deferred Compensation Plan. The Bank maintains a deferred compensation plan that is available to all eligible Bank officers and directors. The defined contribution portion of the plan is comprised of two components: (i) officer or director deferral of current compensation, and (ii) make-up matching contributions for officers that would have been made by the Bank under the Savings Plan had the compensation not been deferred. The make-up benefits under the Deferred Compensation Plan vest according to the corresponding provisions of the Savings Plan. The Deferred Compensation Plan liability consists of the accumulated compensation deferrals and accrued earnings on the deferrals, as well as the make-up matching contributions and any accrued earnings on the contributions. The Bank's obligation for this plan at December 31, 2013, 2012, and 2011, was \$30, \$25, and \$22, respectively.

Incentive Compensation Plans

The Bank provides incentive compensation plans for many of its employees, including senior officers. Other liabilities include \$12 and \$12 for incentive compensation at December 31, 2013 and 2012, respectively.

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

Note 18 — Segment Information

The Bank uses an analysis of financial performance based on the balances and adjusted net interest income of two operating segments, the advances-related business and the mortgage-related business, as well as other financial information, to review and assess financial performance and to determine the allocation of resources to these two major business segments. For purposes of segment reporting, adjusted net interest income includes interest income and expense associated with economic hedges that are recorded in “Net gain/(loss) on derivatives and hedging activities” in other income and excludes interest expense that is recorded in “Mandatorily redeemable capital stock.” Other key financial information, such as any credit-related OTTI charges on the Bank’s PLRMBS, other expenses, and assessments, is not included in the segment reporting analysis, but is incorporated into the Bank’s overall assessment of financial performance.

The advances-related business consists of advances and other credit products, related financing and hedging instruments, liquidity and other non-MBS investments associated with the Bank’s role as a liquidity provider, and capital stock. Adjusted net interest income for this segment is derived primarily from the difference, or spread, between the yield on all assets associated with the business activities in this segment and the cost of funding those activities, including cash flows from associated interest rate exchange agreements.

The mortgage-related business consists of MBS investments, mortgage loans acquired through the MPF Program, the consolidated obligations specifically identified as funding those assets, and related hedging instruments. Adjusted net interest income for this segment is derived primarily from the difference, or spread, between the yield on the MBS and mortgage loans and the cost of the consolidated obligations funding those assets, including the cash flows from associated interest rate exchange agreements, less the provision for credit losses on mortgage loans.

The following table presents the Bank’s adjusted net interest income by operating segment and reconciles total adjusted net interest income to income before assessments for the years ended December 31, 2013, 2012, and 2011.

	Advances- Related Business	Mortgage- Related Business ⁽¹⁾	Adjusted Net Interest Income	Amortization of Basis Adjustments ⁽²⁾	Net Interest Income/ (Expense) on Economic Hedges ⁽³⁾	Interest Expense on Mandatorily Redeemable Capital Stock ⁽⁴⁾	Net Interest Income	Other Income/ (Loss)	Other Expense	Income Before Assessments
2013	175	449	624	(48)	34	155	483	5	128	360
2012	274	512	786	(104)	(10)	51	849	(164)	134	551
2011	335	555	890	(118)	(33)	12	1,029	(645)	126	258

- (1) Does not include credit-related OTTI charges of \$7, \$44, and \$413 for the years ended December 31, 2013, 2012, and 2011, respectively.
- (2) Represents amortization of amounts deferred for adjusted net interest income purposes only, in accordance with the Bank’s Excess Stock Repurchase, Retained Earnings, and Dividend Framework.
- (3) The Bank includes interest income and interest expense associated with economic hedges in adjusted net interest income in its analysis of financial performance for its two operating segments. For financial reporting purposes, the Bank does not include these amounts in net interest income in the Statements of Income, but instead records them in other income in “Net gain/(loss) on derivatives and hedging activities.”
- (4) The Bank excludes interest expense on mandatorily redeemable capital stock from adjusted net interest income in its analysis of financial performance for its two operating segments.

The following table presents total assets by operating segment at December 31, 2013, 2012, and 2011.

	Advances- Related Business	Mortgage- Related Business	Total Assets
2013	\$ 62,297	\$ 23,477	\$ 85,774
2012	62,306	24,115	86,421
2011	88,302	25,250	113,552

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Note 19 — Derivatives and Hedging Activities

General. The Bank may enter into interest rate swaps (including callable, putable, and basis swaps); swaptions; and cap, floor, corridor, and collar agreements (collectively, interest rate exchange agreements or derivatives). Most of the Bank's interest rate exchange agreements are executed in conjunction with the origination of advances and the issuance of consolidated obligation bonds to create variable rate structures. The interest rate exchange agreements are generally executed at the same time the advances and bonds are transacted and generally have the same maturity dates as the related advances and bonds. The Bank transacts most of its derivatives with large banks and major broker-dealers. Some of these banks and broker-dealers or their affiliates buy, sell, and distribute consolidated obligations. Over-the-counter derivatives may be either transacted with a counterparty (bilateral derivatives) or cleared through a clearing agent with a derivative clearing organization (cleared derivatives). Once a derivative transaction has been accepted for clearing by a derivative clearing organization (clearinghouse), the derivative transaction is novated and the executing counterparty is replaced with the clearinghouse. The clearinghouse notifies the clearing agent of the required initial and variation margin, and the clearing agent notifies the Bank and transmits the required initial and variation margin from the Bank to the clearinghouse. The Bank is not a derivative dealer and does not trade derivatives for short-term profit.

Additional uses of interest rate exchange agreements include: (i) offsetting embedded features in assets and liabilities, (ii) hedging the anticipated issuance of debt, (iii) matching against consolidated obligation discount notes or bonds to create the equivalent of callable or non-callable fixed rate debt, (iv) modifying the repricing frequency of assets and liabilities, (v) matching against certain advances and consolidated obligations for which the Bank elected the fair value option, and (vi) exactly offsetting other derivatives executed with members (with the Bank serving as an intermediary). The Bank's use of interest rate exchange agreements results in one of the following classifications: (i) a fair value hedge of an underlying financial instrument, (ii) a cash flow hedge of an underlying financial instrument, (iii) an economic hedge of a specific asset or liability, or (iv) an intermediary transaction for members.

Interest Rate Swaps – An interest rate swap is an agreement between two entities to exchange cash flows in the future. The agreement sets the dates on which the cash flows will be paid and the manner in which the cash flows will be calculated. One of the simplest forms of an interest rate swap involves the promise by one party to pay cash flows equivalent to the interest on a notional principal amount at a predetermined fixed rate for a given period of time. In return for this promise, the party receives cash flows equivalent to the interest on the same notional principal amount at a variable rate for the same period of time. The variable rate received or paid by the Bank in most interest rate exchange agreements is indexed to LIBOR.

Swaptions – A swaption is an option on a swap that gives the buyer the right to enter into a specified interest rate swap at a certain time in the future. When used as a hedge, for example, a swaption can protect the Bank against future interest rate changes when it is planning to lend or borrow funds in the future.

Interest Rate Caps and Floors – In a cap agreement, additional cash flow is generated if the price or interest rate of an underlying variable rises above a certain threshold (or cap) price. In a floor agreement, additional cash flow is generated if the price or interest rate of an underlying variable falls below a certain threshold (or floor) price. Caps and floors may be used in conjunction with assets or liabilities. In general, caps and floors are designed as protection against the interest rate on a variable rate asset or liability rising above or falling below a certain level.

Hedging Activities. The Bank documents all relationships between derivative hedging instruments and hedged items, its risk management objectives and strategies for undertaking various hedge transactions, and its method of assessing effectiveness. This process includes linking all derivatives that are designated as fair value or cash flow hedges to: (i) assets and liabilities on the balance sheet, (ii) firm commitments, or (iii) forecasted transactions. The Bank also formally assesses (both at the hedge's inception and at least quarterly on an ongoing basis) whether the derivatives that are used in hedging transactions have been effective in offsetting changes in the fair value or cash flows of hedged items attributable to the hedged risk and whether those derivatives may be expected to remain

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

effective in future periods. The Bank typically uses regression analyses or other statistical analyses to assess the effectiveness of its hedges. When it is determined that a derivative has not been or is not expected to be effective as a hedge, the Bank discontinues hedge accounting prospectively.

The Bank discontinues hedge accounting prospectively when: (i) it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (ii) the derivative and/or the hedged item expires or is sold, terminated, or exercised; (iii) it is no longer probable that the forecasted transaction will occur in the originally expected period; (iv) a hedged firm commitment no longer meets the definition of a firm commitment; (v) it determines that designating the derivative as a hedging instrument is no longer appropriate; or (vi) it decides to use the derivative to offset changes in the fair value of other derivatives or instruments carried at fair value.

Intermediation – As an additional service to its members, the Bank has in the past entered into offsetting interest rate exchange agreements, acting as an intermediary between offsetting derivative transactions with members and other counterparties. This intermediation allows members indirect access to the derivatives market. Derivatives in which the Bank is an intermediary may also arise when the Bank enters into derivatives to offset the economic effect of other derivatives that are no longer designated to advances, investments, or consolidated obligations. The offsetting derivatives used in intermediary activities do not receive hedge accounting treatment and are separately marked to market through earnings. The net result of the accounting for these derivatives does not significantly affect the operating results of the Bank.

The notional principal of the interest rate exchange agreements associated with derivatives with members and offsetting derivatives with other counterparties was \$330 at December 31, 2013, and \$430 at December 31, 2012. The Bank did not have any interest rate exchange agreements outstanding at December 31, 2013 and 2012, that were used to offset the economic effect of other derivatives that were no longer designated to advances, investments, or consolidated obligations.

Investments – The Bank may invest in U.S. Treasury and agency obligations, agency MBS, and the taxable portion of highly rated state or local housing finance agency obligations. In the past, the Bank has also invested in PLRMBS rated AAA at the time of acquisition. The interest rate and prepayment risk associated with these investment securities is managed through a combination of debt issuance and derivatives. The Bank may manage prepayment risk and interest rate risk by funding investment securities with consolidated obligations that have call features or by hedging the prepayment risk with a combination of consolidated obligations and callable swaps or swaptions. The Bank may execute callable swaps and purchase swaptions in conjunction with the issuance of certain liabilities to create funding that is economically equivalent to fixed rate callable debt. Although these derivatives are economic hedges against prepayment risk and are designated to individual liabilities, they do not receive either fair value or cash flow hedge accounting treatment. Investment securities may be classified as trading, AFS, or HTM.

The Bank may also manage the risk arising from changing market prices or cash flows of investment securities classified as trading by entering into interest rate exchange agreements (economic hedges) that offset the changes in fair value or cash flows of the securities. The market value changes of both the trading securities and the associated interest rate exchange agreements are included in other income in the Statements of Income.

Advances – The Bank offers a wide array of advances structures to meet members' funding needs. These advances may have maturities up to 30 years with fixed or adjustable rates and may include early termination features or options. The Bank may use derivatives to adjust the repricing and/or options characteristics of advances to more closely match the characteristics of the Bank's funding liabilities. In general, whenever a member executes a fixed rate advance or a variable rate advance with embedded options, the Bank will simultaneously execute an interest rate exchange agreement with terms that offset the terms and embedded options, if any, in the advance. The combination of the advance and the interest rate exchange agreement effectively creates a variable rate asset. This type of hedge is treated as a fair value hedge.

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Notes to Financial Statements (continued)**

In addition, for certain advances for which the Bank has elected the fair value option, the Bank will simultaneously execute an interest rate exchange agreement with terms that economically offset the terms of the advance. However, this type of hedge is treated as an economic hedge because these combinations generally do not meet the requirements for fair value hedge accounting treatment.

Mortgage Loans – The Bank’s investment portfolio includes fixed rate mortgage loans. The prepayment options embedded in mortgage loans can result in extensions or contractions in the expected repayment of these investments, depending on changes in estimated prepayment speeds. The Bank manages the interest rate risk and prepayment risk associated with fixed rate mortgage loans through a combination of debt issuance and derivatives. The Bank uses both callable and non-callable debt to achieve cash flow patterns and market value sensitivities for liabilities similar to those expected on the mortgage loans. Net income could be reduced if the Bank replaces prepaid mortgages with lower-yielding assets and the Bank’s higher funding costs are not reduced accordingly.

The Bank executes callable swaps and purchases swaptions in conjunction with the issuance of certain consolidated obligations to create funding that is economically equivalent to fixed rate callable bonds. Although these derivatives are economic hedges against the prepayment risk of specific loan pools and are referenced to individual liabilities, they do not receive either fair value or cash flow hedge accounting treatment.

Consolidated Obligations – Consolidated obligation bonds are structured to meet the Bank’s and/or investors’ needs. Common structures include fixed rate bonds with or without call options and adjustable rate bonds with or without embedded options. In general, when bonds with these structures are issued, the Bank will simultaneously execute an interest rate exchange agreement with terms that offset the terms and embedded options, if any, of the consolidated obligation bond. This combination of the consolidated obligation bond and the interest rate exchange agreement effectively creates an adjustable rate bond. The cost of this funding combination is generally lower than the cost that would be available through the issuance of an adjustable rate bond alone. The Bank will generally elect fair value hedge accounting treatment for these hedging relationships.

In addition, for certain consolidated obligation bonds for which the Bank has elected the fair value option, the Bank will simultaneously execute an interest rate exchange agreement with terms that economically offset the terms of the consolidated obligation bond. However, this type of hedge is treated as an economic hedge because these combinations generally do not meet the requirements for fair value hedge accounting treatment.

The Bank did not have any consolidated obligations denominated in currencies other than U.S. dollars outstanding during 2013, 2012, or 2011.

Credit Risk – The Bank is subject to credit risk as a result of the risk of potential nonperformance by counterparties to the derivative agreements. All of the Bank’s agreements governing bilateral derivative transactions contain master netting provisions to help mitigate the credit risk exposure to each counterparty. The Bank manages counterparty credit risk through credit analyses and collateral requirements and by following the requirements of the Bank’s risk management policies and credit guidelines and Finance Agency regulations. In addition, for bilateral derivatives, credit risk is mitigated by the master netting arrangements included in the contracts. The Bank also requires collateral agreements with collateral delivery thresholds on all bilateral derivatives. In addition, collateral related to derivative transactions with member institutions includes collateral pledged to the Bank, as evidenced by the Advances and Security Agreement, and held by the member institution for the benefit of the Bank.

For cleared derivatives, the clearinghouse is the Bank’s counterparty. The requirement that the Bank post initial and variation margin through the clearing agent, to the clearinghouse, exposes the Bank to institutional credit risk in the event that the clearing agent or the clearinghouse fails to meet its obligations. The use of cleared derivatives mitigates credit risk exposure because a central counterparty is substituted for individual counterparties and variation margin is posted daily for changes in the value of cleared derivatives through a clearing agent. The Bank has analyzed the enforceability of offsetting rights applicable to its cleared derivative transactions and determined that the exercise of those offsetting rights by a non-defaulting party under these transactions should be upheld under

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

applicable bankruptcy law and CFTC rules in the event of a clearinghouse or clearing agent insolvency and under applicable clearinghouse rules upon a non-insolvency-based event of default of the clearinghouse or clearing agent. Based on this analysis, the Bank presents a net derivative receivable or payable for all of its transactions through a particular clearing agent with a particular clearinghouse.

Based on the Bank's credit analyses and the collateral requirements, the Bank does not expect to incur any credit losses on its derivative transactions.

The notional amount of an interest rate exchange agreement serves as a factor in determining periodic interest payments or cash flows received and paid. However, the notional amount of derivatives represents neither the actual amounts exchanged nor the overall exposure of the Bank to credit risk and market risk. The risks of derivatives can be measured meaningfully on a portfolio basis by taking into account the counterparties, the types of derivatives, the items being hedged, and any offsets between the derivatives and the items being hedged.

The Bank's agreements for bilateral derivative transactions contain provisions that link the Bank's credit rating from Moody's and Standard & Poor's to various rights and obligations. Certain of these derivative agreements provide that, if the Bank's long-term debt rating falls below A3/A- (and in one agreement, below A2/A), the Bank's counterparty would have the right, but not the obligation, to terminate all of its outstanding derivative transactions with the Bank; the Bank's agreements with its clearing agents for cleared derivative transactions have similar provisions with respect to the debt rating of FHLBank System consolidated bonds. If this occurs, the Bank may choose to enter into replacement hedges, either by transferring the existing transactions to another counterparty or entering into new replacement transactions, based on prevailing market rates. In addition, the amount of collateral that the Bank is required to deliver to a counterparty under its agreements for bilateral derivative transactions depends on the Bank's credit rating. The aggregate fair value of all bilateral derivative instruments with credit-risk-related contingent features that were in a net derivative liability position (before cash collateral and related accrued interest) at December 31, 2013, was \$88, for which the Bank had posted cash collateral of \$46 in the normal course of business. If the Bank's credit rating at December 31, 2013, had been Aa/AA (the next lower rating that might require an increase in collateral to be delivered by the Bank) instead of Aaa/AA+ (the Bank's current rating), then the Bank would have been required to deliver up to \$26 of collateral (at fair value) to its derivative counterparties at December 31, 2013.

The following table summarizes the fair value of derivative instruments without the effect of netting arrangements or collateral as of December 31, 2013 and 2012. For purposes of this disclosure, the derivative values include the fair value of derivatives and related accrued interest.

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Notes to Financial Statements (continued)**

	2013			2012		
	Notional Amount of Derivatives	Derivative Assets	Derivative Liabilities	Notional Amount of Derivatives	Derivative Assets	Derivative Liabilities
Derivatives designated as hedging instruments:						
Interest rate swaps	\$ 31,395	\$ 572	\$ 156	\$ 30,634	\$ 941	\$ 286
Total	31,395	572	156	30,634	941	286
Derivatives not designated as hedging instruments:						
Interest rate swaps	49,715	146	242	59,211	264	338
Interest rate caps, floors, corridors, and/or collars	460	2	4	571	1	6
Total	50,175	148	246	59,782	265	344
Total derivatives before netting and collateral adjustments	\$ 81,570	720	402	\$ 90,416	1,206	630
Netting adjustments by counterparty		(313)	(313)		(587)	(587)
Cash collateral and related accrued interest		(291)	(42)		(90)	(20)
Total collateral and netting adjustments⁽¹⁾		(604)	(355)		(677)	(607)
Total derivative assets and total derivative liabilities		\$ 116	\$ 47		\$ 529	\$ 23

(1) Amounts include the netting of derivative assets and liabilities by counterparty, including cash collateral and related accrued interest, where the netting requirements have been met.

The following table presents the components of net gain/(loss) on derivatives and hedging activities as presented in the Statements of Income for the years ended December 31, 2013, 2012 and 2011.

	2013	2012	2011
	Gain/(Loss)	Gain/(Loss)	Gain/(Loss)
Derivatives and hedged items in fair value hedging relationships – hedge ineffectiveness by derivative type:			
Interest rate swaps	\$ (2)	\$ (19)	\$ (31)
Total net gain/(loss) related to fair value hedge ineffectiveness	(2)	(19)	(31)
Derivatives not designated as hedging instruments:			
Economic hedges:			
Interest rate swaps	(8)	(73)	(192)
Interest rate caps, floors, corridors and/or collars	2	1	—
Net interest settlements	34	(10)	(33)
Total net gain/(loss) related to derivatives not designated as hedging instruments	28	(82)	(225)
Net gain/(loss) on derivatives and hedging activities	\$ 26	\$ (101)	\$ (256)

The following table presents, by type of hedged item, the gains and losses on derivatives and the related hedged items in fair value hedging relationships and the impact of those derivatives on the Bank's net interest income for the years ended December 31, 2013, 2012, and 2011.

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Notes to Financial Statements (continued)**

Hedged Item Type	Gain/(Loss) on Derivatives	Gain/(Loss) on Hedged Item	Net Fair Value Hedge Ineffectiveness	Effect of Derivatives on Net Interest Income ⁽¹⁾
Year ended December 31, 2013:				
Advances	\$ 178	\$ (175)	\$ 3	\$ (126)
Consolidated obligation bonds	(373)	368	(5)	366
Total	\$ (195)	\$ 193	\$ (2)	\$ 240
Year ended December 31, 2012:				
Advances	\$ (32)	\$ 32	\$ —	\$ (143)
Consolidated obligation bonds	(259)	240	(19)	519
Total	\$ (291)	\$ 272	\$ (19)	\$ 376
Year ended December 31, 2011:				
Advances	\$ 21	\$ (19)	\$ 2	\$ (260)
Consolidated obligation bonds	(372)	339	(33)	1,092
Total	\$ (351)	\$ 320	\$ (31)	\$ 832

(1) The net interest on derivatives in fair value hedge relationships is presented in the interest income/expense line item of the respective hedged item.

The Bank may present derivative instruments, related cash collateral received or pledged, and associated accrued interest by clearing agent or by counterparty when the netting requirements have been met.

The following table presents separately the fair value of derivative assets and derivative liabilities that have met the netting requirements, including the related collateral received from or pledged to counterparties as of December 31, 2013 and 2012.

	2013		2012	
	Derivative Assets	Derivative Liabilities	Derivative Assets	Derivative Liabilities
Derivative instruments meeting netting requirements				
Gross recognized amount				
Bilateral derivatives	\$ 699	\$ 395	\$ 1,206	\$ 630
Cleared derivatives	21	7	—	—
Total gross recognized amount	720	402	1,206	630
Gross amounts of netting adjustments and cash collateral				
Bilateral derivatives	(604)	(348)	(677)	(607)
Cleared derivatives	—	(7)	—	—
Total gross amounts of netting adjustments and cash collateral	(604)	(355)	(677)	(607)
Total derivative assets and total derivative liabilities				
Bilateral derivatives	95	47	529	23
Cleared derivatives	21	—	—	—
Total derivative assets and derivative liabilities presented in the Statements of Condition	116	47	529	23
Non-cash collateral received or pledged not offset				
Can be sold or repledged - Bilateral derivatives	89	—	525	2
Net unsecured amount				
Bilateral derivatives	6	47	4	21
Cleared derivatives	21	—	—	—
Total net unsecured amount	\$ 27	\$ 47	\$ 4	\$ 21

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

Note 20 — Fair Value

The following fair value amounts have been determined by the Bank using available market information and the Bank's best judgment of appropriate valuation methods. These estimates are based on pertinent information available to the Bank at December 31, 2013 and 2012. Although the Bank uses its best judgment in estimating the fair value of these financial instruments, there are inherent limitations in any estimation technique or valuation methodology. For example, because an active secondary market does not exist for a portion of the Bank's financial instruments, in certain cases fair values are not subject to precise quantification or verification and may change as economic and market factors and evaluation of those factors change. The Bank continues to refine its valuation methodologies as markets and products develop and the pricing for certain products becomes more or less transparent. While the Bank believes that its valuation methodologies are appropriate and consistent with those of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a materially different estimate of fair value as of the reporting date. Therefore, the fair values are not necessarily indicative of the amounts that would be realized in current market transactions, although they do reflect the Bank's judgment as to how a market participant would estimate the fair values. The fair value summary table does not represent an estimate of the overall market value of the Bank as a going concern, which would take into account future business opportunities and the net profitability of total assets and liabilities on a combined basis.

The following tables present the carrying value, the estimated fair value, and the fair value hierarchy level of the Bank's financial instruments at December 31, 2013 and 2012.

	December 31, 2013					
	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3	Netting Adjustments ⁽¹⁾
Assets						
Cash and due from banks	\$ 4,906	\$ 4,906	\$ 4,906	\$ —	\$ —	\$ —
Federal funds sold	7,498	7,498	—	7,498	—	—
Trading securities	3,208	3,208	—	3,208	—	—
AFS securities	7,047	7,047	—	—	7,047	—
HTM securities	17,507	17,352	—	14,802	2,550	—
Advances	44,395	44,457	—	44,457	—	—
Mortgage loans held for portfolio, net of allowance for credit losses on mortgage loans	905	956	—	956	—	—
Accrued interest receivable	81	81	—	81	—	—
Derivative assets, net ⁽¹⁾	116	116	—	720	—	(604)
Other assets ⁽³⁾	10	10	10	—	—	—
Liabilities						
Deposits	193	193	—	193	—	—
Consolidated obligations:						
Bonds	53,207	52,940	—	52,940	—	—
Discount notes	24,194	24,195	—	24,195	—	—
Total consolidated obligations	77,401	77,135	—	77,135	—	—
Mandatorily redeemable capital stock	2,071	2,071	2,071	—	—	—
Accrued interest payable	95	95	—	95	—	—
Derivative liabilities, net ⁽¹⁾	47	47	—	402	—	(355)
Other						
Standby letters of credit	12	12	—	12	—	—
Commitments to fund advances ⁽²⁾	—	(1)	—	(1)	—	—

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

	December 31, 2012					
	Carrying Value	Estimated Fair Value	Level 1	Level 2	Level 3	Netting Adjustments ^(b)
Assets						
Cash and due from banks	\$ 104	\$ 104	\$ 104	\$ —	\$ —	\$ —
Securities purchased under agreements to resell	1,500	1,500	—	1,500	—	—
Federal funds sold	10,857	10,857	—	10,857	—	—
Trading securities	3,191	3,191	—	3,191	—	—
AFS securities	7,604	7,604	—	—	7,604	—
HTM securities	17,376	17,584	—	14,338	3,246	—
Advances	43,750	43,919	—	43,919	—	—
Mortgage loans held for portfolio, net of allowance for credit losses on mortgage loans	1,289	1,368	—	1,368	—	—
Accrued interest receivable	101	101	—	101	—	—
Derivative assets, net ⁽¹⁾	529	529	—	1,206	—	(677)
Other assets ⁽³⁾	9	9	9	—	—	—
Liabilities						
Deposits	227	227	—	227	—	—
Consolidated obligations:						
Bonds	70,310	70,577	—	70,577	—	—
Discount notes	5,209	5,210	—	5,210	—	—
Total consolidated obligations	75,519	75,787	—	75,787	—	—
Mandatorily redeemable capital stock	4,343	4,343	4,343	—	—	—
Accrued interest payable	175	175	—	175	—	—
Derivative liabilities, net ⁽¹⁾	23	23	—	630	—	(607)
Other						
Standby letters of credit	13	13	—	13	—	—
Commitments to fund advances ⁽²⁾	—	1	—	1	—	—
Commitments to issue consolidated obligation bonds ⁽²⁾	—	5	—	5	—	—

- (1) Amounts include the netting of derivative assets and liabilities by counterparty, including cash collateral and related accrued interest, where the netting requirements have been met.
- (2) Estimated fair values of these commitments are presented as a net gain or (loss). For more information regarding these commitments, see Note 21 – Commitments and Contingencies.
- (3) Represents publicly traded mutual funds held in a grantor trust.

Fair Value Hierarchy. The fair value hierarchy is used to prioritize the fair value methodologies and valuation techniques as well as the inputs to the valuation techniques used to measure fair value for assets and liabilities carried at fair value on the Statements of Condition. The inputs are evaluated and an overall level for the fair value measurement is determined. This overall level is an indication of market observability of the fair value measurement for the asset or liability. The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). An entity must disclose the level within the fair value hierarchy in which the measurements are classified for all financial assets and liabilities measured on a recurring or non-recurring basis.

The application of the fair value hierarchy to the Bank's financial assets and financial liabilities that are carried at fair value either on a recurring or non-recurring basis is as follows:

- Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in an active market that the reporting entity can access on the measurement date.
- Level 2 – Inputs other than quoted prices within Level 1 that are observable inputs for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

(1) quoted prices for similar assets or liabilities in active markets; (2) quoted prices for identical or similar assets or liabilities in markets that are not active; (3) inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates and yield curves that are observable at commonly quoted intervals, and implied volatilities); and (4) inputs that are derived principally from or corroborated by observable market data by correlation or other means.

- Level 3 – Unobservable inputs for the asset or liability.

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The following assets and liabilities, including those for which the Bank has elected the fair value option, are carried at fair value on the Statements of Condition as of December 31, 2013:

- Trading securities
- AFS securities
- Certain advances
- Derivative assets and liabilities
- Certain consolidated obligation bonds
- Certain other assets

For instruments carried at fair value, the Bank reviews the fair value hierarchy classifications on a quarterly basis. Changes in the observability of the valuation inputs may result in a reclassification of certain assets or liabilities. Such reclassifications are reported as transfers in or out as of the beginning of the quarter in which the changes occur. For the periods presented, the Bank did not have any reclassifications for transfers in or out of the fair value hierarchy levels.

Summary of Valuation Methodologies and Primary Inputs.

Cash and Due from Banks – The estimated fair value equals the carrying value.

Federal Funds Sold and Securities Purchased Under Agreements to Resell – The estimated fair value of overnight Federal funds sold and securities purchased under agreements to resell approximates the carrying value. The estimated fair value of term Federal funds sold and term securities purchased under agreements to resell has been determined by calculating the present value of expected cash flows for the instruments and reducing the amount for accrued interest receivable. The discount rates used in these calculations are the replacement rates for comparable instruments with similar terms.

Investment Securities – Certificates of Deposit – The estimated fair values of these investments are determined by calculating the present value of expected cash flows and reducing the amount for accrued interest receivable, using market-observable inputs as of the last business day of the period or using industry standard analytical models and certain actual and estimated market information. The discount rates used in these calculations are the replacement rates for comparable instruments with similar terms.

Investment Securities – MBS – To value its MBS, the Bank obtains prices from four designated third-party pricing vendors when available. The pricing vendors use various proprietary models to price these securities. The inputs to those models are derived from various sources including, but not limited to: benchmark yields, reported trades, dealer estimates, issuer spreads, benchmark securities, bids, offers, and other market-related data. Since many securities do not trade on a daily basis, the pricing vendors use available information as applicable, such as benchmark yield curves, benchmarking of like securities, sector groupings, and matrix pricing, to determine the prices for individual securities. Each pricing vendor has an established challenge process in place for all security valuations, which facilitates resolution of price discrepancies identified by the Bank.

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Notes to Financial Statements (continued)**

In January 2014, the Bank conducted reviews of the four pricing vendors to update and confirm its understanding of the vendors' pricing processes, methodologies, and control procedures.

The Bank's valuation technique for estimating the fair values of its MBS first requires the establishment of a "median" vendor price for each security. If four vendor prices are received, the average of the middle two prices is the median price; if three prices are received, the middle price is the median price; if two prices are received, the average of the two prices is the median price; and if one price is received, it is the median price (and also the default fair value) subject to additional validation. All vendor prices that are within a specified tolerance threshold of the median price are included in the cluster of vendor prices that are averaged to establish a default fair value. All vendor prices that are outside the threshold (outliers) are subject to further analysis including, but not limited to, comparison to prices provided by an additional third-party valuation service, prices for similar securities and/or dealer estimates, or use of internal model prices, which are deemed to be reflective of all relevant facts and circumstances that a market participant would consider. Such analysis is also applied in those limited instances where no third-party vendor price or only one third-party vendor price is available in order to arrive at an estimated fair value. If an outlier (or some other price identified in the analysis) is determined to be a better estimate of fair value, then the outlier (or the other price, as appropriate) is used as the fair value rather than the default fair value. If, instead, the analysis confirms that an outlier is (or outliers are) not representative of fair value and the default fair value is the best estimate, then the default fair value is used as the fair value.

If all vendor prices received for a security are outside the tolerance threshold level of the median price, then there is no default fair value, and the fair value is determined by an evaluation of all outlier prices (or the other prices, as appropriate) as described above.

As of December 31, 2013, four vendor prices were received for most of the Bank's MBS, and the fair value estimates for most of those securities were determined by averaging the four vendor prices. Based on the Bank's reviews of the pricing methods employed by the third-party pricing vendors and the relative lack of dispersion among the vendor prices (or, in those instances in which there were outliers or significant yield variances, the Bank's additional analyses), the Bank believes that its fair value estimates are reasonable and that the fair value measurements are classified appropriately in the fair value hierarchy. Based on limited market liquidity for PLRMBS, the fair value measurements for these securities were classified as Level 3 within the fair value hierarchy.

As an additional step, the Bank reviewed the fair value estimates of its PLRMBS as of December 31, 2013, for reasonableness using a market-implied yield test. The Bank calculated a market-implied yield for each of its PLRMBS using the estimated fair value derived from the process described above and the security's projected cash flows from the Bank's OTTI process and compared the market-implied yield to the yields for comparable securities according to dealers and other third-party sources to the extent comparable market yield data was available. This analysis did not indicate that any adjustments to the fair value estimates were necessary.

Investment Securities – FFCB Bonds and CalHFA Bonds – The Bank estimates the fair values of these securities using the same methodology as described above for *Investment Securities – MBS*.

Advances – Because quoted prices are not available for advances, the fair values are measured using model-based valuation techniques (such as calculating the present value of future cash flows and reducing the amount for accrued interest receivable).

The Bank's primary inputs for measuring the fair value of advances are market-based consolidated obligation yield curve (CO Curve) inputs obtained from the Office of Finance. The CO Curve is then adjusted to reflect the rates on replacement advances with similar terms and collateral. These spread adjustments are not market-observable and are evaluated for significance in the overall fair value measurement and the fair value hierarchy level of the advance. The Bank obtains market-observable inputs from derivative dealers for complex advances. These inputs may include volatility assumptions, which are market-based expectations of future interest rate volatility implied from current market prices for similar options (swaption volatility and volatility skew). The discount rates used in these

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

calculations are the replacement advance rates for advances with similar terms. Pursuant to the Finance Agency's advances regulation, advances with an original term to maturity or repricing period greater than six months generally require a prepayment fee sufficient to make the Bank financially indifferent to the borrower's decision to prepay the advances. The Bank determined that no adjustment is required to the fair value measurement of advances for prepayment fees. In addition, the Bank did not adjust its fair value measurement of advances for creditworthiness primarily because advances were fully collateralized.

Mortgage Loans Held for Portfolio – The estimated fair value for mortgage loans represents modeled prices based on observable market prices for agency mortgage loan commitment rates adjusted for differences in coupon, average loan rate, seasoning, and cash flow remittance between the Bank's mortgage loans and the referenced mortgage loans. Market prices are highly dependent on the underlying prepayment assumptions. Changes in the prepayment speeds often have a material effect on the fair value estimates. These underlying prepayment assumptions are susceptible to material changes in the near term because they are made at a specific point in time.

Accrued Interest Receivable and Payable – The estimated fair value approximates the carrying value of accrued interest receivable and accrued interest payable.

Derivative Assets and Liabilities – In general, derivative instruments transacted and held by the Bank for risk management activities are traded in over-the-counter markets where quoted market prices are not readily available. These derivatives are interest rate-related. For these derivatives, the Bank measures fair value using internally developed discounted cash flow models that use market-observable inputs, such as the overnight index swap (OIS) curve; volatility assumptions, which are market-based expectations of future interest rate volatility implied from current market prices for similar options (swaption volatility and volatility skew) adjusted for counterparty credit risk, as necessary; and prepayment assumptions. Effective December 31, 2012, the Bank refined its method for estimating the fair values of its derivatives by using the OIS curve to discount the cash flows of its derivatives to determine fair value, instead of using the LIBOR swap curve, which was used in prior periods.

The Bank is subject to credit risk because of the risk of potential nonperformance by its derivative counterparties. To mitigate this risk, the Bank executes bilateral derivative transactions only with highly rated derivative dealers and major banks (derivative dealer counterparties) that meet the Bank's eligibility criteria. In addition, the Bank has entered into master netting agreements and bilateral security agreements with all active derivative dealer counterparties that provide for delivery of collateral at specified levels to limit the Bank's net unsecured credit exposure to these counterparties. Under these policies and agreements, the amount of unsecured credit exposure to an individual derivative dealer counterparty is limited to an absolute dollar credit exposure limit according to the counterparty's credit rating, as determined by rating agency long-term credit ratings of the counterparty's debt securities or deposits. The Bank executes cleared derivative transactions only with clearing agents that meet the Bank's strict eligibility requirements, and the Bank's credit exposure to the clearinghouse is secured by variation margin received from the clearinghouse. All credit exposure from derivative transactions entered into by the Bank with member counterparties that are not derivative dealers must be fully secured by eligible collateral. The Bank evaluated the potential for the fair value of the instruments to be affected by counterparty credit risk and determined that no adjustments to the overall fair value measurements were required.

The fair values of the derivative assets and liabilities include accrued interest receivable/payable and cash collateral remitted to/received from counterparties. The estimated fair values of the accrued interest receivable/payable and cash collateral approximate their carrying values because of their short-term nature. The fair values of derivatives that met the netting requirements are presented on a net basis. If these netted amounts are positive, they are classified as an asset and, if negative, they are classified as a liability.

Deposits – The fair value of deposits is generally equal to the carrying value of the deposits because the deposits are primarily overnight deposits or due on demand. The Bank determines the fair values of term deposits by calculating the present value of expected future cash flows from the deposits and reducing the amount for accrued interest payable. The discount rates used in these calculations are the cost of deposits with similar terms.

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Notes to Financial Statements (continued)**

Consolidated Obligations – Because quoted prices in active markets are not generally available for identical liabilities, the Bank measures fair values using internally developed models that use primarily market-observable inputs. The Bank’s primary inputs for measuring the fair value of consolidated obligation bonds are market-based CO Curve inputs obtained from the Office of Finance. The Office of Finance constructs the CO Curve using the Treasury yield curve as a base curve, which may be adjusted by indicative spreads obtained from market-observable sources. These market indications are generally derived from pricing indications from dealers, historical pricing relationships, and market activity for similar liabilities, such as recent GSE trades or secondary market activity. For consolidated obligation bonds with embedded options, the Bank also obtains market-observable quotes and inputs from derivative dealers. These inputs may include volatility assumptions, which are market-based expectations of future interest rate volatility implied from current market prices for similar options (swaption volatility and volatility skew).

Adjustments may be necessary to reflect the Bank’s credit quality or the credit quality of the FHLBank System when valuing consolidated obligation bonds measured at fair value. The Bank monitors its own creditworthiness and the creditworthiness of the other 11 FHLBanks and the FHLBank System to determine whether any adjustments are necessary for creditworthiness in its fair value measurement of consolidated obligation bonds. The credit ratings of the FHLBank System and any changes to the credit ratings are the basis for the Bank to determine whether the fair values of consolidated obligations have been significantly affected during the reporting period by changes in the instrument-specific credit risk.

Mandatorily Redeemable Capital Stock – The estimated fair value of capital stock subject to mandatory redemption is generally at par value as indicated by contemporaneous purchases, redemptions, and repurchases at par value. Fair value includes estimated dividends earned at the time of reclassification from capital to liabilities, until such amount is paid, and any subsequently declared capital stock dividend. The Bank’s capital stock can only be acquired by members at par value and redeemed or repurchased at par value, subject to statutory and regulatory requirements. The Bank’s capital stock is not traded, and no market mechanism exists for the exchange of Bank capital stock outside the cooperative ownership structure.

Commitments – The estimated fair value of standby letters of credit is based on the present value of fees currently charged for similar agreements and is recorded in other liabilities. The estimated fair value of off-balance sheet fixed rate commitments to fund advances and commitments to issue consolidated obligations takes into account the difference between current and committed interest rates.

Subjectivity of Estimates Related to Fair Values of Financial Instruments. Estimates of the fair value of financial assets and liabilities using the methodologies described above are subjective and require judgments regarding significant matters, such as the amount and timing of future cash flows, prepayment speed assumptions, expected interest rate volatility, methods to determine possible distributions of future interest rates used to value options, and the selection of discount rates that appropriately reflect market and credit risks. Changes in these judgments often have a material effect on the fair value estimates.

Fair Value Measurements. The tables below present the fair value of assets and liabilities, which are recorded on a recurring or nonrecurring basis at December 31, 2013 and 2012, by level within the fair value hierarchy.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

December 31, 2013

	Fair Value Measurement Using:			Netting Adjustments ⁽¹⁾	Total
	Level 1	Level 2	Level 3		
Recurring fair value measurements – Assets:					
Trading securities:					
GSEs – FFCB bonds	\$ —	\$ 3,194	\$ —	\$ —	\$ 3,194
MBS:					
Other U.S. obligations – Ginnie Mae	—	14	—	—	14
Total trading securities	—	3,208	—	—	3,208
AFS securities:					
PLRMBS	—	—	7,047	—	7,047
Total AFS securities	—	—	7,047	—	7,047
Advances ⁽²⁾	—	7,069	—	—	7,069
Derivative assets, net: interest rate-related	—	720	—	(604)	116
Other assets	10	—	—	—	10
Total recurring fair value measurements – Assets	\$ 10	\$ 10,997	\$ 7,047	\$ (604)	\$ 17,450
Recurring fair value measurements – Liabilities:					
Consolidated obligation bonds ⁽³⁾	\$ —	\$ 10,115	\$ —	\$ —	\$ 10,115
Derivative liabilities, net: interest rate-related	—	402	—	(355)	47
Total recurring fair value measurements – Liabilities	\$ —	\$ 10,517	\$ —	\$ (355)	\$ 10,162
Nonrecurring fair value measurements – Assets:					
REO	\$ —	\$ —	\$ 2	\$ —	\$ 2

December 31, 2012

	Fair Value Measurement Using:			Netting Adjustments ⁽¹⁾	Total
	Level 1	Level 2	Level 3		
Recurring fair value measurements – Assets:					
Trading securities:					
GSEs – FFCB bonds	\$ —	\$ 3,175	\$ —	\$ —	\$ 3,175
MBS:					
Other U.S. obligations – Ginnie Mae	—	16	—	—	16
Total trading securities	—	3,191	—	—	3,191
AFS securities:					
PLRMBS	—	—	7,604	—	7,604
Total AFS securities	—	—	7,604	—	7,604
Advances ⁽²⁾	—	7,401	—	—	7,401
Derivative assets, net: interest rate-related	—	1,206	—	(677)	529
Other assets	9	—	—	—	9
Total recurring fair value measurements – Assets	\$ 9	\$ 11,798	\$ 7,604	\$ (677)	\$ 18,734
Recurring fair value measurements – Liabilities:					
Consolidated obligation bonds ⁽³⁾	\$ —	\$ 27,884	\$ —	\$ —	\$ 27,884
Derivative liabilities, net: interest rate-related	—	630	—	(607)	23
Total recurring fair value measurements – Liabilities	\$ —	\$ 28,514	\$ —	\$ (607)	\$ 27,907
Nonrecurring fair value measurements – Assets:					
REO	\$ —	\$ —	\$ 2	\$ —	\$ 2

(1) Amounts represent the netting of derivative assets and liabilities by counterparty, including cash collateral, where the netting requirements have been met.
(2) Includes \$7,069 and \$7,390 of advances recorded under the fair value option at December 31, 2013 and 2012, respectively, and \$0 and \$11 of advances recorded at fair value at December 31, 2013 and 2012, respectively, where the exposure to overall changes in fair value was hedged in accordance with the accounting for derivative instruments and hedging activities.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

(3) Includes \$10,115 and \$27,884 of consolidated obligation bonds recorded under the fair value option at December 31, 2013 and 2012, respectively. There were no consolidated obligation bonds recorded at fair value at December 31, 2013 and 2012, where the exposure to overall changes in fair value was hedged in accordance with the accounting for derivative instruments and hedging activities.

The following tables present a reconciliation of the Bank's AFS PLRMBS that are measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2013 and 2012.

	2013	2012
Balance, beginning of the year	\$ 7,604	\$ 7,687
Total gain/(loss) realized and unrealized included in:		
Interest income	21	(11)
Net OTTI loss, credit-related	(7)	(44)
Unrealized gain/(loss) of other-than-temporarily impaired securities included in AOCI	644	1,102
Reclassification of non-credit-related OTTI included in net income/(loss)	(3)	14
Settlements	(1,284)	(1,284)
Transfers of HTM securities to AFS securities	72	140
Balance, end of the year	\$ 7,047	\$ 7,604
Total amount of gain/(loss) for the period included in earnings attributable to the change in unrealized gains/losses relating to assets and liabilities still held at the end of the year	\$ 15	\$ (55)

Fair Value Option. The fair value option provides an entity with an irrevocable option to elect fair value as an alternative measurement for selected financial assets, financial liabilities, unrecognized firm commitments, and written loan commitments not previously carried at fair value. It requires an entity to display the fair value of those assets and liabilities for which the entity has chosen to use fair value on the face of the Statements of Condition. Fair value is used for both the initial and subsequent measurement of the designated assets, liabilities, and commitments, with the changes in fair value recognized in net income. Interest income and interest expense on advances and consolidated bonds carried at fair value are recognized solely on the contractual amount of interest due or unpaid. Any transaction fees or costs are immediately recognized in non-interest income or non-interest expense.

The Bank elected the fair value option for certain financial instruments as follows:

- Adjustable rate advances with embedded options
- Callable fixed rate advances
- Putable fixed rate advances
- Putable fixed rate advances with embedded options
- Fixed rate advances with partial prepayment symmetry
- Callable or non-callable capped floater consolidated obligation bonds
- Convertible consolidated obligation bonds
- Adjustable or fixed rate range accrual consolidated obligation bonds
- Ratchet consolidated obligation bonds
- Adjustable rate advances indexed to non-LIBOR indices such as the Prime Rate, U.S. Treasury bill, and Federal funds effective rate
- Adjustable rate consolidated obligation bonds indexed to non-LIBOR indices such as the Prime Rate, U.S. Treasury bill, and Federal funds effective rate
- Step-up callable bonds, which pay interest at increasing fixed rates for specified intervals over the life of the bond and can generally be called at the Bank's option on the step-up dates
- Step-down callable bonds, which pay interest at decreasing fixed rates for specified intervals over the life of the bond and can generally be called at the Bank's option on the step-down dates

The Bank has elected the fair value option for certain financial instruments to assist in mitigating potential earnings volatility that can arise from economic hedging relationships in which the carrying value of the hedged item is not

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

adjusted for changes in fair value. The potential earnings volatility associated with using fair value only for the derivative is the Bank's primary reason for electing the fair value option for financial assets and liabilities that do not qualify for hedge accounting or that have not previously met or may be at risk for not meeting the hedge effectiveness requirements.

The following table summarizes the activity related to financial assets and liabilities for which the Bank elected the fair value option during the years ended December 31, 2013, 2012, and 2011:

	2013		2012		2011	
	Advances	Consolidated Obligation Bonds	Advances	Consolidated Obligation Bonds	Advances	Consolidated Obligation Bonds
Balance, beginning of the year	\$ 7,390	\$ 27,884	\$ 8,684	\$ 15,712	\$ 10,490	\$ 20,872
New transactions elected for fair value option	837	3,547	862	25,925	2,045	16,668
Maturities and terminations	(988)	(21,165)	(2,127)	(13,745)	(4,023)	(21,982)
Net gain/(loss) on advances and net (gain)/loss on consolidated obligation bonds held under fair value option	(169)	(146)	(22)	(7)	184	159
Change in accrued interest	(1)	(5)	(7)	(1)	(12)	(5)
Balance, end of the year	\$ 7,069	\$ 10,115	\$ 7,390	\$ 27,884	\$ 8,684	\$ 15,712

For instruments for which the fair value option has been elected, the related contractual interest income and contractual interest expense are recorded as part of net interest income on the Statements of Income. The remaining changes in fair value for instruments for which the fair value option has been elected are recorded as net gains/ (losses) on financial instruments held under the fair value option in the Statements of Income. The change in fair value does not include changes in instrument-specific credit risk. For advances and consolidated obligations recorded under the fair value option, the Bank determined that no adjustments to the fair values of these instruments for instrument-specific credit risk were necessary for the years ended December 31, 2013, 2012, and 2011.

The following table presents the difference between the aggregate remaining contractual principal balance outstanding and aggregate fair value of advances and consolidated obligation bonds for which the Bank elected the fair value option at December 31, 2013 and 2012:

	At December 31, 2013			At December 31, 2012		
	Principal Balance	Fair Value	Fair Value Over/(Under) Principal Balance	Principal Balance	Fair Value	Fair Value Over/(Under) Principal Balance
Advances ⁽¹⁾	\$ 6,956	\$ 7,069	\$ 113	\$ 7,102	\$ 7,390	\$ 288
Consolidated obligation bonds	10,230	10,115	(115)	27,848	27,884	36

(1) At December 31, 2013 and 2012, none of these advances were 90 days or more past due or had been placed on nonaccrual status.

Note 21 — Commitments and Contingencies

As provided by the FHLBank Act or regulations governing the operations of the FHLBanks, all FHLBanks have joint and several liability for all FHLBank consolidated obligations, which are backed only by the financial resources of the FHLBanks. The joint and several liability regulation authorizes the Finance Agency to require any FHLBank to repay all or a portion of the principal or interest on consolidated obligations for which another FHLBank is the primary obligor. The regulations provide a general framework for addressing the possibility that an FHLBank may be unable to repay the consolidated obligations for which it is the primary obligor. The Bank has never been asked or required to repay the principal or interest on any consolidated obligation on behalf of another

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

FHLBank, and as of December 31, 2013, and through the filing date of this report, does not believe that it is probable that it will be asked to do so.

The Bank determined that it was not necessary to recognize a liability for the fair value of the Bank's joint and several liability for all consolidated obligations. The joint and several obligations are mandated by the FHLBank Act or regulations governing the operations of the FHLBanks and are not the result of arms-length transactions among the FHLBanks. The FHLBanks have no control over the amount of the guarantee or the determination of how each FHLBank would perform under the joint and several obligations. Because the FHLBanks are subject to the authority of the Finance Agency as it relates to decisions involving the allocation of the joint and several liability for the FHLBanks' consolidated obligations, the FHLBanks' joint and several obligations are excluded from the initial recognition and measurement provisions. Accordingly, the Bank has not recognized a liability for its joint and several obligation related to other FHLBanks' participations in the consolidated obligations. The par value of the outstanding consolidated obligations of all 12 FHLBanks was \$766,837 at December 31, 2013, and \$687,902 at December 31, 2012. The par value of the Bank's participation in consolidated obligations was \$76,968 at December 31, 2013, and \$74,532 at December 31, 2012.

The joint and several liability regulation provides a general framework for addressing the possibility that an FHLBank may be unable to repay its participation in the consolidated obligations for which it is the primary obligor. In accordance with this regulation, the president of each FHLBank is required to provide a quarterly certification that, among other things, the FHLBank will remain capable of making full and timely payment of all its current obligations, including direct obligations.

In addition, the regulation requires that an FHLBank must provide written notice to the Finance Agency if at any time the FHLBank is unable to provide the quarterly certification; projects that it will be unable to fully meet all of its current obligations, including direct obligations, on a timely basis during the quarter; or negotiates or enters into an agreement with another FHLBank for financial assistance to meet its obligations. If an FHLBank gives any one of these notices (other than in a case of a temporary interruption in the FHLBank's debt servicing operations resulting from an external event such as a natural disaster or a power failure), it must promptly file a consolidated obligations payment plan for Finance Agency approval specifying the measures the FHLBank will undertake to make full and timely payments of all its current obligations.

Notwithstanding any other provisions in the regulation, the regulation provides that the Finance Agency in its discretion may at any time order any FHLBank to make any principal or interest payment due on any consolidated obligation. To the extent an FHLBank makes any payment on any consolidated obligation on behalf of another FHLBank, the paying FHLBank is entitled to reimbursement from the FHLBank that is the primary obligor, which will have a corresponding obligation to reimburse the FHLBank for the payment and associated costs, including interest.

The regulation also provides that the Finance Agency may allocate the outstanding liability of an FHLBank for consolidated obligations among the other FHLBanks on a pro rata basis in proportion to each FHLBank's participation in all consolidated obligations outstanding. The Finance Agency reserves the right to allocate the outstanding liabilities for the consolidated obligations among the FHLBanks in any other manner it may determine to ensure that the FHLBanks operate in a safe and sound manner.

Off-balance sheet commitments as of December 31, 2013 and 2012, were as follows:

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

	2013			2012		
	Expire Within One Year	Expire After One Year	Total	Expire Within One Year	Expire After One Year	Total
Standby letters of credit outstanding	\$ 1,031	\$ 2,572	\$ 3,603	\$ 1,010	\$ 2,409	\$ 3,419
Commitments to fund advances ⁽¹⁾	4	4	8	20	1	21
Commitments to issue consolidated obligation bonds, par ⁽²⁾	1,640	—	1,640	635	—	635

- (1) At December 31, 2013, none of the commitments to fund additional advances were hedged with associated interest rate swaps. At December 31, 2012, \$16 was hedged with associated interest rate swaps.
- (2) At December 31, 2013 and 2012, \$1,640 and \$500, respectively, of the unsettled consolidated obligation bonds were hedged with associated interest rate swaps.

Standby letters of credit are generally issued for a fee on behalf of members to support their obligations to third parties. If the Bank is required to make a payment for a beneficiary's drawing under a letter of credit, the amount is immediately due and payable by the member to the Bank and is charged to the member's demand deposit account with the Bank. The original terms of these standby letters of credit range from 107 days to 10 years, including a final expiration in 2023. The Bank monitors the creditworthiness of members that have standby letters of credit. In addition, standby letters of credit are fully collateralized. As a result, the Bank determined that it was not necessary to record any allowance for losses on these commitments.

The value of the Bank's obligations related to standby letters of credit is recorded in other liabilities and amounted to \$12 at December 31, 2013, and \$13 at December 31, 2012. Letters of credit are fully collateralized at the time of issuance. Based on the Bank's credit analyses of members' financial condition and collateral requirements, the Bank deemed it unnecessary to record any additional liability on the letters of credit outstanding as of December 31, 2013 and 2012.

Commitments to fund advances totaled \$8 at December 31, 2013, and \$21 at December 31, 2012. Advances funded under advance commitments are fully collateralized at the time of funding (see Note 10 – Allowance for Credit Losses). Based on the Bank's credit analyses of members' financial condition and collateral requirements, the Bank deemed it unnecessary to record any additional liability on the advance commitments outstanding as of December 31, 2013 and 2012.

Commitments to issue consolidated obligations totaled \$1,640 and \$635 at December 31, 2013 and 2012.

The Bank executes over-the-counter bilateral interest rate exchange agreements with major banks and derivative entities affiliated with broker-dealers and with its members. The Bank enters into master agreements with netting provisions with all bilateral swap counterparties and into bilateral security agreements with all active derivative dealer counterparties. All member counterparty master agreements, excluding those with derivative dealers, are subject to the terms of the Bank's Advances and Security Agreement with members, and all member counterparties (except for those that are derivative dealers) must fully collateralize the Bank's net credit exposure. For cleared derivatives, the clearinghouse is the Bank's counterparty, and the Bank has clearing agreements with clearing agents that provide for delivery of initial margin to, and exchange of variation margin with, the clearinghouse. See Note 19 – Derivatives and Hedging Activities for additional information about the Bank's pledged collateral and other credit-risk-related contingent features. As of December 31, 2013, the Bank had pledged cash collateral of \$149 to counterparties and the clearing house that had market risk exposure to the Bank related to derivatives. As of December 31, 2012, the Bank had pledged total collateral of \$23, including securities with a carrying value of \$2, all of which could be sold or repledged, and cash of \$21 to counterparties that had market risk exposure to the Bank related to derivatives.

The Bank charged operating expenses for net rental and related costs of approximately \$5, \$5, and \$5 for the years ended December 31, 2013, 2012, and 2011, respectively. Future minimum rentals at December 31, 2013, were as follows:

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

Year	Future Minimum Rentals
2014	\$ 4
2015	4
2016	4
2017	4
2018	4
Thereafter	6
Total	\$ 26

Lease agreements for Bank premises generally provide for increases in the basic rentals resulting from increases in property taxes and maintenance expenses. Such increases are not expected to have a material effect on the Bank's financial condition or results of operations.

The Bank may be subject to various pending legal proceedings that may arise in the normal course of business. After consultation with legal counsel, the Bank does not anticipate that the ultimate liability, if any, arising out of these matters will have a material effect on its financial condition or results of operations.

Other commitments and contingencies are discussed in Note 1 – Summary of Significant Accounting Policies, Note 8 – Advances, Note 9 – Mortgage Loans Held for Portfolio, Note 12 – Consolidated Obligations, Note 13 – Affordable Housing Program, Note 14 – Resolution Funding Corporation Assessments, Note 16 – Capital, Note 17 – Employee Retirement Plans and Incentive Compensation Plans, and Note 19 – Derivatives and Hedging Activities.

Note 22 — Transactions with Certain Members, Certain Nonmembers, and Other FHLBanks

Transactions with Members. The Bank has a cooperative ownership structure under which current member institutions, certain former members, and certain other nonmembers own the capital stock of the Bank. Former members and certain nonmembers own the remaining capital stock and are required to maintain their investment in the Bank's capital stock until their outstanding transactions mature or are paid off or until their capital stock is redeemed following the five-year redemption period for capital stock or is repurchased by the Bank, in accordance with the Bank's capital requirements (see Note 16 – Capital for further information).

All advances are made to members, and all mortgage loans held for portfolio were purchased from members. The Bank also maintains deposit accounts for members primarily to facilitate settlement activities that are directly related to advances and mortgage loan purchases. All transactions with members and their affiliates are entered into in the normal course of business. In instances where the member has an officer or director who is a director of the Bank, transactions with the member are subject to the same eligibility and credit criteria, as well as the same conditions, as comparable transactions with all other members, in accordance with regulations governing the operations of the FHLBanks.

The Bank has investments in Federal funds sold, interest-bearing deposits, and commercial paper, and executes MBS and derivatives transactions with members or their affiliates. The Bank purchases MBS through securities brokers or dealers and executes all MBS investments without preference to the status of the counterparty or the issuer of the investment as a nonmember, member, or affiliate of a member. When the Bank executes non-MBS investments with a member, the Bank may give consideration to the member's secured credit and the Bank's advances pricing. As an additional service to its members, the Bank has in the past entered into offsetting interest rate exchange agreements, acting as an intermediary between exactly offsetting derivatives transactions with members and other counterparties. These transactions are executed at market rates.

**Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)**

Transactions with Certain Members and Certain Nonmembers. The following tables set forth information at the dates and for the periods indicated with respect to transactions with: (i) members and nonmembers that held more than 10% of the outstanding shares of the Bank’s capital stock, including mandatorily redeemable capital stock, at any time during the periods indicated, (ii) members that had an officer or director serving on the Bank’s Board of Directors at any time during the periods indicated, and (iii) affiliates of the foregoing members and nonmembers. All transactions with members, the nonmembers described in the preceding sentence, and their respective affiliates are entered into in the normal course of business. The tables include securities transactions where certain members, nonmembers, and their affiliates (as described above) are the issuers or obligors of the securities, but do not include securities purchased, sold or issued through, or otherwise underwritten by, affiliates of certain members and nonmembers. The tables also do not include any AHP or Community Investment Cash Advance (CICA) grants. Securities purchased, sold or issued through, or otherwise underwritten by, and AHP or CICA grants provided to, the affiliates of certain members and nonmembers are in the ordinary course of the Bank’s business.

	December 31, 2013	December 31, 2012
Assets:		
Cash and due from banks	\$ —	\$ 1
Investments ⁽¹⁾	1,176	3,929
Advances	11,268	20,787
Mortgage loans held for portfolio	760	1,074
Accrued interest receivable	25	32
Other assets	37	10
Derivative assets, net	257	362
Total Assets	\$ 13,523	\$ 26,195
Liabilities:		
Deposits	\$ 260	\$ 31
Mandatorily redeemable capital stock	1,356	3,850
Derivative liabilities, net	37	15
Total Liabilities	\$ 1,653	\$ 3,896
Notional amount of derivatives	\$ 12,256	\$ 16,863
Standby letters of credit	205	255

(1) Investments consist of securities purchased under agreements to resell, Federal funds sold, AFS securities, and HTM securities issued by and/or purchased from the members or nonmembers described in this section or their affiliates.

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

	For the Years Ended December 31,		
	2013	2012	2011
Interest Income:			
Investments ⁽¹⁾	\$ 30	\$ 38	\$ 53
Advances ⁽²⁾	134	174	185
Mortgage loans held for portfolio	44	63	82
Total Interest Income	\$ 208	\$ 275	\$ 320
Interest Expense:			
Mandatorily redeemable capital stock	\$ 138	\$ 45	\$ 10
Consolidated obligations ⁽²⁾	(166)	(217)	(414)
Total Interest Expense	\$ (28)	\$ (172)	\$ (404)
Other Income/(Loss):			
Net gain/(loss) on derivatives and hedging activities	\$ (118)	\$ (159)	\$ (217)
Other income	—	1	3
Total Other Income/(Loss)	\$ (118)	\$ (158)	\$ (214)

(1) Investments consist of securities purchased under agreements to resell, Federal funds sold, AFS securities, and HTM securities issued by and/or purchased from the members or nonmembers described in this section or their affiliates.

(2) Reflects the effect of associated derivatives with the members or nonmembers described in this section or their affiliates.

The FHLBank Act requires the Bank to establish an AHP. The Bank provides subsidies to members, which use the funds to assist in the purchase, construction, or rehabilitation of housing for very low-, low-, and moderate-income households. Subsidies may be in the form of direct grants or below-market interest rate advances. Only Bank members, along with their nonmember AHP project sponsors, may submit AHP applications. All AHP subsidies are made in the normal course of business.

The FHLBank Act also requires the Bank to establish a Community Investment Program (CIP) and authorizes the Bank to offer additional CICA programs. Under these programs, the Bank provides subsidies in the form of grants and below-market interest rate advances or standby letters of credit to members for community lending and economic development projects. Only Bank members may submit applications for CICA subsidies. All CICA subsidies are made in the normal course of business.

In instances where an AHP or CICA transaction involves a member that owns more than 10% of the Bank's capital stock (or an affiliate of such a member), a member with an officer or director who is a director of the Bank, or an entity with an officer, director, or general partner who serves as a director of the Bank (and that has a direct or indirect interest in the subsidy), the transaction is subject to the same eligibility and other program criteria and requirements as all other comparable transactions and to the regulations governing the operations of the relevant program.

Transactions with Other FHLBanks. Transactions with other FHLBanks are identified on the face of the Bank's financial statements.

Note 23 — Other

The table below discloses the categories included in other operating expense for the years ended December 31, 2013, 2012, and 2011.

Federal Home Loan Bank of San Francisco
Notes to Financial Statements (continued)

	2013		2012		2011
Professional and contract services	\$ 33	\$	31	\$	27
Travel	2		2		2
Occupancy	5		5		5
Equipment	9		10		8
Other	4		4		4
Total	\$ 53	\$	52	\$	46

Note 24 — Subsequent Events

The Bank evaluated events subsequent to December 31, 2013, until the time of the Form 10-K filing with the Securities and Exchange Commission, and no material subsequent events were identified.

APPENDIX D

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This CONTINUING DISCLOSURE CERTIFICATE (the “Disclosure Certificate”) is executed by SOCIAL MODEL RECOVERY SYSTEMS, INC., a California nonprofit public benefit corporation (the “Corporation”), in connection with the issuance of \$5,000,000 California Health Facilities Financing Authority Taxable Variable Rate Demand Revenue Bonds (Social Model Recovery Systems, Inc.), Series 2014 (the “Bonds”). The Bonds are being issued pursuant to an Indenture, dated as of April 1, 2014 (the “Indenture”), by and between the California Health Facilities Financing Authority (the “Authority”) and U.S. Bank National Association, as trustee (the “Trustee”). The proceeds of the Bonds are being loaned by the Authority to the Corporation pursuant to a Loan Agreement, dated as of April 1, 2014, by and between the Authority and the Corporation (the “Loan Agreement”). Pursuant to Section 5.15 of the Loan Agreement, the Corporation covenants and agree as follows:

Section 1. Definitions. In addition to the definitions set forth in the Indenture, which apply to any capitalized term used in this the Disclosure Certificate, unless otherwise defined in this Section 1, the following capitalized terms shall have the following meanings when used in this the Disclosure Certificate:

“*Annual Report*” shall mean any Annual Report provided by the Corporation pursuant to, and as described in, Sections 3 and 4 of this the Disclosure Certificate.

“*Beneficial Owner*” shall mean any person who (a) has the power, directly or indirectly, to vote or consent with respect to, or to dispose of ownership of, any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries), or (b) is treated as the owner of any Bonds for federal income tax purposes.

“*Dissemination Agent*” shall mean U.S. Bank National Association, or any successor Dissemination Agent designated in writing by the Corporation and which has filed with the Corporation a written acceptance of such designation. In the absence of such a designation, the Corporation shall act as the Dissemination Agent.

“*EMMA*” or “*Electronic Municipal Market Access*” means the centralized on-line repository for documents to be filed with the MSRB, such as official statements and disclosure information relating to municipal bonds, notes and other securities as issued by state and local governments.

“*Listed Events*” shall mean any of the events listed in Section 5(a) or 5(b) of this the Disclosure Certificate.

“*MSRB*” means the Municipal Securities Rulemaking Board, which has been designated by the Securities and Exchange Commission as the sole repository of disclosure information for purposes of the Rule, or any other repository of disclosure information which may be designated by the Securities and Exchange Commission as such for purposes of the Rule in the future.

“*Participating Underwriter*” shall mean any original underwriter of the Bonds required to comply with the Rule in connection with offering of the Bonds.

“*Rule*” shall mean Rule 15c2-12 adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

Section 2. Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the Corporation for the benefit of the owners and Beneficial Owners of the Bonds and in order to assist the Participating Underwriter in complying with Securities and Exchange Commission Rule 15c2-12(b)(5).

Section 3. Provision of Annual Reports.

(a) *Delivery of Annual Report.* The Corporation shall, or shall cause the Dissemination Agent to, not later than nine months after the end of the Corporation's fiscal year (which currently ends on December 31), commencing with the report for the 2013-14 Fiscal Year, which is due not later than March 31, 2015, file with EMMA, in a readable PDF or other electronic format as prescribed by the MSRB, an Annual Report that is consistent with the requirements of Section 4 of this the Disclosure Certificate. The Annual Report may be submitted as a single document or as separate documents comprising a package and may cross-reference other information as provided in Section 4 of this the Disclosure Certificate; provided that the audited financial statements of the Corporation may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date.

(b) *Change of Fiscal Year.* If the Corporation's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(c), and subsequent Annual Report filings shall be made no later than six months after the end of such new fiscal year end.

(c) *Delivery of Annual Report to Dissemination Agent.* Not later than fifteen (15) Business Days prior to the date specified in subsection (a) (or, if applicable, subsection (c)) of this Section 3 for providing the Annual Report to EMMA, the Corporation shall provide the Annual Report to the Dissemination Agent (if other than the Corporation). If by such date, the Dissemination Agent has not received a copy of the Annual Report, the Dissemination Agent shall notify the Corporation.

(d) *Report of Non-Compliance.* If the Corporation is the Dissemination Agent and is unable to file an Annual Report by the date required in subsection (a) (or, if applicable, subsection (b)) of this Section 3, the Corporation shall send a notice to EMMA substantially in the form attached hereto as Exhibit A. If the Corporation is not the Dissemination Agent and is unable to provide an Annual Report to the Dissemination Agent by the date required in subsection (d) of this Section 3, the Dissemination Agent shall send a notice to EMMA in substantially the form attached hereto as Exhibit A.

(e) *Compliance Certification.* The Dissemination Agent shall, if the Dissemination Agent is other than the Corporation, file a report with the Corporation certifying that the Annual Report has been filed with EMMA pursuant to Section 3 of this the Disclosure Certificate, stating the dates they were so provided and filed.

Section 4. Content of Annual Reports. The Annual Report shall contain or incorporate by reference the following:

(i) **Financial Statements.** Audited financial statements of the Corporation for the preceding fiscal year, prepared in accordance generally accepted accounting principles. If the Corporation's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(ii) **Other Annual Information.** To the extent not included in the audited final statements of the Corporation, the Annual Report shall also include the sources of revenue and financial ratio data substantially similar to that provided in the official statement for the Bonds.

(iii) **Cross References.** Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the Corporation or related public entities, which are available to the public on EMMA. The Corporation shall clearly identify each such other document so included by reference.

If the document included by reference is a final official statement, it must be available from EMMA.

(iv) **Further Information.** In addition to any of the information expressly required to be provided under subparagraph (ii) of this paragraph (a) of this Section 4, the Corporation shall provide such further information, if any, as may be necessary to make the specifically required statements, in the light of the circumstances under which they are made, not misleading.

Section 5. Reporting of Listed Events.

(a) *Reportable Events.* The Corporation shall, or shall cause the Dissemination (if not the Corporation) to, give notice of the occurrence of any of the following events with respect to the Bonds:

- (1) Principal and interest payment delinquencies.
- (2) Unscheduled draws on debt service reserves reflecting financial difficulties.
- (3) Unscheduled draws on credit enhancements reflecting financial difficulties.
- (4) Substitution of credit or liquidity providers, or their failure to perform.
- (5) Defeasances.
- (6) Rating changes.
- (7) Tender offers.
- (8) Bankruptcy, insolvency, receivership or similar event of the obligated person.
- (9) 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 the security, or other material events affecting the tax status of the security.

(b) *Material Reportable Events.* The Corporation shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material:

- (1) Non-payment related defaults.
- (2) Modifications to rights of security holders.
- (3) Bond calls.
- (4) The release, substitution, or sale of property securing repayment of the securities.
- (5) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, 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.
- (6) Appointment of a successor or additional trustee, or the change of name of a trustee.

(c) *Time to Disclose.* Whenever the Corporation obtains knowledge of the occurrence of a Listed Event, the Corporation shall, or shall cause the Dissemination Agent (if not the Corporation) to, file a notice of such occurrence with EMMA, in an electronic format as prescribed by the MSRB, in a timely manner not in excess of 10 business

days after the occurrence of the Listed Event. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(5) and (b)(3) above need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to owners of affected Bonds under the Indenture.

Section 6. Identifying Information for Filings with EMMA. All documents provided to EMMA under this the Disclosure Certificate shall be accompanied by identifying information as prescribed by the MSRB.

Section 7. Termination of Reporting Obligation. The Corporation's obligations under this the Disclosure Certificate shall terminate upon the defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the Corporation shall give notice of such termination in the same manner as for a Listed Event under Section 5(c).

Section 8. Dissemination Agent.

(a) *Appointment of Dissemination Agent*. The Corporation may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this the Disclosure Certificate and may discharge any such agent, with or without appointing a successor Dissemination Agent. If the Dissemination Agent is not the Corporation, the Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the Corporation pursuant to this the Disclosure Certificate. It is understood and agreed that any information that the Dissemination Agent may be instructed to file with EMMA shall be prepared and provided to it by the Corporation. The Dissemination Agent has undertaken no responsibility with respect to the content of any reports, notices or disclosures provided to it under this the Disclosure Certificate and has no liability to any person, including any Bondholder, with respect to any such reports, notices or disclosures. The fact that the Dissemination Agent or any affiliate thereof may have any fiduciary or banking relationship with the Corporation shall not be construed to mean that the Dissemination Agent has actual knowledge of any event or condition, except as may be provided by written notice from the Corporation.

(b) *Compensation of Dissemination Agent*. The Dissemination Agent shall be paid compensation by the Corporation for its services provided hereunder in accordance with its schedule of fees as agreed to between the Dissemination Agent and the Corporation from time to time and all expenses, legal fees and expenses and advances made or incurred by the Dissemination Agent in the performance of its duties hereunder. The Dissemination Agent shall not be deemed to be acting in any fiduciary capacity for the Corporation, owners or Beneficial Owners, or any other party. The Dissemination Agent may rely, and shall be protected in acting or refraining from acting, upon any direction from the Corporation or an opinion of nationally recognized bond counsel. The Dissemination Agent may at any time resign by giving written notice of such resignation to the Corporation. The Dissemination Agent shall not be liable hereunder except for its negligence or willful misconduct.

(c) *Responsibilities of Dissemination Agent*. In addition of the filing obligations of the Dissemination Agent set forth in Sections 3(e) and 5, the Dissemination Agent shall be obligated, and hereby agrees, to provide a request to the Corporation to compile the information required for its Annual Report at least 30 days prior to the date such information is to be provided to the Dissemination Agent pursuant to subsection (c) of Section 3. The failure to provide or receive any such request shall not affect the obligations of the Corporation under Section 3.

Section 9. Amendment; Waiver. Notwithstanding any other provision of this the Disclosure Certificate, the Corporation may amend this the Disclosure Certificate (and the Dissemination Agent shall agree to any amendment so requested by the Corporation that does not impose any greater duties or risk of liability on the Dissemination Agent), and any provision of this the Disclosure Certificate may be waived, provided that all of the following conditions are satisfied:

(a) *Change in Circumstances*. If the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a) or (b), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of an obligated person with respect to the Bonds, or the type of business conducted.

(b) *Compliance as of Issue Date.* The undertaking, as amended or taking into account such waiver, would, in the opinion of a nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances.

(c) *Consent of Holders; Non-impairment Opinion.* The amendment or waiver either (i) is approved by the Bondholders in the same manner as provided in the Indenture for amendments to the Indenture with the consent of Bondholders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Bondholders or Beneficial Owners.

If this the Disclosure Certificate is amended or any provision of this the Disclosure Certificate is waived, the Corporation shall describe such amendment or waiver in the next following Annual Report and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the Corporation. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(c), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 10. Additional Information. Nothing in this the Disclosure Certificate shall be deemed to prevent the Corporation from disseminating any other information, using the means of dissemination set forth in this the Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this the Disclosure Certificate. If the Corporation chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this the Disclosure Certificate, the Corporation shall have no obligation under this the Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Section 11. Default. In the event of a failure of the Corporation to comply with any provision of this the Disclosure Certificate, any Bondholder or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the Corporation to comply with its obligations under this the Disclosure Certificate. The sole remedy under this the Disclosure Certificate in the event of any failure of the Corporation to comply with this the Disclosure Certificate shall be an action to compel performance.

Section 12. Duties, Immunities and Liabilities of Dissemination Agent. The Dissemination Agent shall have only such duties as are specifically set forth in this the Disclosure Certificate, and no implied covenants or obligations shall be read into this the Disclosure Certificate against the Dissemination Agent, and the Corporation agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and agents, harmless against any loss, expense and liabilities which it may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys fees and expenses) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The Dissemination Agent shall have the same rights, privileges and immunities hereunder as are afforded to the Trustee under the Indenture. The obligations of the Corporation under this Section 12 shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

Section 13. Beneficiaries. This the Disclosure Certificate shall inure solely to the benefit of the Corporation, the Dissemination Agent, the Participating Underwriter and the owners and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Date: [Closing Date]

SOCIAL MODEL RECOVERY SYSTEMS, INC.

By _____
Authorized Officer

ACCEPTANCE OF DISSEMINATION AGENT:

The undersigned hereby accepts the designation of Dissemination Agent and agrees to carry out the duties of the Dissemination Agent set forth in the foregoing Continuing Disclosure Certificate.

U.S. BANK NATIONAL ASSOCIATION, as Dissemination Agent

By _____
Authorized Officer

EXHIBIT A

NOTICE TO EMMA OF FAILURE TO FILE ANNUAL REPORT

Name of Obligor: Social Model Recovery Systems, Inc.

Name of Bond Issue: \$5,000,000 California Health Facilities Financing Authority Taxable Variable Rate Demand Revenue Bonds (Social Model Recovery Systems, Inc.), Series 2014

Date of Issuance: [Closing Date]

NOTICE IS HEREBY GIVEN that the Obligor has not provided an Annual Report with respect to the above-named Bonds as required by the Continuing Disclosure Certificate dated [Closing Date], furnished by the Obligor in connection with the Issue. The Obligor anticipates that the Annual Report will be filed by _____.

Dated: _____

U.S. BANK NATIONAL ASSOCIATION, as Dis-semination Agent

By _____
Title _____

cc: Trustee

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APPENDIX E

SPECIMEN LETTER OF CREDIT AND CONFIRMING LETTER OF CREDIT

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IRREVOCABLE LETTER OF CREDIT

April 2, 2014
Letter of Credit No. STB14/00420

U.S. Bank National Association
1420 Fifth Ave., 7th Flr.
Seattle, Washington 98101
Attention: Global Corporate Trust Services

Ladies and Gentlemen:

We hereby establish in your favor at the request and for the account of Social Model Recovery Systems, Inc. our irrevocable letter of credit in the amount of U.S. \$5,058,905.00 (Five Million Fifty Eight Thousand Nine Hundred Five Dollars) in connection with the Bonds (as defined below) available with ourselves by sight payment against presentation of one or more signed and dated demands addressed by you to Preferred Bank, Letter of Credit Operations Office, Los Angeles, California, each in the form of Annex A (an "A Drawing"), Annex B (a "B Drawing"), Annex C (a "C Drawing"), or Annex D (a "D Drawing") hereto, with all instructions in brackets therein being complied with. Each such demand must be presented to us in its original form at the Presentation Office (as hereinafter defined) or by facsimile transmission of such original form to us at (213) 622-2096.

Each such presentation must be made at or before 5:00 p.m. California time on a Business Day (as hereinafter defined) to our office in Los Angeles, California, located at 601 South Grand Avenue, 29th Floor, Los Angeles, California 90017, (the "Presentation Office").

This Letter of Credit expires at our Letter of Credit Operations Office in Los Angeles, California on April 2, 2015, but shall be automatically extended, without written amendment, to April 2nd in each succeeding calendar year up to, but not beyond, April 2, 2024 unless you have received written notice from us sent by express courier or registered mail to your address above, or by facsimile transmission to (206) 344-4630 (the "Fax Number"), that we elect not to extend this Letter of Credit beyond the April 2nd specified in such notice, which date will be a date before April 2, 2024. (The earlier of (i) the date specified in such notice from us and (ii) April 2, 2024, or if such earlier date is not a Business Day then the first (1st) succeeding Business Day thereafter, will be hereinafter referred to as the "Expiration Date".) To be effective, such notice from us must be received by you at least 90 calendar days before the Expiration Date. As used herein the term "Business Day" shall mean a day on which our Los Angeles Letter of Credit Operations Office is open for business.

The amount of any demand presented hereunder will be the amount inserted in numbered Paragraph 4 of said demand. By honoring any such demand we make no representation as to the correctness of the amount demanded.

We hereby agree with you that each demand presented hereunder in full compliance with the terms hereof will be duly honored by our payment to you of the amount of such demand, in immediately available funds of Preferred Bank:

- (i) not later than 10:00 a.m., California time, on the Business Day following the Business Day on which such demand is presented to us as aforesaid if such presentation is made to us at or before noon, California time, or
- (ii) not later than 10:00 a.m., California time, on the second Business Day following the Business Day on which such demand is presented to us as aforesaid, if such presentation is made to us after noon, California time.

Notwithstanding the foregoing, any demand presented hereunder, in full compliance with the terms hereof, for a C Drawing will be duly honored (i) not later than 12:30 p.m., California time, on the Business Day on which such demand is presented to us as aforesaid if such presentation is made to us at or before 8:00 a.m., California time, and (ii) not later than 11:00 a.m., California time, on the Business Day following the Business Day on which such demand is presented to us as aforesaid if such presentation is made to us after 8:00 a.m., California time.

If the remittance instructions included with any demand presented under this Letter of Credit require that payment is to be made by transfer to an account with us or with another bank, we and/or such other bank may rely solely on the account number specified in such instructions even if the account is in the name of a person or entity different from the intended payee.

With respect to any demand that is honored hereunder, the total amount of this Letter of Credit shall be reduced as follows:

- (A) With respect to each A Drawing paid by us, the total amount of this Letter of Credit shall be reduced by the amount of such A Drawing with respect to all demands presented to us after the time we receive such A Drawing; provided, however, that the amount of such A Drawing shall be automatically reinstated on the fourth (4th) day following the date such A Drawing is honored by us, unless (i) you shall have received notice from us sent to you at your above address by express courier or registered mail, or by facsimile transmission to the Fax Number, no later than three (3) days after such A Drawing is honored by us that there shall be no such reinstatement, or (ii) such fourth (4th) day falls after the Expiration Date;
- (B) With respect to each B Drawing paid by us, the total amount of this Letter of Credit shall be reduced with respect to all demands presented to us after the time we receive such B Drawing by the sum of (1) the amount inserted as principal in paragraph 5(A) of the B Drawing plus (2) the greater of (a) the amount inserted as interest in paragraph 5(B) of the B Drawing and (b) interest on the amount inserted as principal in paragraph 5(A) of the B Drawing calculated for 43 days at the rate of ten percent (10.0%) per annum based on a year of 365 days (with any fraction of a cent being rounded upward to the nearest whole cent), and no part of such sum shall be reinstated;
- (C) With respect to each C Drawing paid by us, the total amount of this Letter of Credit shall be reduced with respect to all demands presented to us after the time we receive such C Drawing by the sum of (1) the amount inserted as principal in paragraph 5(A) of the C Drawing plus (2) the greater of (a) the amount inserted as interest in paragraph 5(B) of the C Drawing and (b) interest on the amount inserted as principal in paragraph 5(A) of the C Drawing calculated for 43 days at the rate of ten percent (10.0%) per annum based on a year of 365 days (with any fraction of a cent being rounded upward to the nearest whole cent); provided, however, that if the Bonds (as defined below) related to such C Drawing are remarketed and the remarketing proceeds are paid to us prior to the Expiration Date, then on the day we receive such remarketing proceeds the amount of this Letter of Credit shall be reinstated by an amount which equals the sum of (i) the amount paid to us from such remarketing proceeds and (ii) interest on such amount calculated for the same number of days, at the same interest rate, and on the basis of a year of the same number of days as is specified in (2)(b) of this paragraph (C) (with any fraction of a cent being rounded upward to the nearest whole cent), with such reinstatement and its amount being promptly advised to you; provided, however, that in no event will the total amount of all C Drawing reinstatements exceed the total amount of all Letter of Credit reductions made pursuant to this paragraph (C).

Upon presentation to us of a D Drawing in compliance with the terms of this Letter of Credit, no further demand whatsoever may be presented hereunder.

No more than one A Drawing which we honor shall be presented to us during any consecutive twenty-seven (27) calendar day period. No A Drawing which we honor shall be for an amount more than U.S. \$5,058,905.00.

It is a condition of this Letter of Credit that the amount available for drawing under this Letter of Credit shall be decreased automatically without amendment upon our receipt of each reduction authorization in the form of Annex E to this Letter of Credit (with all instructions therein in brackets being complied with) sent to us at the Presentation Office as a signed and dated original form.

This Letter of Credit is subject to, and engages us in accordance with the terms of, the Uniform Customs and Practice for Documentary Credits (2007 Revision), Publication No. 600 of the International Chamber of Commerce (the "UCP"); provided, however, that if any provision of the UCP contradicts a provision of this Letter of Credit such provision of the UCP will not be applicable to this Letter of Credit, and provided further that Article 32, the second sentence of Article 36, and subsection (e) of Article 38 of the UCP shall not apply to this Letter of Credit. Furthermore, as provided in the first sentence of Article 36 of the UCP, we assume no liability or responsibility for

consequences arising out of the interruption of our business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts, or any other causes beyond our control. Matters related to this Letter of Credit which are not covered by the UCP will be governed by the laws of the State of California, including, without limitation, the Uniform Commercial Code as in effect in the State of California, except to the extent such laws are inconsistent with the provisions of the UCP or this Letter of Credit.

This Letter of Credit is transferable and may be transferred more than once, but in each case only in the amount of the full unutilized balance hereof to any single transferee who you shall have advised us pursuant to Annex F has succeeded U.S. Bank National Association or a successor trustee as Trustee under the Indenture of Trust dated as of April 1, 2014, as supplemented from time to time (the "Indenture") between the California Health Facilities Financing Authority (the "Issuer") and U.S. Bank National Association, as Trustee, pursuant to which U.S. \$5,000,000 in aggregate principal amount of the Issuer's Taxable Variable Rate Demand Revenue Bonds (Social Model Recovery Systems, Inc.), Series 2014 (the "Bonds") were issued. Transfers may be effected without charge to the transferor and only through ourselves and only upon presentation to us at the Presentation Office of a duly executed instrument of transfer in the form attached hereto as Annex F. Any transfer of this Letter of Credit as aforesaid must be endorsed by us on the reverse hereof and may not change the place of presentation of demands from our office in Los Angeles, California.

All payments hereunder shall be made from our own funds.

This Letter of Credit sets forth in full our undertaking, and such undertaking shall not in any way be modified, amended, amplified or limited by reference to any document, instrument or agreement referred to herein (including, without limitation, the Bonds and the Indenture), except the UCP to the extent the UCP is not inconsistent with or made inapplicable by this Letter of Credit; and any such reference shall not be deemed to incorporate herein by reference any document, instrument or agreement except the UCP.

PREFERRED BANK

By: _____

Authorized Signature

Annex A to Preferred Bank
Irrevocable Letter of Credit No.

PREFERRED BANK
LETTER OF CREDIT OPERATIONS
601 SOUTH FIGUEROA STREET, 29th FLOOR
LOS ANGELES, CALIFORNIA 90017

FOR THE URGENT ATTENTION OF LETTER OF CREDIT MANAGER

[INSERT NAME OF BENEFICIARY] (THE "TRUSTEE") HEREBY CERTIFIES TO PREFERRED BANK (THE "BANK") WITH REFERENCE TO IRREVOCABLE LETTER OF CREDIT NO. _____ (THE "LETTER OF CREDIT"; THE TERMS THE "BONDS", "BUSINESS DAY", THE "INDENTURE", AND THE "PRESENTATION OFFICE" USED HEREIN SHALL HAVE THEIR RESPECTIVE MEANINGS SET FORTH IN THE LETTER OF CREDIT) THAT:

- (1) THE TRUSTEE IS THE TRUSTEE OR A SUCCESSOR TRUSTEE UNDER THE INDENTURE.
- (2) THE TRUSTEE IS MAKING A DEMAND UNDER THE LETTER OF CREDIT FOR PAYMENT, ON AN INTEREST PAYMENT DATE (AS DEFINED IN THE INDENTURE), OF UNPAID INTEREST ON THE BONDS.
- (3) THE AMOUNT OF THIS DEMAND FOR PAYMENT WAS COMPUTED IN ACCORDANCE WITH THE TERMS AND CONDITIONS OF THE BONDS AND THE INDENTURE AND IS DEMANDED IN ACCORDANCE WITH THE INDENTURE, WHICH AMOUNT PLEASE REMIT TO THE UNDERSIGNED AS FOLLOWS:

[INSERT REMITTANCE INSTRUCTIONS].

- (4) THE AMOUNT HEREBY DEMANDED UNDER THE LETTER OF CREDIT IS \$**[INSERT AMOUNT]**.
- (5) THE TRUSTEE HAS CONTACTED OR ATTEMPTED TO CONTACT BY TELEPHONE AN OFFICER OF THE BANK AT THE PRESENTATION OFFICE REGARDING THE AMOUNT OF THIS DEMAND AND THE DATE AND TIME BY WHICH PAYMENT IS DEMANDED.
- (6) IF THIS DEMAND IS RECEIVED AT THE PRESENTATION OFFICE BY YOU AT OR BEFORE NOON, CALIFORNIA TIME ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 10:00 A.M., CALIFORNIA TIME, ON THE NEXT BUSINESS DAY. IF THIS DEMAND IS RECEIVED BY YOU AT THE PRESENTATION OFFICE AFTER NOON, CALIFORNIA TIME, ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 10:00 A.M., CALIFORNIA TIME, ON THE SECOND BUSINESS DAY FOLLOWING SUCH BUSINESS DAY.

[INSERT NAME OF BENEFICIARY]

[INSERT SIGNATURE AND DATE]

Annex B to Preferred Bank
Irrevocable Letter of Credit No.

PREFERRED BANK
LETTER OF CREDIT OPERATIONS
601 SOUTH FIGUEROA STREET, 29th FLOOR
LOS ANGELES, CALIFORNIA 90017

FOR THE URGENT ATTENTION OF LETTER OF CREDIT MANAGER.

[INSERT NAME OF BENEFICIARY] (THE "TRUSTEE") HEREBY CERTIFIES TO PREFERRED BANK (THE "BANK") WITH REFERENCE TO IRREVOCABLE LETTER OF CREDIT NO. _____ (THE "LETTER OF CREDIT"; THE TERMS THE "BONDS", "BUSINESS DAY", THE "INDENTURE", AND THE "PRESENTATION OFFICE" USED HEREIN SHALL HAVE THEIR RESPECTIVE MEANINGS SET FORTH IN THE LETTER OF CREDIT) THAT:

- (1) THE TRUSTEE IS THE TRUSTEE OR A SUCCESSOR TRUSTEE UNDER THE INDENTURE.
- (2) THE TRUSTEE IS MAKING A DEMAND UNDER THE LETTER OF CREDIT FOR PAYMENT OF THE PRINCIPAL AMOUNT OF, AND THE UNPAID INTEREST ON, REDEEMED BONDS UPON AN OPTIONAL AND/OR MANDATORY REDEMPTION OF LESS THAN ALL OF THE BONDS CURRENTLY OUTSTANDING.
- (3) THE AMOUNT OF THIS DEMAND FOR PAYMENT WAS COMPUTED IN ACCORDANCE WITH THE TERMS AND CONDITIONS OF THE BONDS AND THE INDENTURE AND IS DEMANDED IN ACCORDANCE WITH THE INDENTURE, WHICH AMOUNT PLEASE REMIT TO THE UNDERSIGNED AS FOLLOWS:

[INSERT REMITTANCE INSTRUCTIONS].

- (4) THE AMOUNT HEREBY DEMANDED UNDER THE LETTER OF CREDIT IS **\$(INSERT AMOUNT WHICH IS THE SUM OF THE TWO AMOUNTS INSERTED IN PARAGRAPH 5 BELOW)**.
- (5) THE AMOUNT HEREBY DEMANDED IS EQUAL TO THE SUM OF (A) **\$(INSERT AMOUNT)** BEING DRAWN WITH RESPECT TO THE PAYMENT OF THE PRINCIPAL OF THE REDEEMED BONDS AND (B) **\$(INSERT AMOUNT)** BEING DRAWN WITH RESPECT TO THE PAYMENT OF THE UNPAID INTEREST ON THE REDEEMED BONDS.
- (6) THE TRUSTEE HAS CONTACTED OR ATTEMPTED TO CONTACT BY TELEPHONE AN OFFICER OF THE BANK AT THE PRESENTATION OFFICE REGARDING THE AMOUNT OF THIS DEMAND AND THE DATE AND TIME BY WHICH PAYMENT IS DEMANDED.
- (7) IF THIS DEMAND IS RECEIVED BY YOU AT THE PRESENTATION OFFICE AT OR BEFORE NOON, CALIFORNIA TIME ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 10.00 A.M., CALIFORNIA TIME, ON THE NEXT BUSINESS DAY. IF THIS DEMAND IS RECEIVED BY YOU AT THE PRESENTATION OFFICE AFTER NOON, CALIFORNIA TIME, ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 10:00 A.M., CALIFORNIA TIME, ON THE SECOND BUSINESS DAY FOLLOWING SUCH BUSINESS DAY.

[INSERT NAME OF BENEFICIARY]

[INSERT SIGNATURE AND DATE]

SPECIMEN

Annex C to Preferred Bank
Irrevocable Letter of Credit No.

PREFERRED BANK
LETTER OF CREDIT OPERATIONS
601 SOUTH FIGUEROA STREET, 29th FLOOR
LOS ANGELES, CALIFORNIA 90017

FOR THE URGENT ATTENTION OF LETTER OF CREDIT MANAGER.

[INSERT NAME OF BENEFICIARY] (THE "**TRUSTEE**") HEREBY CERTIFIES TO PREFERRED BANK (THE "**BANK**") WITH REFERENCE TO IRREVOCABLE LETTER OF CREDIT NO. _____ (THE "**LETTER OF CREDIT**"; THE TERMS THE "**BONDS**", "**BUSINESS DAY**", THE "**INDENTURE**", AND THE "**PRESENTATION OFFICE**" USED HEREIN SHALL HAVE THEIR RESPECTIVE MEANINGS SET FORTH IN THE LETTER OF CREDIT) THAT:

- (1) THE TRUSTEE IS THE TRUSTEE OR A SUCCESSOR TRUSTEE UNDER THE INDENTURE.
- (2) THE TRUSTEE IS MAKING A DEMAND UNDER THE LETTER OF CREDIT FOR PAYMENT OF THE PRINCIPAL AMOUNT OF, AND INTEREST DUE ON, THOSE BONDS WHICH THE REMARKETING AGENT (AS DEFINED IN THE INDENTURE) HAS BEEN UNABLE TO REMARKET WITHIN THE TIME LIMITS ESTABLISHED IN THE INDENTURE.
- (3) THE AMOUNT OF THIS DEMAND FOR PAYMENT WAS COMPUTED IN ACCORDANCE WITH THE TERMS AND CONDITIONS OF THE BONDS AND THE INDENTURE AND IS DEMANDED IN ACCORDANCE WITH THE INDENTURE, WHICH AMOUNT PLEASE REMIT TO THE UNDERSIGNED AS FOLLOWS:

[INSERT REMITTANCE INSTRUCTIONS].

- (4) THE AMOUNT HEREBY DEMANDED UNDER THE LETTER OF CREDIT IS \$**[INSERT AMOUNT WHICH IS THE SUM OF THE TWO AMOUNTS INSERTED IN PARAGRAPH 5 BELOW]**.
- (5) THE AMOUNT OF THIS DEMAND IS EQUAL TO THE SUM OF (A) \$**[INSERT AMOUNT]** BEING DRAWN WITH RESPECT TO THE PAYMENT OF PRINCIPAL OF THE BONDS AND (B) \$**[INSERT AMOUNT]** BEING DRAWN WITH RESPECT TO THE PAYMENT OF INTEREST DUE ON THE BONDS.
- (6) THE TRUSTEE HAS CONTACTED OR ATTEMPTED TO CONTACT BY TELEPHONE AN OFFICER OF THE BANK AT THE PRESENTATION OFFICE REGARDING THE AMOUNT OF THIS DEMAND AND THE DATE AND TIME BY WHICH PAYMENT IS DEMANDED.
- (7) IF THIS DEMAND IS RECEIVED BY YOU AT THE PRESENTATION OFFICE AT OR BEFORE 8:00 A.M., CALIFORNIA TIME ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 12:30 P.M., CALIFORNIA TIME, ON SAID BUSINESS DAY. IF THIS DEMAND IS RECEIVED BY YOU AT

THE PRESENTATION OFFICE AFTER 8:00 A.M., ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 11:00 A.M., CALIFORNIA TIME, ON THE BUSINESS DAY FOLLOWING SAID BUSINESS DAY.

[INSERT NAME OF BENEFICIARY]

[INSERT SIGNATURE AND DATE]

SPECIMEN

Annex D to Preferred Bank
Irrevocable Letter of Credit No.

PREFERRED BANK
LETTER OF CREDIT OPERATIONS
601 SOUTH FIGUEROA STREET, 29th FLOOR
LOS ANGELES, CALIFORNIA 90017

FOR THE URGENT ATTENTION OF LETTER OF CREDIT MANAGER.

[INSERT NAME OF BENEFICIARY] (THE "TRUSTEE") HEREBY CERTIFIES TO PREFERRED BANK (THE "BANK") WITH REFERENCE TO IRREVOCABLE LETTER OF CREDIT NO. _____ (THE "LETTER OF CREDIT"; THE TERMS THE "BONDS", "BUSINESS DAY", THE "INDENTURE", AND THE "PRESENTATION OFFICE" USED HEREIN SHALL HAVE THEIR RESPECTIVE MEANINGS SET FORTH IN THE LETTER OF CREDIT) THAT:

- (1) THE TRUSTEE IS THE TRUSTEE OR A SUCCESSOR TRUSTEE UNDER THE INDENTURE.
- (2) THE TRUSTEE IS MAKING A DEMAND UNDER THE LETTER OF CREDIT FOR PAYMENT OF THE TOTAL UNPAID PRINCIPAL OF, AND UNPAID INTEREST ON, ALL OF THE BONDS WHICH ARE CURRENTLY OUTSTANDING UPON (A) THE STATED MATURITY OF ALL SUCH BONDS, (B) THE ACCELERATION OF ALL SUCH BONDS FOLLOWING AN EVENT OF DEFAULT UNDER THE INDENTURE, (C) THE MANDATORY TENDER OF ALL SUCH BONDS, OR (D) THE REDEMPTION OF ALL SUCH BONDS.
- (3) THE AMOUNT OF THIS DEMAND FOR PAYMENT WAS COMPUTED IN ACCORDANCE WITH THE TERMS AND CONDITIONS OF THE BONDS AND THE INDENTURE AND IS DEMANDED IN ACCORDANCE WITH THE INDENTURE, WHICH AMOUNT PLEASE REMIT TO THE UNDERSIGNED AS FOLLOWS:

[INSERT REMITTANCE INSTRUCTIONS].

- (4) THE AMOUNT HEREBY DEMANDED UNDER THE LETTER OF CREDIT IS \$[INSERT AMOUNT WHICH IS THE SUM OF THE TWO AMOUNTS SET FORTH IN PARAGRAPH 5, BELOW].
- (5) THE AMOUNT OF THIS DEMAND IS EQUAL TO THE SUM OF (A) \$[INSERT AMOUNT] BEING DRAWN WITH RESPECT TO THE PAYMENT OF THE UNPAID PRINCIPAL OF THE OUTSTANDING BONDS AND (B) \$[INSERT AMOUNT] BEING DRAWN WITH RESPECT TO THE PAYMENT OF THE UNPAID INTEREST ON THE OUTSTANDING BONDS.
- (6) THE TRUSTEE HAS CONTACTED OR ATTEMPTED TO CONTACT BY TELEPHONE AN OFFICER OF THE BANK AT THE PRESENTATION OFFICE REGARDING THE AMOUNT OF THIS DEMAND AND THE DATE AND TIME BY WHICH PAYMENT IS DEMANDED.
- (7) IF THIS DEMAND IS RECEIVED BY YOU AT THE PRESENTATION OFFICE AT OR BEFORE NOON, CALIFORNIA TIME ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 10:00 A.M., CALIFORNIA TIME, ON THE NEXT BUSINESS DAY. IF THIS DEMAND IS RECEIVED BY YOU AT THE PRESENTATION OFFICE AFTER NOON, CALIFORNIA TIME, ON A BUSINESS DAY, YOU MUST MAKE PAYMENT ON THIS DEMAND AT OR BEFORE 10:00 A.M., CALIFORNIA TIME, ON THE SECOND BUSINESS DAY FOLLOWING SUCH BUSINESS DAY.

[INSERT NAME OF BENEFICIARY]

[INSERT SIGNATURE AND DATE]

Annex E to Preferred Bank, National Association
Irrevocable Letter of Credit No.

PREFERRED BANK
LETTER OF CREDIT OPERATIONS
601 SOUTH FIGUEROA STREET, 29th FLOOR
LOS ANGELES, CALIFORNIA 90017

FOR THE URGENT ATTENTION OF LETTER OF CREDIT MANAGER

LETTER OF CREDIT REDUCTION AUTHORIZATION

[INSERT NAME OF BENEFICIARY], WITH REFERENCE TO LETTER OF CREDIT NO. _____
_____ ISSUED BY PREFERRED BANK (THE "BANK"), HEREBY UNCONDITIONALLY AND
IRREVOCABLY REQUESTS THAT THE BANK DECREASE THE AMOUNT AVAILABLE FOR DRAWING
UNDER THE LETTER OF CREDIT BY \$**[INSERT AMOUNT]**.

[FOR SIGNED REDUCTION AUTHORIZATIONS ONLY]

[INSERT NAME OF BENEFICIARY]

By: [INSERT SIGNATURE]

TITLE: [INSERT TITLE]

DATE: [INSERT DATE]

Annex F to Preferred Bank
Irrevocable Letter of Credit No.

PREFERRED BANK
LETTER OF CREDIT OPERATIONS
601 SOUTH FIGUEROA STREET, 29th FLOOR
LOS ANGELES, CALIFORNIA 90017

FOR THE URGENT ATTENTION OF LETTER OF CREDIT MANAGER

[INSERT DATE]

Subject: Your Letter of Credit No. _____

Ladies and Gentlemen:

For value received, we hereby irrevocably assign and transfer all of our rights under the above-captioned Letter of Credit, as heretofore and hereafter amended, extended, increased or reduced to:

[Name of Transferee]

[Address of Transferee]

By this transfer, all of our rights in the Letter of Credit are transferred to the transferee, and the transferee shall have sole rights as beneficiary under the Letter of Credit, including sole rights relating to any amendments, whether increases or extensions or other amendments, and whether now existing or hereafter made. You are hereby irrevocably instructed to advise future amendment(s) of the Letter of Credit to the transferee without our consent or notice to us.

The original Letter of Credit is returned with all amendments to this date. Please notify the transferee in such form as you deem advisable of this transfer and of the terms and conditions to this Letter of Credit, including amendments as transferred.

You are hereby advised that the transferee named above has succeeded U.S. Bank National Association, or a successor trustee, as Trustee under the Indenture of Trust dated as of April 1, 2014, as supplemented from time to time (the "Indenture") between the California Health Facilities Financing Authority (the "Issuer") and U.S. Bank National Association, as Trustee, pursuant to which U. S. \$5,000,000 in aggregate principal amount of Issuer's Taxable Variable Rate Demand Revenue Bonds (Social Model Recovery Systems, Inc.) Series 2014 (the "Bonds") were issued.

Very truly yours,

[Insert Name of Transferor]

By: _____
[Insert Name and Title]

TRANSFEROR'S SIGNATURE GUARANTEED

By: _____
[Bank Name]

By: _____
[Insert Name and Title]

By its signature below, the undersigned transferee acknowledges that it has duly succeeded _____ or a successor trustee as Trustee under the Indenture.

[Insert Name of Transferee]

By: _____
[Insert Name and Title]

SPECIMEN

IRREVOCABLE STANDBY LETTER OF CREDIT

Date: April 2, 2014
No: 2014-27

U.S. Bank National Association
1420 Fifth Avenue, 7th Floor
Seattle, Washington 98101
Attention: Global Corporate Trust Services

Greetings:

At the request and for the account of our customer, Preferred Bank, Los Angeles, California (the "Member"), we (the "Bank") hereby establish this Irrevocable Standby Letter of Credit (the "Letter of Credit") in your favor as Trustee under the Indenture of Trust dated as of April 1, 2014, as supplemented from time to time (the "Indenture") between the California Health Facilities Financing Authority (the "Issuer") and U.S. Bank National Association (the "Trustee"), pursuant to which U.S. \$5,000,000 in aggregate principal amount of the Issuer's Taxable Variable Rate Revenue Bonds (Social Model Recovery Systems, Inc.) Series 2014 (the "Bonds") were issued. Subject to the terms and conditions herein, this Letter of Credit authorizes you to draw on us an amount not exceeding \$5,058,905 (the "Credit Amount").

This Letter of Credit will expire at 4:00 p.m., California time, on the date (the "Expiration Date") that is the earliest of: (i) April 2, 2015 (the "Termination Date"); (ii) the date of any demand for payment honored by the Bank under this Letter of Credit; or (iii) the date you surrender this Letter of Credit to the Bank for cancellation.

This Letter of Credit is deemed to be automatically extended without amendment for one (1) year from the initial Termination Date or any future Termination Date, unless at least ninety (90) days prior to such Termination Date, the Bank notifies you in writing (by confirmed delivery) at the address set forth above that we elect not to renew this Letter of Credit. Notwithstanding the above, this Letter of Credit shall not be extended beyond April 2, 2024.

Subject to the other provisions of this Letter of Credit, you may demand payment under this Letter of Credit at or before 11:00 a.m., California time, on or prior to the Expiration Date by presenting your certificate in the form of Annex A, prepared in the form of a letter on your letterhead, signed by your authorized officer, with the blanks appropriately completed (the "Certification"), delivered to the Bank at 600 California Street, San Francisco, California 94108, Attention: Portfolio Operations/Letters of Credit. All payments under this Letter of Credit will be made with funds of the Bank and not from funds of the Issuer or the Member.

The Bank will honor a Certification presented in full compliance with the terms of this Letter of Credit (a "Drawing") at or before 11:00 a.m., California time, on a Business Day by making payment to you, in immediately available funds, of the Drawing amount specified in the Certification (up to the Credit Amount) at or before 10:30 a.m. California time, on the next Business Day. Documents received after 11:00 a.m., California time, will be deemed to have been received before 10:00 a.m. on the next Business Day. As used in this Letter of Credit, a "Business Day" is any day on which the Bank is open for business.

Upon honoring a Drawing under this Letter of Credit, the Bank's obligations in respect of the Drawing are discharged and the Bank will have no further obligations with respect to the Drawing. If you make a demand for payment under this

Letter of Credit that does not conform, in any instance, to the terms of this Letter of Credit, we will give you notice that the purported demand does not conform with the terms of the Letter of Credit and we may hold the documents at your disposal or return them to you, at our option. You may attempt to correct your nonconforming demand for payment if, and to the extent that, you are entitled (without regard to the provisions of this sentence) and able to do so. Any correction or resubmission of your demand for payment will be considered a new demand.

By honoring a Drawing under this Letter of Credit, we make no representation as to the correctness of the amount of the Drawing, the authority of any person signing on your behalf or your representations on the Certification.

Upon the Bank's receipt of your request for reduction in the form of Annex B ("Request for Reduction"), the Credit Amount shall be reduced to the amount stated in the Request for Reduction by an amendment to this Letter of Credit, effective on the later of the date set forth in the Request for Reduction or the date of the Bank's receipt of such Request for Reduction.

The Bank will transfer this Letter of Credit to a successor Trustee under the Indenture if you present the Letter of Credit accompanied by a certificate designating the successor Trustee.

This Letter of Credit will be governed by and construed in accordance with the Uniform Customs and Practice for Documentary Credits (2007 Revision), International Chamber of Commerce Publication 600 (the "Uniform Customs and Practice"), and, to the extent not inconsistent with the Uniform Customs and Practice, the laws of the State of California. Notwithstanding anything in Article 36 of the Uniform Customs and Practice to the contrary, if you may properly draw on this Letter of Credit prior to the Expiration Date during an interruption of business as described in said Article, then the Bank shall be specifically authorized and agrees to effect payment in accordance with such drawing, so long as this Letter of Credit is drawn on within three Business Days of the Bank's written notice to you that the Bank has resumed business.

Communications with respect to this Letter of Credit must be in writing, must specifically refer to the number of this Letter of Credit, and must be delivered to the Bank at the address indicated above.

This Letter of Credit, including Annexes A and B, sets forth in full our undertaking, which may not be modified, amplified or limited by reference to any document, instrument, or agreement (including, without limitation, the Bonds and the Indenture), and any such reference will not be deemed to incorporate by reference any document, instrument or agreement.

Very truly yours,

FEDERAL HOME LOAN BANK
OF SAN FRANCISCO

By: _____

Title: _____

By: _____

Title: _____

SPECIMEN

ANNEX A
CERTIFICATION

Federal Home Loan Bank of San Francisco
600 California Street
San Francisco, CA 94108
Attention: Portfolio Operations/Letters of Credit

Letter of Credit No. 2014-27

The undersigned, a duly authorized officer of the Trustee, certifies as follows to the Federal Home Loan Bank of San Francisco, as issuer of the above-referenced Letter of Credit:

1. All terms defined in the Letter of Credit are used in this certification with the same meanings.
2. The Trustee is the Trustee under the Indenture, is the beneficiary under the Letter of Credit, and is entitled to present this certificate.
3. The Member has not timely honored a draw, the Trustee is precluded by operation of law from timely drawing on or the Member has repudiated the Member's Irrevocable Standby Letter of Credit No. _____, dated April 2, 2014.
4. The Trustee is entitled to draw \$ _____ under the above-referenced Letter of Credit, which amount does not exceed the Credit Amount of the Letter of Credit.
5. Wire Instructions: _____

Dated: _____

U.S. Bank National Association

By: _____

Title: _____
Authorized Officer

[Beneficiary Letterhead]

ANNEX B

REQUEST FOR REDUCTION

Date: _____

Federal Home Loan Bank
of San Francisco
600 California Street
San Francisco, CA 94108
Attention: Portfolio Operations/Letters of Credit

Re: Letter of Credit No. 2014-27

Greetings:

At the request of U.S. Bank National Association, the Beneficiary, please reduce the Credit Amount for the above-referenced Letter of Credit to \$ _____, effective on the later of _____, 20__ or receipt of this letter.

Sincerely,

U.S. Bank National Association

By: _____

Title: _____

Authorized Signature

SPECIMEN

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APPENDIX F

SUMMARY OF THE INDENTURE AND THE LOAN AGREEMENT

The following is a summary of certain provisions of the Indenture and the Loan Agreement which are not described elsewhere in this Official Statement. These summaries do not purport to be comprehensive and reference should be made to the Indenture and the Loan Agreement for a full and complete statement of their provisions. All capitalized terms not defined in this Official Statement have the meaning set forth in the Indenture.

DEFINITIONS OF CERTAIN TERMS

“*Accountant*” means any firm of independent certified public accountants selected by the Corporation and reasonably acceptable to the Bank.

“*Act*” means the California Health Facilities Financing Authority Act, constituting Part 7.2 of Division 3 of Title 2 of the California Government Code, as now in effect and as it may from time to time hereafter be amended or supplemented.

“*Act of Bankruptcy*” means the entry of an order or decree, by a court having jurisdiction in the matter, for relief against the Corporation in an involuntary case under any applicable bankruptcy, insolvency, or other similar law now or hereafter in effect, or appointing a receiver, liquidator, assignee, custodian, trustee, sequestrator, or other similar official, of the Corporation or of any substantial part of the property of the Corporation, or ordering the winding up or liquidation of the affairs of the Corporation; or the institution or commencement by or against the Corporation of a voluntary or involuntary case under any applicable bankruptcy, insolvency, or other similar law now or hereafter in effect; provided, however, that in the event of an involuntary case such involuntary case or proceeding shall remain undismissed for a period of 60 days, or the consent by it to the entry of an order for relief against it in any involuntary case under any such law, or to the appointment of a receiver, liquidator, assignee, custodian, trustee, sequestrator, or other similar official, of the Corporation or of any substantial part of the property of the Corporation, or the making by the Corporation of an assignment for the benefit of creditors, or the failure of it generally to pay its debts as they become due, or the admission by it in writing of such failure, or the taking of any action by the Corporation in furtherance of any such action, or if a receiver of the business or of the property or assets of the Corporation shall be appointed by any court.

“*Additional Payments*” means the payments required to be made by the Corporation pursuant to the Loan Agreement.

“*Agreement*” or “*Loan Agreement*” means that certain loan agreement by and between the Authority and the Corporation, dated as of April 1, 2014, as originally executed and as it may from time-to-time be supplemented, modified or amended in accordance with the terms thereof and of the Indenture.

“*Alternate Credit Facility*” means bond insurance or other similar credit enhancement facility meeting the requirements of the Loan Agreement.

“*Alternate Fixed Rate*” has the meaning ascribed to such term in the Indenture.

“*Alternate Letter of Credit*” means an alternate irrevocable letter of credit, or similar credit facility issued by a commercial bank or savings institution, the terms of which, other than the expiration date, shall in all material respects be the same as those of the initial Letter of Credit and/or the Confirming Letter of Credit, as applicable, delivered to the Trustee pursuant to the Loan Agreement.

“*Alternate Weekly Rate*” has the meaning ascribed to such term in the Indenture.

“*Authority*” means the California Health Facilities Financing Authority created by the Act, or its successors and assigns.

“*Authorized Denomination*” means \$100,000 or any multiple of \$5,000 in excess of \$100,000, or any multiple of \$5,000 after the Fixed Rate Date.

“*Authorized Representative*” means, (a) with respect to the Corporation, its Board Chair, its Chief Executive Officer, its Chief Operating Officer, its Chief Financial Officer or any other person designated as an Authorized Representative of the Corporation by a Certificate of the Corporation signed by its Board Chair or Chief Executive Officer and filed with the Trustee, and (b) with respect to the Authority, its Chairman (or any Deputy), Executive Director, or any other Person or Persons designated as an Authorized Representative of the Authority by a Certificate of the Authority signed by its Chairman (or any Deputy), or Executive Director. Such authorization shall remain in effect until the Trustee has received written notice to the contrary accompanied by a new designation.

“*Available Moneys*” means moneys which are (a) continuously on deposit with the Trustee in trust for a period of 370 days for the benefit of the Registered Owners in a separate and segregated account in which only Available Moneys are held and during and prior to which period no Act of Bankruptcy of the Corporation or the Authority occurs and (b) proceeds of (i) the Bonds received contemporaneously with the issuance and sale of the Bonds, (ii) a drawing under the Letter of Credit, (iii) a drawing under the Confirming Letter of Credit, (iv) any other moneys for which the Trustee has received a written opinion of nationally recognized counsel experienced in bankruptcy matters to the effect that payment of such moneys to the Registered Owners would not constitute an avoidable preference under Section 547 of the United States Bankruptcy Code in the event the Authority, the Corporation or any Related Party were to become a debtor under the United States Bankruptcy Code, which opinion is acceptable to each rating agency then rating the Bonds, or (v) moneys derived from the investment of funds qualifying as Available Moneys under the foregoing clauses.

“*Bank*” means Preferred Bank, or any other commercial bank or other financial institution issuing a Letter of Credit then in effect and party to a Reimbursement Agreement.

“*Bank Bonds*” means Bonds tendered or subject to mandatory tender pursuant to the Indenture and purchased from funds described in the Indenture.

“*Beneficial Owner*” means generally any Person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds and with respect to Bonds held by DTC, those individuals, partnerships, corporations, or other entities for whom the Direct Participants have caused DTC to hold Bonds.

“*Bond*” or “*Bonds*” means the California Health Facilities Financing Authority Taxable Variable Rate Demand Revenue Bonds (Social Model Recovery Systems, Inc.), Series 2014, issued in the aggregate principal amount of \$5,000,000, authorized by, and at any time Outstanding pursuant to, the Indenture.

“*Bond Counsel*” means any attorney at law experienced in matters pertaining to the exclusion of interest from gross income for federal income tax purposes on bonds issued by states and political subdivisions, and duly admitted to practice law before the highest court of any state of the United States of America, approved by the Authority, but shall not include counsel for the Corporation.

“*Bond Payment Date*” means any date on which any principal of, premium, if any, or interest on, any Outstanding Bond shall be due and payable whether at maturity or on a scheduled Interest Payment Date or upon redemption, in each case in accordance with the terms of the Bonds and the Indenture.

“*Bond Purchase Agreement*” means, as to the Bonds, the Purchase Contract, dated April 1, 2014, by and between the Authority and the State Treasurer and Wulff Hansen & Co., as underwriter, and approved by the Corporation.

“*Bond Registrar*” means the Bond Registrar specified in the Indenture.

“*Business Day*” means any day other than (a) a Saturday, (b) a Sunday, (c) a day on which banks located in the cities in which the principal office of the Trustee, the Bank or the Confirming Bank, or the offices of the Tender Agent or Remarketing Agent, respectively, at which the duties of such Person relating to the Bonds are to be performed, is located are required or authorized by law or executive order to be closed, or (d) a day on which the payment system of the Federal Reserve System is not operational. For purposes of this definition, the Bank’s principal office shall be that office of the Bank at which drawings are to be presented under the Letter of Credit. For purposes of this definition, the Confirming Bank’s principal office shall be that office of the Confirming Bank at which drawings are to be presented under the Confirming Letter of Credit.

“*Certificate*,” “*Statement*,” “*Request*,” “*Requisition*” and “*Order*” of the Authority or the Corporation means, respectively, a written certificate, statement, request, requisition or order signed in the name of the Authority by an Authorized Representative of the Authority or in the name of the Corporation by an Authorized Representative of the Corporation. Any such instrument and supporting opinions or representations, if any, may, but need not, be combined in a single instrument with any other instrument, opinion or representation, and the two or more so combined shall be read and construed as a single instrument. Each such instrument shall include the statements provided for in the Indenture.

“*Closing Date*” means the date upon which there is a physical delivery of the Bonds in exchange for the amount representing the purchase price of the Bonds by the Original Purchaser.

“*Continuing Disclosure Certificate*” means that certain Continuing Disclosure Certificate of the Corporation, dated the date of issuance and delivery of the Bonds, as originally executed and as it may be amended from time to time in accordance with the terms thereof.

“*Corporation*” means Social Model Recovery Systems, Inc., a nonprofit corporation, duly organized and validly existing under the laws of the State of California and qualified as a nonprofit corporation pursuant section 501(c)(3) of the Code, its successor and assigns or any entity which is the surviving, resulting or transferee entity in any merger, consolidation or transfer of assets permitted under the Loan Agreement.

“*Code*” means the Internal Revenue Code of 1986, as amended from time-to-time, and any regulations from time-to-time promulgated or deemed in effect thereunder.

“*Confirming Bank*” means the Federal Home Loan Bank of San Francisco or any other commercial bank or other financial institution issuing a Confirming Letter of Credit then in effect.

“*Confirming Letter of Credit*” means an irrevocable letter of credit or confirmation (including an alternate irrevocable letter of credit or alternate confirmation) issued by the Confirming Bank guaranteeing the payments required to be made by the Bank under the Letter of Credit and naming the Trustee as the beneficiary.

“*Confirming Letter of Credit Account*” means the account of that name established in the Revenue Fund pursuant to the Indenture.

“*Costs of Issuance*” means all items of expense directly or indirectly payable by or reimbursable to the Authority or the Corporation and related to the authorization, issuance, sale and delivery of the Bonds, including but not limited to costs of preparation and reproduction of documents, printing expenses, application, filing and recording fees, fees and charges of the Bank and its counsel, initial fees and charges of the Trustee, Escrow Bank, Dissemination Agent, and Tender Agent, legal fees and charges, including the fees and charges of the Authority, Bond Counsel, fees and disbursements of consultants and professionals, rating agency fees, fees and charges for preparation, execution and safekeeping of the Bonds and any other cost, charge or fee in connection with the original issuance of the Bonds.

“*Costs of Issuance Fund*” means the fund of that name established pursuant to the Indenture.

“*Deeds of Trust*” means, collectively, those certain Deeds of Trust with Fixture Filing and Security Agreement, dated as of April 1, 2014, to be executed by the Corporation, as trustor, in favor of the Deed Trustee for the benefit of the Bank, as beneficiary, as amended, modified and supplemented from time to time.

“*Deed Trustee*” means the Person at the time serving as such under the Deed of Trust.

“*Direct Participant*” means those securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations for which DTC, from time-to-time, holds the Bonds as securities depository.

“*Dissemination Agent*” means the dissemination agent identified in the Continuing Disclosure Certificate.

“*DTC*” means The Depository Trust Company, New York, New York, or any successor securities depository.

“*Eligible Account*” means an account that is either (a) maintained with a federal or state-chartered depository institution or trust company that has an S&P short-term debt rating of at least “A-2” (or, if no short-term debt rating, a long-term debt rating of at least “BBB+”), or (b) maintained with the corporate trust department of a federal depository institution or state-chartered depository institution subject to regulations regarding fiduciary funds on deposit similar to Title 12 of the U.S. Code of Federal Regulation, section 9.10(b), which, in either case, has corporate trust powers and is acting in its fiduciary capacity.

“*ERISA*” means the Employee Retirement Income Security Act of 1974.

“*Environmental Claim*” means any accusation, allegation, notice of violation, claim, demand, abatement order or other order or direction (conditional or otherwise) by any governmental authority or any Person for any damage, including, without limitation, personal injury (including sickness, disease or death), tangible or intangible property damage, contribution, indemnity, indirect or consequential damages, damage to the environment, nuisance, pollution, contamination or other adverse effects on the environment, or for fines, penalties or restrictions, resulting from or based upon:

(a) the existence of a Release (whether sudden or nonsudden or accidental or non-accidental) of, or exposure to, any Hazardous Material, in, into or onto the environment at, in, by, from or related to the Facilities,

(b) the use, handling, transportation, storage, treatment or disposal of Hazardous Materials in connection with the operation of the Facilities, or

(c) the violation, or alleged violation, of any statutes, ordinances, orders, rules, regulations, permits, licenses or authorizations of or from any governmental authority, agency or court relating to environmental matters connected with the Facilities.

“*Environmental Laws*” means any federal, state or local law, statute, code, ordinance, regulation, requirement or rule relating to dangerous, toxic or hazardous pollutants, Hazardous Materials, chemical waste, materials or substances to which Corporation or its properties are subject.

“*Escrow Agreements*” means, collectively, the 2001 Escrow Agreement and the 2005 Escrow Agreement.

“*Escrow Bank*” means U.S. Bank National Association, a national banking association organized and existing under and by virtue of the laws of the United States of America, or any successor thereto, as escrow agent under the Escrow Agreements.

“*Event of Default*” means any of the events specified in the Indenture and the Loan Agreement.

“*Expiration Date*” means the stated date upon which the Letter of Credit, the Confirming Letter of Credit or an Alternate Letter of Credit shall expire in accordance with its terms.

“*Facilities*” means (a) the real property of the Corporation described in the Deeds of Trust; (b) all buildings and structures thereon and fixtures and improvements thereto, whether now existing or hereafter constructed, installed or acquired; and (c) all tangible personal property owned by the Corporation, whether now existing or hereafter constructed, installed or acquired, and used in, around or about the aforesaid real property.

“*Fiscal Year*” means the period of 12 calendar months ending on June 30 of each year, or any other 12-month period selected and designated as the fiscal year of the Corporation.

“*Fitch*” means Fitch Ratings, a majority owned subsidiary of Fimalac, S.A., an international business support services group headquartered in Paris, France, its successors and their assigns, or, if such corporation shall be dissolved, liquidated or replaced by the Authority, following consultation with the Corporation, as the rating agency for the Bonds, or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated in writing by the Authority, following consultation with the Corporation, which is requested to provide a rating on the Bonds.

“*Fixed Interest Rate*” means the interest rate borne by the Bonds from and after the Fixed Rate Date and determined in accordance with the Indenture

“*Fixed Rate Date*” means the date on which the Bonds begin to bear interest at the Fixed Interest Rate, which shall be an Interest Payment Date.

“*Government Obligations*” means and includes any of the following securities, if and to the extent the same are non-callable and not subject to redemption at the option of the issuer, at the time legal for investment: direct obligations of, or obligations the full and timely payment of principal of and interest on which are unconditionally guaranteed by, the United States of America, including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America and including a receipt, certificate, or any other evidence of a direct ownership interest of future payments in an obligation of, or unconditionally guaranteed by, the United States of America, or in specified portions thereof held by a custodian in safekeeping for the holders of such receipt, certificate, or any other evidence of ownership (which may consist of specified portions of interest thereon) which is rated or assessed in the highest rating category of Moody’s, Fitch and S&P to the extent each such rating agency is then rating the Bonds, but excluding any share or interest in any unitary investment trust or mutual fund unless such unitary investment trust or mutual fund is rated or assessed in the highest rating category of Moody’s, Fitch and S&P to the extent each such rating agency is then rating the Bonds.

“*Hazardous Material Activity*” means any actual, proposed or threatened storage, holding, existence, release, emission, discharge, generation, processing, abatement, removal, disposition, handling or transportation of any Hazardous Materials from, under, into or on the Facilities or surrounding property.

“*Hazardous Materials*” means:

(a) any oil, flammable substance, explosives, radioactive materials, hazardous wastes or substances, toxic wastes or substances or any other wastes, materials or pollutants which (i) pose a hazard to the Project or to persons on or about the Project [or the Prior Project] or (ii) cause the Project to be in violation of any Environmental Laws;

(b) asbestos in any form which is or could become friable, urea formaldehyde foam insulation, transformers or other equipment which contain dielectric fluid containing levels of polychlorinated biphenyls, or radon gas;

(c) any chemical, material or substance defined as or included in the definition of “waste,” “hazardous substances,” “hazardous wastes,” “hazardous materials,” “extremely hazardous waste,” “restricted hazardous waste,” or “toxic substances” or words of similar import under any Environmental Laws including, but not limited to, the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”), 42 USC §§ 9601 et seq.; the Resource Conservation and Recovery Act (“RCRA”), 42 USC §§ 6901 et seq.; the Hazardous Materials Transportation Act, 49 USC §§ 1801 et seq.; the Federal Water Pollution Control Act, 33 USC §§ 1251 et seq.; the California Hazardous Waste Control Law (“HWCL”), Cal. Health & Safety Code §§ 25100 et seq.; the Hazardous Substance Account Act (“HSAA”), Cal. Health & Safety Code §§ 25300 et seq.; the Underground Storage of Hazardous Substances Act, Cal. Health & Safety Code §§ 25280 et seq.; the Porter-Cologne Water Quality Control Act (the “Porter-Cologne Act”), Cal. Water Code §§ 13000 et seq., the Safe Drinking Water and Toxic Enforcement Act of 1986 (Proposition 65); and Title 22 of the California Code of Regulations, Division 4, Chapter 30;

(d) any other chemical, material or substance, exposure to which is prohibited, limited or regulated by any governmental authority or agency or may or could pose a hazard to the health and safety of the occupants of the Project or the owners and/or occupants of property adjacent to or surrounding the Project, or any other person coming upon the Project or adjacent property; or

(e) any other chemical, materials or substance which may or could pose a hazard to the environment.

“*Indenture*” means the Indenture of Trust, dated as of April 1, 2014, by and between the Authority and the Trustee, as originally executed or as it may from time-to-time be supplemented, modified or amended by any Supplemental Indenture.

“*Information Service*” means the Electronic Municipal Market Access System (referred to as “EMMA”), a facility of the Municipal Securities Rulemaking Board, (at <http://emma.msrb.org>); *provided, however*, in accordance with then current guidelines of the Securities and Exchange Commission, shall mean such other organizations providing information with respect to the Bonds shall mean such other organizations providing information with respect to called bonds, or no such services, as the Corporation may designate in a certificate of the Corporation delivered to the Trustee.

“*Interest Account*” means the account of that name in the Revenue Fund established pursuant to the Indenture.

“*Interest Payment Date*” means (a) on and prior to the Fixed Rate Date, the first day of each calendar month, commencing May 1, 2014 thereafter; and (b) after the Fixed Rate Date: April 1 and October 1 of each year commencing on the April 1 or October 1 next succeeding the Fixed Rate Date; provided, however, with respect to Bank Bonds, means the dates set forth for the payment of the interest on Bank Bonds in the Reimbursement Agreement.

“*Interest Period*” means the period from and including the date of the first authentication and delivery of the Bonds to and including April 9, 2014, and, thereafter, the period from and including an Interest Payment Date to and including the day next preceding the immediately succeeding Interest Payment Date.

“*Investment Securities*” means any of the following:

(a) Direct obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) or obligations the timely payment of the principal of and interest on which are fully guaranteed by the United States of America, including instruments evidencing an ownership interest in securities described in this clause (a) such as CATS, TIGRs, Treasury Receipts and Stripped Treasury Coupons;

(b) Obligations of any of the following federal agencies which obligations represent the full faith and credit of the United States of America (including stripped securities if the agency has stripped them itself)

(i) U.S. Export-Import Bank;

(ii) Farmers Home Administration;

(iii) Federal Financing Bank;

(iv) Federal Housing Administration;

(v) General Services Administration;

(vi) Government National Mortgage Association (“GNMA”) (including guaranteed mortgage-backed bonds and guaranteed pass-through obligations);

(vii) Rural Economic Community Development Administration;

(viii) Small Business Administration;

(ix) U.S. Maritime Administration (guaranteed Title XI financing); and

(x) U.S. Department of Housing and Urban Development (including project notes, local authority bonds, new communities debentures, U.S. government guaranteed debentures, U.S. Public Housing Notes and Bonds and U.S. government guaranteed public housing notes and bonds;

(c) Debentures, bonds, notes or other evidence of indebtedness issued or guaranteed by any of the following U.S. government agencies which obligations are not fully guaranteed by the full faith and credit of the United States of America (including stripped securities if the agency has stripped them itself):

(i) Federal Home Loan Bank System (senior debt obligations);

(ii) Resolution Funding Corporation (REFCORP) obligations;

(iii) Federal Home Loan Mortgage Corporation (FHLMC or “Freddie Mac”) senior debt obligations or participation certificates; and

(iv) Federal National Mortgage Association (FNMA or “Fannie Mae”) mortgage-backed securities and senior debt obligations.

(d) Investments in money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and having a rating by S&P of AAAM-G, AAAM or better (including funds for which the Trustee, its parent holding company, if any, or any affiliates or subsidiaries of the Trustee provide investment advisory or other management services);

(e) Pre-refunded municipal obligations defined as follows: any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice; and

(i) which are rated, based on an irrevocable escrow account or fund (the “Escrow”), in the highest rating category of Moody’s or S&P or any successors thereto; or

(ii) (A) which are fully secured as to principal, interest and redemption premium, if any, by an Escrow consisting only of cash or obligations described in paragraph (a) above, which Escrow may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (B) which Escrow is sufficient, as verified by an Accountant, to pay principal of and interest and redemption premium, if any on the bonds or other obligations described in this paragraph on the maturity date or dates specified in the irrevocable instructions referred to above, as appropriate;

(f) Repurchase agreements fully secured by collateral security described in clauses (a) (b), (c), or (h) of this definition, which collateral (i) is held by the Trustee or a third party agent during the term of such repurchase agreement, (ii) is not, pursuant to the terms of such agreement, subject to liens or claims of third parties and (iii) has a market value (determined at least once every five days) at least equal to the amount so invested;

(g) Demand deposits, including trust accounts, trust funds, interest bearing money market accounts, overnight bank deposits, interest bearing deposits, banker's acceptances or certificates of deposit of, or time deposits in, any bank (including the Trustee or any of its affiliates) or savings and loan association (i) which certificates of deposit or time deposits are fully insured by the Federal Deposit Insurance Corporation or (ii) which certificates of deposit (including those placed by a third party pursuant to an agreement between the Trustee and the Corporations) or time deposits are secured at all times, in the manner and to the extent provided by law, by collateral security (described in clauses (a), (b), (c), or (h) of this definition) with a market value (valued at least quarterly) of no less than the original amount of moneys so invested;

(h) Municipal obligations rated "Aaa/AAA" on the basis of insurance or credit enhancement, provided the underlying rating of the municipal obligation must be at least "Baa/BBB," uninsured or unenhanced municipal obligations rated at least Aa2/AA or general obligations of states with a rating of "A2/A" by Moody's or S&P;

(i) U.S. dollar denominated deposit accounts, federal funds or bankers acceptances with domestic commercial banks which may include the Trustee and its affiliates which have a rating on their short term certificates of deposit on the date of purchase of "P-1" by Moody's and "A-1" or "A-1+" by S&P (for purposes of rating, ratings on holding companies are not considered as the rating of the bank) and maturing not more than 360 calendar days after the date of purchase;

(j) the Local Agency Investment Fund of the State, created pursuant to Section 16429.1 of the California Government Code, to the extent the Trustee is authorized to register such investment in its name; and

(k) direct obligations of the State of California (including obligations issued or held in book-entry form on the books of the Office of the Treasurer of the State of California) or obligations the timely payment of the principal of and interest on which are fully guaranteed by the State of California.

"Letter of Credit" means (a) that certain Letter of Credit issued by the Bank pursuant to the Reimbursement Agreement, as the same may be amended or modified in accordance with its terms pursuant to the Indenture, naming the Trustee as beneficiary and delivered on the Closing Date; (b) in the event of delivery of an Alternate Letter of Credit, such Alternate Letter of Credit; or (c) in the event of delivery of an Alternate Credit Facility, such Alternate Credit Facility.

"Letter of Credit Account" means the account of that name established in the Revenue Fund pursuant to the Indenture.

"Letter of Credit Substitution Date" means the date an Alternate Letter of Credit is delivered to the Trustee pursuant to the Loan Agreement.

“*Liquidity Account*” means the account of that name established in the Purchase Fund pursuant to the Indenture.

“*Loan*” means the loan of the proceeds of the Bonds made by the Authority to the Corporation pursuant to the Loan Agreement.

“*Loan Default Event*” means any one or more of the events specified in the Loan Agreement.

“*Loan Repayments*” means the payments required to be made by the Corporation pursuant to the Loan Agreement.

“*Mandatory Purchase Date*” means the date established by the Trustee for the mandatory purchase of Bonds pursuant to the Indenture.

“*Mandatory Tender Date*” means the (a) Fixed Rate Date; and (b) any Letter of Credit Substitution Date, pursuant to which the Bonds are required to be tendered for purchase in accordance with the Indenture.

“*Moody’s*” means Moody’s Investors Service, Inc. a corporation organized and existing under the laws of the State of Delaware, its successors and their assigns, or, if such corporation shall be dissolved, liquidated or replaced by the Authority, following consultation with the Corporation, as the rating agency for the Bonds, or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated in writing by the Authority, following consultation with the Corporation, which is requested to provide a rating on the Bonds.

“*Net Proceeds*” means the proceeds from insurance or from actual or threatened condemnation or eminent domain action with respect to the Project, less any costs reasonably expended by the Corporation to receive such proceeds.

“*1999 Loan*” means the taxable loan from Meredith A. Jury to Stepping Stones Home, since assumed by the Corporation, currently outstanding in the principal amount of \$45,000, the proceeds of which were used to finance the acquisition of a residential treatment facility known as, Stepping Stones, located at 17727 East Cypress, Covina, California.

“*Non-Tendered Bonds*” has the meaning ascribed to such term in the Indenture.

“*Official Statement*” means the Official Statement with respect to the Bonds.

“*Opinion of Bond Counsel*” means a written opinion of Bond Counsel. If and to the extent required by the provisions of the Indenture, each Opinion of Bond Counsel shall include the statements provided for in the Indenture.

“*Organization Documents*” means, if any, the Corporation’s articles or certificate of incorporation and bylaws if the Corporation is a corporation, articles of organization and operating agreement if the Corporation is a limited liability company, partnership agreement if the Corporation is a partnership and trust agreement or declaration of trust if the Corporation is a trust, as such Organization Documents may be amended from time-to-time.

“*Outstanding*” means, when used as of any particular time with reference to Bonds, (subject to the provisions of the Indenture) all Bonds theretofore, or thereupon being, authenticated and delivered by the Bond Registrar under the Indenture except (a) Bonds theretofore cancelled by the Bond Registrar or surrendered to the Bond Registrar for cancellation; (b) Bonds with respect to which liability of the Authority shall have been discharged in accordance with the Indenture, including Bonds (or portions of Bonds) referred to in the Indenture; (c) Bonds for the transfer or exchange of or in lieu of or in substitution for which other Bonds shall have been authenticated and

delivered by the Bond Registrar pursuant to the Indenture; and (d) Bonds which have been deemed purchased pursuant to the Indenture, and for which replacement Bonds have been issued and authenticated.

“*Owner*” or “*Registered Owner*” means, whenever used in the Indenture with respect to a Bond, the Person in whose name such Bond is registered.

“*Paying Agent*” means the Trustee.

“*Permitted Encumbrances*” means:

(a) liens and security interests securing indebtedness owed by the Corporation to the Authority and/or the Bank;

(b) liens arising by reason of good faith deposits in connection with tenders, leases of real estate, bids or contracts (other than contracts for the payment of borrowed money);

(c) any lien arising by reason of deposits with, or the giving of any form of security to, any governmental agency or any body created or approved by law or governmental regulation for any purpose at any time as required by law or governmental regulation as a condition to the transaction of any business or the exercise of any privilege or license, or to enable the Corporation to maintain self-insurance or to participate in any funds established to cover any insurance risks or in connection with workers’ compensation, unemployment insurance, pensions or profit sharing plans or other social security plans or programs, or to share in the privileges or benefits required for corporations participating in such arrangements;

(d) liens arising by reason of good faith deposits made by or to the Corporation in the ordinary course of business (for other than borrowed money), deposits by the Corporation to secure public or statutory obligations or deposits to secure, or in lieu of, surety, stay or appeal bonds, and deposits as security for the payment of taxes or assessments or other similar charges;

(e) attachment or judgment liens not constituting a default under the Indenture, or any attachment or judgment lien against the Corporation so long as such judgment is being contested in good faith and execution thereon is stayed;

(f) rights reserved to or vested in any municipality or public authority by the terms of any right, power, franchise, grant, license, permit or provision of law affecting the Facilities, to: (1) terminate such right, power, franchise, grant, license, or permit, provided, that the exercise of such right would not materially impair the use of such Facilities in the ordinary course by the Corporation or materially and adversely affect the value thereof, or (2) purchase, condemn appropriate or recapture, or designate a purchaser of, the Facilities or any portion thereof;

(g) liens for taxes, assessments, or similar charges either not yet due or being contested in good faith;

(h) liens of materialmen, mechanics, warehousemen, or carriers, or other like liens arising in the ordinary course of business and securing obligations which are not yet delinquent; or which are being contested in good faith for a period no longer than the ninety (90) days after the due date of such lien;

(i) easements, rights-of-way, servitudes, restrictions, deed restrictions, oil, gas, or other mineral reservations and other minor defects, encumbrances, and irregularities in the title to the Facilities which do not materially impair the use of such Facilities in the ordinary course by the Corporation or materially and adversely affect the value thereof;

(j) rights reserved to or vested in any municipality or public authority to control or regulate the Facilities or to use such Facilities in any manner, which rights do not materially impair the use of such Facilities or materially and adversely affect the value thereof, to the extent that it affects title to the Facilities;

(k) liens on property received by the Corporation through gifts, grants or bequests, such liens being due to restrictions on such gifts, grants or bequests or the income thereon, so long as the fair market value of any such property is greater than the amount of the indebtedness secured by the lien on such property; and

(l) liens securing indebtedness to the extent permitted under the Reimbursement Agreement.

“*Permitted Investments*” means cash, Treasury Funds, Government Obligations and Investment Securities.

“*Person*” means an individual, corporation, firm, association, partnership, trust, or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

“*Principal Account*” means the account of that name in the Revenue Fund established pursuant to the Indenture.

“*Principal Office*” means, with respect to the Trustee, the Tender Agent, the Bond Registrar, the Paying Agent, the Bank, the Confirming Bank or the Remarketing Agent, the office at the address set forth in the Indenture, or such other office which may be designated as such, from time-to-time, by the respective party in writing to the Authority, the Corporation, the Trustee, the Tender Agent, the Paying Agent, the Bond Registrar, the Remarketing Agent, the Bank and the Confirming Bank.

“*Project*” has the meaning ascribed thereto in the Indenture.

“*Project Fund*” means the fund by that name established pursuant to the Indenture.

“*Purchase Date*” means (a) the date specified in each notice given by a Registered Owner pursuant to the Indenture on which the Bonds being tendered by such Registered Owner shall be purchased by the Tender Agent, and (b) the Mandatory Tender Date.

“*Purchase Fund*” means the fund of that name established pursuant to the Indenture.

“*Record Date*” means, prior to the Fixed Rate Date, the Business Day preceding each Interest Payment Date, and after the Fixed Rate Date, the fifteenth day of the calendar month preceding each Interest Payment Date, whether or not such day is a Business Day.

“*Redemption Account*” means the account of that name established in the Revenue Fund pursuant to the Indenture.

“*Reimbursement Agreement*” means the Reimbursement Agreement, dated as of April 1, 2014, between the Corporation and the Bank, as from time-to-time amended or supplemented, or any other similar agreement entered into by the Corporation and the Bank in connection with the issuance of any Alternate Letter of Credit or Alternate Credit Facility.

“*Related Party*” means any general partner, member, affiliate or guarantor of the Corporation and any lessee of the Project.

“*Release*” means any release, spill, emission, leaking, pumping, pouring, injection, escaping, deposit, disposal, discharge, dispersal, leaching, or migration into the indoor or outdoor environment (including, without limitation, the abandonment or disposal of any barrels, containers or other closed receptacles containing any Hazardous Materials), or into or out of the Facilities, including the movement of any Hazardous Material through the air, soil, surface water, groundwater or property.

“*Remarketing Account*” means the account of that name established in the Purchase Fund pursuant to the Indenture.

“*Remarketing Agent*” means the remarketing agent or agents appointed in accordance with the Indenture. The Remarketing Agent shall initially be Gates Capital Corporation, or any entity which is the surviving, resulting or transferee entity in any acquisition, merger or consolidation.

“*Remarketing Agreement*” means the Remarketing Agreement, dated as of April 1, 2014, between the Corporation and the Remarketing Agent, as such agreement may from time-to-time be amended and supplemented, to remarket the Bonds delivered or deemed to be delivered for purchase by the Registered Owners thereof, and any other similar agreement entered into with any successor Remarketing Agent. No such amendment or supplement or similar agreement shall alter the rights or obligations of the Registered Owners of Bonds to deliver their Bonds for purchase as provided in the Indenture.

“*Revenue Fund*” means the fund of that name established pursuant to the Indenture.

“*Revenues*” means all amounts received by the Authority or the Trustee for the account of the Authority pursuant or with respect to the Agreement, the Letter of Credit or the Confirming Letter of Credit, including, without limiting the generality of the foregoing, Loan Repayments (including both timely and delinquent payments, and any late charges, paid from whatever source), prepayments, insurance proceeds, condemnation proceeds, and all interest, profits or other income derived from the investment of amounts in any fund or account established pursuant to the Indenture, but not including any Additional Payments.

“*S&P*” means Standard & Poor’s, a division of The McGraw-Hill Companies, Inc., a corporation organized and existing under the laws of the State of New York, its successors and their assigns, or, if such corporation shall be dissolved, liquidated or replaced by the Authority, following consultation with the Corporation, as the rating agency for the Bonds, or shall no longer perform the functions of a securities rating agency, any other nationally recognized securities rating agency designated in writing by the Authority, following consultation with the Corporation, which is requested to provide a rating on the Bonds.

“*Securities Depositories*” means The Depository Trust Company, 50th Floor, 55 Water Street, New York, New York 10041-0099, Facsimile: (212) 855-7232; or, in accordance with then current guidelines of the Securities and Exchange Commission, to such other addresses and/or such other securities depositories, or no such depositories, as the Authority or the Securities and Exchange Commission may designate in a certificate of the Authority delivered to the Trustee.

“*Special Record Date*” means the date established by the Trustee pursuant to the Indenture as a record date for the payment of defaulted interest on the Bonds.

“*State*” means the State of California.

“*Supplemental Indenture*” means any indenture hereafter duly authorized and entered into between the Authority and the Trustee, supplementing, modifying or amending the Indenture; but only if and to the extent that such Supplemental Indenture is specifically authorized by the Indenture.

“*Tender Agent*” means the Trustee.

“*Treasury Funds*” means (a) any investment portfolio consisting of direct obligations of the United States Treasury Department and repurchase agreements in respect of those obligations, including any such money market mutual fund investment portfolio maintained by the Trustee, including, without limitation, any mutual fund for which the Trustee or an affiliate of the Trustee serves as investment manager, administrator, shareholder servicing agent, and/or custodian or subcustodian, notwithstanding that (i) the Trustee or an affiliate of the Trustee receives fees from such funds for services rendered, (ii) the Trustee charges and collects fees for services rendered pursuant

to the Indenture, which fees are separate from the fees received from such funds, and (iii) services performed for such funds and pursuant to the Indenture may at times duplicate those provided to such funds by the Trustee or its affiliates, demand deposits, including interest bearing money market accounts, time deposits, trust funds, trust accounts, overnight bank deposits, interest-bearing deposits, certificates of deposit, including those placed by a third party pursuant to an agreement between the Trustee and the Corporation, and bankers' acceptances of depository institutions, including the Trustee and any of its affiliates, or the Bank; (b) any investment or security permitted pursuant to Section 53601 of the California Government Code, including any investment or security portfolio consisting of any one or more of such investments or securities; and (c) any other investment or security permitted by law and approved by the Bank.

“*Trustee*” means U.S. Bank National Association, a national banking association organized and existing under and by virtue of the laws of the United States of America, or its successor as Trustee under the Indenture as provided in the Indenture.

“*2001 Bonds*” means the portion of the outstanding California Health Facilities Financing Authority Insured Health Facility Revenue Bonds (Prototypes/Social Model), 2001 Series A, issued for the benefit of the Corporation, currently outstanding in the principal amount of \$1,245,000, the proceeds of which were used to finance the acquisition and renovation of a leased facility, known as River Community, located at 23701 East Fork Road in the Angeles National Forest, approximately 15 miles north of the City of Azusa, California.

“*2001 Escrow Agreement*” means the Escrow Deposit and Trust Agreement, Agreement, dated April 2, 2014, by and between the Corporation and the Escrow Bank, relating to the defeasance of the 2001 Bonds.

“*2004 Note*” means the California Statewide Communities Development Authority 501(c)(3) Land, Building and Equipment Program Note (Mid Valley Recovery Services, Inc. Project), Series 2004-1, issued for the benefit of Mid Valley Recovery Services, Inc., since assumed by the Corporation, currently outstanding in the principal amount of \$815,000, the proceeds of which were used to finance the acquisition of three residential treatment facilities now operated by the Corporation, known as, Omni Center, located at 3430 Cogswell Road, El Monte, California, Mariposa, located at 453 South Indiana Street, Los Angeles, California, and Sabina House, located at 3543 Sabina Street, Los Angeles, California.

“*2005 Bonds*” means the portion of the outstanding California Health Facilities Financing Authority Insured Refunding Revenue Bonds (Small Facilities Refinancing Program), 2005 Series A, issued for the benefit of the Corporation, the proceeds of which were used to refund the portion of the California Health Facilities Financing Authority Insured Health Facility Revenue Bonds (Small Facilities Pooled Loan Program), Series B (1994), issued for the benefit of the Corporation, currently outstanding in the principal amount of \$590,000, the proceeds of which were used to finance and refinance the acquisition, construction, installation, and/or equipping of projects at the health care facilities, known as Touchstones, located at 525 North Parker Street, Orange, California.

“*2005 Escrow Agreement*” means the Escrow Deposit and Trust Agreement, Agreement, dated April 2, 2014, by and between the Corporation and the Escrow Bank, relating to the defeasance of the 2005 Bonds.

“*2014 Project*” means (a) the acquisition of an 86 bed, two story treatment facility, known as Bimini Recovery House, located at 155 Bimini Place Los Angeles, California, (b) the acquisition, construction and equipping of various improvements to the following residential treatment facilities: (i) River Community, 23701 East Fork Road in the Angeles National Forest, approximately 15 miles north of the City of Azusa, California, (ii) Touchstones, 525 North Parker Street, Orange, California, (iii) Omni Center, 3430 Cogswell Road, El Monte, California, (iv) Mariposa, 453 South Indiana Street, Los Angeles, California, (v) Sabina House, 3543 Sabina Street, Los Angeles, California, and (vi) Stepping Stones, 17727 East Cypress, Covina, California, (c) finance the acquisition of a 135 bed, alcohol and drug treatment facility, known as Rena B, located at 4445 Burns Avenue, Los Angeles, California, and (d) finance the acquisition of a 100 bed, alcohol treatment facility, known as Royal Palms, located at 360 South Westlake Avenue, Los Angeles, California.

“*Weekly Interest Rate*” means the interest rate on the Bonds determined pursuant to the Indenture.

THE INDENTURE

The Indenture sets forth the terms of the Bonds, the nature and extent of the security, various rights of the Bondholders, rights, duties and immunities of the Trustee and the rights and obligations of the Authority. *Although certain provisions of the Indenture are summarized below, this summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Indenture.*

Establishment of Funds and Accounts

The Indenture creates the Project Fund, the Revenue Fund (and the Interest Account, Principal Account, Confirming Letter of Credit Account, Letter of Credit Account, and Redemption Account established thereunder), the Purchase Fund (and the Liquidity Account and the Remarketing Account established thereunder), the Costs of Issuance Fund and the Rebate Fund; all of which are to be held by the Trustee.

Costs of Issuance Fund

The costs associated with the issuance of the Bonds will be paid from moneys within the Costs of Issuance Fund. The moneys in the Costs of Issuance Fund shall be used and withdrawn by the Trustee to pay the Costs of Issuance upon receipt by the Trustee of a Requisition of the Corporation stating the Person to whom payment is to be made, the amount to be paid, the purpose for which the obligation was incurred and that such payment is a proper charge against said fund. On the date three months after the Closing Date, or upon the earlier Request of the Corporation, amounts, if any, remaining in the Costs of Issuance Fund shall be transferred to the Project Fund and the Costs of Issuance Fund shall be closed.

Project Fund

The moneys in the Project Fund shall be used and withdrawn by the Trustee, as directed by Requisitions of the Corporation, to pay the costs of the 2014 Project. upon receipt by the Trustee of a Requisition of the Corporation stating the Person to whom payment is to be made, the amount to be paid, the purpose for which the obligation was incurred and that such payment is a proper charge against said fund.

When the 2014 Project shall have been completed, any remaining balance in the Project Fund, less the amount of any such retention, to the Revenue Fund and the Project Fund shall be closed.

Pledge and Assignment

Subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture, all of the Revenues and any other amounts (including proceeds of the sale of Bonds) held in any fund or account established pursuant to the Indenture are pledged by the Authority to secure the payment of the principal and purchase price of and interest on the Bonds in accordance with their terms and the provisions of the Indenture and (so long as the Bank has not dishonored any properly presented and conforming draw under the Letter of Credit) thereafter, on a basis subordinate thereto, for the benefit of the Registered Owners of the Bonds, to secure the Corporation’s obligations to the Bank under the Reimbursement Agreement. Said pledge shall constitute a lien on and security interest in such assets and shall attach, be perfected and be valid and binding from and after delivery by the Trustee of the Bonds, without any physical delivery thereof or further act.

The Authority transfers in trust, and assigns to the Trustee, for the benefit of the Registered Owners of the Bonds and the Bank to the extent of their respective interests therein, all of the Revenues and other assets pledged in

the Indenture and all of the right, title and interest of the Authority in the Agreement (except for (i) the right to receive any administrative fees and expenses to the extent payable to the Authority, (ii) any rights of the Authority to be indemnified, held harmless and defended and rights to inspection and to receive notices, certificates and opinions, and (iii) express rights to give approvals, consents or waivers). The Trustee shall be entitled to and shall collect and receive all of the Revenues, and any Revenues collected or received by the Authority shall be deemed to be held, and to have been collected or received, by the Authority as the agent of the Trustee and shall forthwith be paid by the Authority to the Trustee. The Trustee also shall be entitled to and shall take all steps, actions and proceedings reasonably necessary in its judgment to enforce, either jointly with the Authority or separately, all of the rights of the Authority and all of the obligations of the Corporation under the Agreement other than those rights specifically retained by the Authority.

The Trustee agrees that, so long as the Trustee holds any Revenues or any other amounts (including proceeds of the sale of the Bonds) in any fund or account established pursuant to the Indenture which are pledged by the Authority or the Corporation to secure the payment of the principal and purchase price of and interest on the Bonds and the Corporation's reimbursement obligations under the Reimbursement Agreement as provided in the Indenture, the Trustee shall hold the same as the collateral agent and bailee of the Bank but only to the extent of amounts paid by the Bank under the Letter of Credit for which the Bank has not received reimbursement from the Corporation for purposes of perfecting the lien and security interest of the Bank therein. Upon receipt of written notice from the Bank that the Corporation has failed to reimburse the Bank for a draw under the Letter of Credit as required by the Reimbursement Agreement, the Trustee shall either cause all accounts and investments which are the subject of the preceding sentence to be titled in such a manner to reflect that the Bank has an interest therein as described in the preceding sentence or ensure that each Person with whom the Trustee places or through whom the Trustee invests any moneys which are the subject of the preceding sentence is advised of the Bank's interest therein as described in the preceding sentence and instructed to mark its records to reflect such interest. The Trustee shall not pledge, hypothecate, transfer or release all or any portion of the Revenues to any Persons (including, without limitation, the Corporation) other than Registered Owners of the Bonds in payment thereof or in any manner not in accordance with the Indenture and the Reimbursement Agreement except as otherwise required by a court of law.

All Revenues shall be promptly deposited by the Trustee upon receipt thereof in a special fund designated as the Revenue Fund which the Trustee shall establish, maintain and hold in trust; except as otherwise provided in the Indenture and all moneys received by the Trustee and required to be deposited in the Redemption Account shall be promptly deposited in the Redemption Account, which the Trustee shall establish, maintain and hold in trust. All Revenues deposited with the Trustee shall be held, disbursed, allocated and applied by the Trustee only as provided in the Indenture. All moneys held by the Tender Agent for the payment of the principal or purchase price of, premium, if any, and interest on the Bonds, shall be held by the Tender Agent in trust for the payment of such Bonds.

Allocation of Revenues

Loan Repayments received by the Trustee from the Corporation pursuant to the Loan Agreement shall be deposited by the Trustee into the following respective accounts (each of which the Trustee shall establish and maintain within the Revenue Fund), in the following amounts, in the following order of priority, and the requirements of each such account (including the making up of any deficiencies in any such account resulting from lack of Revenues sufficient to make any earlier required deposit) at the time of deposit shall be satisfied before any transfer is made to any account subsequent in priority; and provided, that no moneys representing drawings under the Letter of Credit shall be transferred into the Interest Account, the Principal Account or the Redemption Account of the Revenue Fund:

FIRST, to the Interest Account, the amount paid by the Corporation and designated as or attributable to interest on the Bonds in the most recent Loan Repayment, so that the aggregate of such amounts will, on the next Interest Payment Date, equal the amount of interest due on the Bonds on such Interest Payment Date;

SECOND, to the Principal Account, the amount paid by the Corporation and designated as or attributable to principal of the Bonds in the most recent Loan Repayment, so that the aggregate of such amounts will, on the next succeeding principal payment date, equal the amount of principal due (whether at maturity or by acceleration) on such principal payment date; and

THIRD, to the Redemption Account, the aggregate amount of principal and premium, if any, next coming due by redemption permitted (as directed in writing by the Corporation) or required under the Indenture, or any portion thereof paid by the Corporation.

Funds for the payment of the principal or redemption price of and interest on the Bonds shall be derived from the following sources in the order of priority indicated in each of the accounts in the Revenue Fund; provided however, that amounts in the respective accounts within the Revenue Fund shall be used to pay the principal or redemption price of and interest on the Bonds (held by Registered Owners other than the Bank, the Confirming Bank or the Corporation) prior to the payment of the principal and interest on the Bonds held by the Bank, the Confirming Bank or the Corporation, and provided further, that if principal or redemption price (or any portion thereof) of and interest on the Bonds is paid with moneys described in the Indenture, any other moneys on deposit in the respective accounts in the Revenue Fund shall be applied to immediately reimburse the Bank or the Confirming Bank, as applicable, by wire transfer in the amount of any such drawings:

(i) moneys paid into the Letter of Credit Account of the Revenue Fund representing the proceeds of drawings by the Trustee under the Letter of Credit;

(ii) moneys paid into the Confirming Letter of Credit Account of the Revenue Fund representing the proceeds of drawings by the Trustee under the Confirming Letter of Credit;

(iii) moneys paid into the Interest Account, if any, representing accrued interest received at the initial sale of the Bonds and proceeds from the investment thereof which shall be applied to the payment of interest on the Bonds;

(iv) moneys paid into the Revenue Fund pursuant to the Indenture and proceeds from the investment thereof, which constitute Available Moneys;

(v) moneys deposited into the Redemption Account pursuant to the Indenture and proceeds from the investment thereof;

(vi) any other moneys (not derived from drawings under the Letter of Credit or the Confirming Letter of Credit) paid into the Revenue Fund and proceeds from the investment thereof, which constitute Available Moneys; and

(vii) any other moneys paid into the Revenue Fund and proceeds from the investment thereof, which are not Available Moneys.

Letter of Credit

Subject to the provisions of the Indenture, the Trustee shall hold and maintain the Letter of Credit for the benefit of the Registered Owners until the Letter of Credit expires or terminates in accordance with its terms. The Trustee shall observe all terms, covenants and conditions of the Letter of Credit, including payment when due of any draws on the Letter of Credit, and the provisions relating to the payment of draws on, and reinstatement of amounts that may be drawn under, the Letter of Credit, and will not consent to, agree to or permit any amendment or modification of the Letter of Credit which would adversely affect the rights or security of the Registered Owners of the Bonds. If at any time during the term of the Letter of Credit, any successor Trustee shall be appointed and qualified under the Indenture, the resigning or removed Trustee shall request that the Bank transfer the Letter of Credit to the successor Trustee in accordance with the procedures for transfer specified in the Letter of Credit. If the

resigning or removed Trustee fails to make this request, the successor Trustee shall do so before accepting appointment. The Trustee shall send notice to the Authority, the Bank, the Confirming Bank and the Corporation of the expiration of the Letter of Credit or the Confirming Letter of Credit at least sixty days prior to the date of such expiration.

Investment

Subject to the following sentence, all moneys in any of the funds or accounts established pursuant to the Indenture shall be invested by the Trustee as directed in writing by an Authorized Representative of the Corporation, in Permitted Investments maturing not later than the date on which it is estimated that such moneys will be required for the purposes specified in the Indenture; provided, however, that: (a) moneys on deposit in the Letter of Credit Account, the Confirming Letter of Credit Account and the Purchase Fund and any moneys held pursuant to the Indenture shall be held uninvested and without liability for interest; (b) any moneys held in trust for the payment or redemption of Bonds pursuant to the Indenture shall be invested as provided in the Indenture; and moneys in the Letter of Credit Account shall be invested in Permitted Investments rated “A-1” or “Prime 1” or higher by S&P and Moody’s which mature not later than the date on which such moneys will be required to pay the Bonds or the interest thereon.

Permitted Investments may be purchased at such prices as the Trustee may be directed by the Corporation or its agent. All Permitted Investments shall be acquired as directed by the Corporation subject to the limitations set forth in the Indenture, and such additional limitations or requirements consistent with the foregoing as may be established by Request of the Corporation. Notwithstanding any other provision in the Indenture, in the absence of written investment instructions from the Corporation directing the Trustee by noon of the Business Day preceding the day when investments are to be made, the Trustee is directed to invest available funds not described in the Indenture in investments described in the definition of Treasury Funds in the Indenture. The Trustee shall not be liable for any consequences resulting from any investments made pursuant to the preceding sentence except for its own negligence or willful misconduct.

All interest, profits and other income received from the investment of moneys in any fund established pursuant to the Indenture shall be deposited in the Revenue Fund; except that any such interest, profits, and other income received from the investment of any moneys held in trust for the payment or redemption of Bonds pursuant to the Indenture shall be applied as provided in the Indenture. Notwithstanding anything to the contrary contained in this paragraph, an amount of interest received with respect to any Permitted Investment equal to the amount of accrued interest, if any, paid as part of the purchase price of such Permitted Investment shall be credited to the fund from which such accrued interest was paid.

Confirming Letter of Credit; Confirming Letter of Credit Account

The Trustee shall hold and maintain the Confirming Letter of Credit for the benefit of the Registered Owners until the Confirming Letter of Credit expires in accordance with its terms. The Trustee shall enforce all terms, covenants and conditions of the Confirming Letter of Credit, including drawing under the Confirming Letter of Credit to make full and timely payment of the principal of, and interest on, the Bonds when due as a result of the dishonor by the Bank of a properly presented and conforming draw on the Letter of Credit or the repudiation of the Letter of Credit by the Bank, and will not consent to, agree to or permit any amendment or modification of the Confirming Letter of Credit which would materially adversely affect the rights or security of the Registered Owners of the Bonds. The Trustee shall send written notice to the Confirming Bank immediately following each redemption pursuant to the Indenture indicating the principal amount of Bonds redeemed and the date of the redemption. If at any time during the term of the Confirming Letter of Credit any successor Trustee shall be appointed and qualified under the Indenture, the resigning or removed Trustee shall request that the Confirming Bank transfer the Confirming Letter of Credit to the successor Trustee. If the resigning or removed Trustee fails to make this request, the successor Trustee shall do so before accepting appointment. When the Confirming Letter of Credit expires in accordance with its terms, the Trustee shall immediately surrender the Confirming Letter of Credit to the Confirming Bank.

The Trustee shall create within the Revenue Fund a separate account called the “Confirming Letter of Credit Account,” which account shall be an Eligible Account, into which all moneys drawn under the Confirming Letter of Credit shall be deposited and disbursed. Neither the Corporation nor any Related Party shall have any rights to or interest in the Confirming Letter of Credit Account. The Authority shall have only that interest in the Confirming Letter of Credit Account necessary to perfect the pledge by the Authority and to complete the transfer to the Trustee in the Indenture, and the Authority shall have no further legal, equitable or beneficial right, title or interest to such account. The Trustee shall have the rights as Trustee pursuant to the Indenture with respect to the application of funds in the Confirming Letter of Credit Account for the benefit of the Registered Owners of the Bonds, and shall have no further legal, equitable or beneficial right, title or interest to such accounts. The Confirming Letter of Credit Account shall be established and maintained by the Trustee and held in trust apart from all other moneys and securities held under the Indenture or otherwise, and over which the Trustee shall have the exclusive and sole right of withdrawal for the exclusive benefit of the Registered Owners of the Bonds with respect to which such drawing was made. Moneys on deposit in the Confirming Letter of Credit Account shall be held uninvested and without liability for interest.

If on the Fixed Rate Date there shall have been delivered to the Trustee an Alternate Credit Facility pursuant the Loan Agreement or if at any time there shall have been delivered to the Trustee an Alternate Letter of Credit pursuant the Loan Agreement, then the Trustee shall accept such Alternate Credit Facility or Alternate Letter of Credit and promptly surrender the Confirming Letter of Credit to the Confirming Bank, in accordance with the terms of such Confirming Letter of Credit, for cancellation. If at any time there shall cease to be any Bonds Outstanding under the Indenture, the Trustee shall promptly surrender the Confirming Letter of Credit to the Confirming Bank, in accordance with the terms of the Confirming Letter of Credit, for cancellation. The Trustee shall comply with the procedures set forth in the Confirming Letter of Credit relating to the termination thereof.

Particular Covenants

Punctual Payment. The Authority shall punctually pay or cause to be paid the principal, premium, if any, and interest to become due in respect of all the Bonds, in strict conformity with the terms of the Bonds and of the Indenture, according to the true intent and meaning thereof, but only out of Revenues and other assets pledged for such payment as provided in the Indenture.

Extension of Payment of Bonds. The Authority shall not directly or indirectly extend or assent to the extension of the maturity of any of the Bonds or the time of payment of any claims for interest by the purchase or funding of such Bonds or claims for interest or by any other arrangement and in case the maturity of any of the Bonds or the time of payment of any such claims for interest shall be extended, such Bonds or claims for interest shall not be entitled, in case of any default under the Indenture, to the benefits of the Indenture, except subject to the prior payment in full of the principal of all of the Bonds then Outstanding and of all claims for interest thereon which shall not have been so extended. Nothing in the Indenture shall be deemed to limit the right of the Authority to amend the Indenture in a manner consistent with the Indenture to extend the maturity of any Bond or to issue bonds for the purpose of refunding any Outstanding Bonds, which issuance shall not be deemed to constitute an extension of maturity of Bonds.

Against Encumbrances. The Authority shall not create, or permit the creation of, any pledge, lien, charge, or other encumbrance upon the Revenues and other assets pledged or assigned under the Indenture while any of the Bonds are Outstanding, except the pledge and assignment created by the Indenture. Subject to this limitation, the Authority expressly reserves the right to enter into one or more other indentures for any of its public purposes, including other programs under the Act, and reserves the right to issue other obligations for such purposes.

Power To Issue Bonds and Make Pledge and Assignment. The Authority is duly authorized pursuant to law to issue the Bonds and to enter into the Indenture and to pledge and assign the Revenues and other assets purported to be pledged and assigned, respectively, under the Indenture in the manner and to the extent provided in the Indenture. The Bonds and the provisions of the Indenture are and will be the legal, valid and binding limited

obligations of the Authority enforceable in accordance with their terms, and the Authority shall at all times but solely from Additional Payments, and to the extent permitted by law, defend, preserve and protect said pledge and assignment of Revenues and other assets and all the rights of the Registered Owners under the Indenture against all claims and demands of all Persons whomsoever.

Accounting Records and Reports. The Trustee shall keep or cause to be kept proper books of record and account in which accurate entries shall be made of all transactions of the Trustee relating to the receipt, investment, disbursement, allocation and application of the Revenues and the proceeds of the Bonds received by the Trustee with respect to all funds and accounts held under the Indenture. Such records shall specify the account or fund to which each investment (or portion thereof) held by the Trustee is to be allocated and shall set forth, in the case of each Investment Security, (a) its purchase price; (b) identifying information, including par amount, coupon rate, and payment dates; (c) the amount received at maturity or its sale price, as the case may be; (d) the amounts and dates of any payments made with respect thereto; and (e) the dates of acquisition and disposition or maturity.

Such records shall be open to inspection by any Registered Owner, the Corporation, the Authority, the Bank, and at the request of the Authority any agent of the Internal Revenue Service performing an audit or investigation of the Bonds, at any reasonable time during regular business hours on reasonable notice. The Trustee shall maintain such records after all Outstanding Bonds are discharged for such period as required by its internal policies or procedures.

Events of Default; Remedies on Default

Each of the following events shall constitute an “Event of Default” under the Indenture:

(a) default in the due and punctual payment of the principal of, or premium, if any, on, any Bond when and as the same shall become due and payable, whether at maturity as therein expressed, by proceedings for redemption, by declaration or otherwise;

(b) default in the due and punctual payment of any installment of interest on any Bond, when and as such interest installment shall become due and payable;

(c) failure to pay the purchase price of any Bond tendered in accordance with the provisions of the Indenture;

(d) failure by the Authority to perform or observe any of the other covenants, agreements or conditions on its part in the Indenture or in the Bonds contained, and the continuation of such failure for a period of 60 days after written notice thereof, specifying such default and requiring the same to be remedied, shall have been given to the Authority, the Bank and the Corporation by the Trustee, or to the Authority, the Bank, the Corporation and the Trustee by the Registered Owners of not less than 25% in aggregate principal amount of the Bonds at the time Outstanding;

(e) the occurrence and continuance of a Loan Default Event described in the Loan Agreement; or

(f) the dishonor by the Bank of a properly presented and conforming draw on the Letter of Credit or the repudiation of the Letter of Credit by the Bank.

No default specified in the Indenture shall constitute an Event of Default unless the Authority or the Corporation shall have failed to correct such default within the applicable period; provided, however, that if the default shall be such that it cannot be corrected within such period, it shall not constitute an Event of Default if corrective action is instituted by the Authority or the Corporation within the applicable period and diligently pursued. With regard to any alleged default concerning which notice is given to the Corporation under the provisions of the Indenture. The Corporation may perform any covenant or obligation the nonperformance of which is alleged

in said notice to constitute a default with full power to do any and all things and actions to the same extent that the Authority could do and perform any such things and actions.

During the continuance of an Event of Default, unless the principal of all the Bonds shall have already become due and payable, the Trustee may, and upon the written request of the Registered Owners of not less than 25% in aggregate principal amount of the Bonds at the time Outstanding, or upon the occurrence of an Event of Default described in the Indenture, the Trustee shall, by notice in writing to the Authority, the Tender Agent, the Remarketing Agent, the Corporation and the Bank declare the principal of all the Bonds then Outstanding, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable, anything in the Indenture or in the Bonds contained to the contrary notwithstanding. Upon any such declaration the Trustee shall immediately draw upon any then existing Letter of Credit and Confirming Letter of Credit in accordance with the terms thereof and apply the amount so drawn to pay the principal of and interest on the Bonds (other than Bank Bonds) so declared to be due and payable. Interest on the Bonds shall cease to accrue upon the declaration of acceleration. The Trustee shall notify the Registered Owners of the date of acceleration and the cessation of accrual of interest on the Bonds in the same manner as for a notice of redemption.

The preceding paragraph, however, is subject to the condition that if, at any time after the principal of the Bonds shall have been so declared due and payable, and before any judgment or decree for the payment of the moneys due shall have been obtained or entered as provided in the Indenture, and before the Letter of Credit or the Confirming Letter of Credit has been drawn upon in accordance with its terms and honored, there shall have been deposited with the Trustee a sum sufficient to pay all the principal of the Bonds matured prior to such declaration and all matured installments of interest (if any) upon all the Bonds, with interest on such overdue installments of principal as provided in the Agreement, and the outstanding fees and the reasonable expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the payment of principal of and interest on the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall have been made therefor, then, and in every such case, the Registered Owners of at least a majority in aggregate principal amount of the Bonds then Outstanding, by written notice to the Authority and to the Trustee, may, on behalf of the Registered Owners of all the Bonds, rescind and annul such declaration and its consequences and waive such default; but no such rescission and annulment shall extend to or shall affect any subsequent default, or shall impair or exhaust any right or power as a consequence thereof.

Notwithstanding anything to the contrary in the Indenture, the Authority shall have no obligation to and instead the Trustee may, without further direction from the Authority, take any and all steps, actions and proceedings, to enforce any or all rights of the Authority (other than those specifically retained by the Authority pursuant to the Indenture) under the Indenture and the Agreement, including, without limitation, the rights to enforce the remedies upon the occurrence and continuation of an Event of Default and the obligations of the Corporation under the Agreement.

Application of Revenues and Other Funds After Default. If an Event of Default shall occur and be continuing, all Revenues and any other funds then held or thereafter received by the Trustee under any of the provisions of the Indenture (other than Additional Payments due to the Authority, and subject to the Indenture) shall be applied by the Trustee as follows and in the following order from the respective funds or accounts:

(a) to the payment of any reasonable expenses necessary in the opinion of the Trustee to protect the interests of the Registered Owners of the Bonds and payment of reasonable fees and expenses of the Trustee (including reasonable fees and disbursements of its counsel) incurred in and about the performance of its powers and duties under the Indenture; provided, however, that moneys in the Letter of Credit Account and the Confirming Letter of Credit Account of the Revenue Fund and moneys derived from drawings under the Letter of Credit or Confirming Letter of Credit in the Liquidity Account of the Purchase Fund, Available Moneys, moneys being aged to become Available Moneys and the proceeds from remarketing of the Bonds shall not be used for the payment of any such expenses;

(b) to the payment of the principal of and interest then due on the Bonds (upon presentation of the Bonds to be paid, and stamping thereon of the payment if only partially paid, or surrender thereof if fully paid) subject to the provisions of the Indenture, as follows:

(i) unless the principal of all of the Bonds shall have become or have been declared due and payable:

FIRST, to the payment to the Persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the Persons entitled thereto, without any discrimination or preference; and

SECOND, to the payment to the Persons entitled thereto of the unpaid principal of any Bonds which shall have become due, whether at maturity or by call for redemption, with interest on the overdue principal at the rate borne by the respective Bonds, and, if the amount available shall not be sufficient to pay in full all the Bonds, together with such interest, then to the payment thereof ratably, according to the amounts of principal due on such date to the Persons entitled thereto, without any discrimination or preference; and

(ii) If the principal of all of the Bonds shall have become or have been declared due and payable, to the payment of the principal and interest then due and unpaid upon the Bonds, with interest on the overdue principal at the rate borne by the Bonds, and, if the amount available shall not be sufficient to pay in full the whole amount so due and unpaid, then to the payment thereof ratably, without preference or priority of principal over interest, or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bond over any other Bond, according to the amounts due respectively for principal and interest, to the Persons entitled thereto without any discrimination or preference; provided, however, that moneys held in the Purchase Fund shall only be used to pay the purchase price of the Bonds; and

(c) To the payment of the Bank and the Confirming Bank of any amounts due and owing under the Reimbursement Agreement, to the Authority of any Additional Payments due and owing and the payment of the remainder, if any, to the Corporation.

Amendment of Indenture

The Indenture and the rights and obligations of the Authority and of the Registered Owners of the Bonds and of the Trustee may be modified or amended from time-to-time and at any time by an indenture or indentures supplemental thereto, which the Authority and the Trustee may enter into when the written consent of the Registered Owners of a majority in aggregate principal amount of all Bonds then Outstanding, the Corporation and the Bank shall have been filed with the Trustee. No such modification or amendment shall (i) extend the fixed maturity of any Bond, or reduce the amount of principal thereof, or extend the time of payment, or change the method of computing the rate of interest thereon, or extend the time of payment of interest thereon, without the consent of the Registered Owner of each Bond so affected; (ii) reduce the aforesaid percentage of Bonds the consent of the Registered Owners of which is required to effect any such modification or amendment, or permit the creation of any lien on the Revenues and other assets pledged under the Indenture prior to or on a parity with the lien created by the Indenture, or deprive the Registered Owners of the Bonds of the lien created by the Indenture on such Revenues and other assets (except as expressly provided in the Indenture), without the consent of the Registered Owners of all of the Bonds then Outstanding; or (iii) adversely affect the interests of the Trustee and the Tender Agent without their prior written consent. It shall not be necessary for the consent of the Registered Owners to approve the particular form of any Supplemental Indenture, but it shall be sufficient if such consent shall approve the substance thereof. Promptly after the execution by the Authority and the Trustee of any Supplemental Indenture

pursuant to the Indenture, the Trustee shall mail a copy of the Supplemental Indenture to the Tender Agent and the Bank and mail a notice, setting forth in general terms the substance of such Supplemental Indenture, to each rating agency then rating the Bonds and the Registered Owners of the Bonds at the address shown on the registration books of the Trustee with a copy to the Bank. Any failure to give such notice, or any defect therein, shall not, however, in any way impair or affect the validity of any such Supplemental Indenture.

The Indenture and the rights and obligations of the Authority, of the Trustee and of the Registered Owners of the Bonds may also be modified or amended from time-to-time and at any time by an indenture or indentures supplemental hereto, which the Authority and the Trustee may enter into without the consent of any Registered Owners but with the written consent of the Corporation and the Bank, but only to the extent permitted by law, including, without limitation, for any one or more of the following purposes:

(i) to add to the covenants and agreements of the Authority contained in the Indenture other covenants and agreements thereafter to be observed, to pledge or assign additional security for the Bonds, or to surrender any right or power reserved to or conferred upon the Authority in the Indenture;

(ii) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing or correcting any defective provision, contained in the Indenture, or in regard to matters or questions arising under the Indenture, upon receipt by the Trustee and the Authority of an Opinion of Bond Counsel that the provisions do not adversely affect the rights of the Registered Owners under the Indenture;

(iii) to modify, amend or supplement the Indenture in such manner as to permit the qualification of the Indenture under the Trust Indenture Act of 1939, as amended, or any similar federal statute hereafter in effect, and to add such other terms, conditions and provisions as may be permitted by said act or similar federal statute;

(iv) to make such provisions for the purpose of conforming to the terms and provisions of any Alternate Letter of Credit or Alternate Credit Facility or to obtain a rating on the Bonds upon receipt by the Trustee and the Authority of an Opinion of Bond Counsel that the provisions do not adversely affect the rights of the Registered Owners under the Indenture; and

(v) to modify, amend or supplement the Indenture in any other respect upon receipt by the Trustee and the Authority of an Opinion of Bond Counsel that the modification, amendment or supplement does not adversely affect the rights of the Registered Owners under the Indenture.

Defeasance

The Bonds may be paid by the Authority in any of the following ways; provided that the Authority also pays or causes to be paid any other sums payable under the Indenture by the Authority or the Corporation:

(a) by paying or causing to be paid with Available Moneys the principal of, interest and premium, if any, on the Bonds, as and when the same become due and payable;

(b) by depositing with the Trustee, in trust, at or before maturity, money or securities in the necessary amount (as provided in the Indenture) to pay or redeem with Available Moneys all Bonds then Outstanding; or

(c) by delivering to the Trustee, for cancellation by it, the Bonds then Outstanding.

If the Bonds are paid by the Authority pursuant to the Indenture prior to the Fixed Rate Date, the Authority and the Corporation shall provide to the Trustee written evidence from each rating agency then rating the Bonds to the effect that such payment will not result in a withdrawal of its rating on the Bonds or a reduction from the rating which then exists as to the Bonds. If the Authority shall also pay or cause to be paid all other sums payable under the

Indenture by the Authority and the Corporation shall have paid all Additional Payments, then and in that case, at the election of the Authority (evidenced by a Certificate of the Authority, filed with the Trustee, signifying the intention of the Authority to discharge all such indebtedness and the Indenture), and notwithstanding that any Bonds shall not have been surrendered for payment, the Indenture and the pledge of Revenues and other assets made under the Indenture and all covenants, agreements and other obligations of the Authority under the Indenture shall cease, terminate, become void and be completely discharged and satisfied except only as provided in the Indenture. In such event, upon Request of the Authority, the Trustee shall cause an accounting for such period or periods as may be requested by the Authority to be prepared and filed with the Authority and shall execute and deliver to the Authority all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee shall pay over, transfer, assign or deliver all moneys or securities or other property held by it pursuant to the Indenture which are not required for the payment of obligations to be paid from Additional Payments or for the payment or redemption of Bonds not theretofore surrendered for such payment or redemption in the following order (a) first, to the Bank to the extent of any amounts due to the Bank pursuant to the Reimbursement Agreement, as certified to the Trustee by the Bank; and (b) otherwise, to the Corporation, provided that moneys in the Letter of Credit Account, the Liquidity Account and the Remarketing Account shall be returned to the Bank and moneys in the Confirming Letter of Credit Account shall be returned to the Confirming Bank.

THE LOAN AGREEMENT

The Loan Agreement provides the terms of the loan of Bond proceeds to the Corporation and the repayment of and security for such loan provided by the Corporation. Certain of the provisions of the Loan Agreement are summarized below. *This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Loan Agreement.*

Loan Repayments and Other Amounts Payable

On or before each Bond Payment Date, until the principal of, premium, if any, and interest on the Bonds shall have been fully paid or provision for such payment shall have been made as provided in the Indenture, the Corporation covenants and agrees to pay to the Trustee as a Loan Repayment on the Loan made to the Corporation from Bond proceeds pursuant to the Loan Agreement, a sum equal to the amount payable on such Bond Payment Date as principal of, and premium, if any, and interest on the Bonds as provided in the Indenture.

The Loan Repayments made pursuant to the Loan Agreement shall at all times be sufficient to pay the total amount of interest and principal (whether at maturity or upon redemption or acceleration) and premium, if any, becoming due and payable on the Bonds on each Bond Payment Date; provided that any amount held by the Trustee in the Revenue Fund on the due date for a Loan Repayment pursuant to the immediately preceding paragraph shall be credited against the Loan Repayment due on such date to the extent available for such purpose under the terms of the Indenture; and provided further that, subject to the provisions of this paragraph, if at any time the amounts held by the Trustee in the Revenue Fund are sufficient to pay all of the principal of and interest and premium, if any, on the Bonds as such payments become due, the Corporation shall be relieved of any obligation to make any further Loan Repayments under the provisions of the Loan Agreement. Notwithstanding the foregoing, if on any date the amount held by the Trustee in the Revenue Fund is insufficient to make any required payments of principal of (whether at maturity or upon redemption or acceleration) and interest and premium, if any, on the Bonds as such payments become due, the Corporation, immediately upon receipt of notice of such deficiency from the Trustee, shall forthwith pay such deficiency as a Loan Repayment under the Loan Agreement.

The obligation of the Corporation to make any payment under the Loan Agreement shall be deemed to have been satisfied to the extent of any corresponding payment made by the Bank or the Confirming Bank to the Trustee as a result of a drawing under the Letter of Credit or the Confirming Letter of Credit, respectively. To the extent the Trustee receives a Loan Repayment from the Corporation pursuant to the Loan Agreement after any payment obligation under the Loan Agreement has been satisfied by a drawing under the Letter of Credit or the Confirming Letter of Credit, the Trustee shall promptly use such Loan Repayment to reimburse the Bank or the Confirming

Bank, as applicable, for such drawing or if the Bank or the Confirming Bank, as applicable, has been reimbursed directly by the Corporation such funds shall be returned to the Corporation.

In addition to Loan Repayments, the Corporation shall also pay to the Authority or the Trustee, the Remarketing Agent, the Bank and the Confirming Bank, as the case may be, "Additional Payments," as provided in the Loan Agreement. Such Additional Payments may be discharged in whole or in part by payment actually received from amounts in the Costs of Issuance Fund or may be billed to the Corporation by the Authority, the Trustee, the Remarketing Agent, the Bank or the Confirming Bank from time to time, together with a statement certifying the amount billed has been incurred or paid for one or more of the below items. After such a demand, amounts so billed shall be paid by the Corporation within thirty (30) days after receipt of the bill by the Corporation. The obligations of the Corporation under the Loan Agreement shall survive the resignation and removal of the Trustee, payment of the Bonds and discharge of the Indenture.

(i) The Additional Payments to the Authority include:

(A) All taxes and assessments of any type or character charged to the Authority affecting the amount available to the Authority from payments to be received under the Loan Agreement or in any way arising due to the transactions contemplated by the Loan Agreement (including taxes and assessments assessed or levied by any public agency or governmental authority of whatsoever character having power to levy taxes or assessments); provided, however, that the Corporation shall have the right to protest any such taxes or assessments and to require the Authority, at the Corporation's expense, to protest and contest any such taxes or assessments levied upon them and that the Corporation shall have the right to withhold payment of any such taxes or assessments pending disposition of any such protest or contest unless such withholding, protest or contest would adversely affect the rights or interests of the Authority and the Corporation has provided the Authority with security and indemnification reasonably deemed adequate by the Authority in respect of such affected rights or interests;

(B) All amounts payable to the Authority under the Loan Agreement;

(C) The reasonable fees and expenses of such accountants, consultants, attorneys and other experts as may be engaged by the Authority to prepare audits, financial statements, reports, opinions or provide such other services required under the Loan Agreement or the Indenture;

(D) The annual fee of the Authority, any and all fees and expenses incurred primarily in connection with the authorization, issuance, sale and delivery of any Bonds and the reasonable fees and expenses of the Authority or any agency of the State selected by the Authority to act on its behalf in connection with the Loan Agreement, the Bonds or the Indenture, including, without limitation, in connection with any litigation, investigation, inquiry or other proceeding which may at any time be instituted involving the Loan Agreement, the Bonds or the Indenture or any of the other documents contemplated thereby, or by the Attorney General of the State or such other counsel as the Authority may select in connection with the reasonable supervision or inspection of the Corporation, its properties, assets or operations or otherwise in connection with the administration (both before and after the execution of the Loan Agreement) of the Loan Agreement or the Indenture; and

(E) All other reasonable and necessary fees and expenses attributable to the Bonds, the Loan Agreement, or related documents.

(ii) The Additional Payments to the Trustee include:

(A) All taxes and assessments of any type or character charged to the Trustee affecting the amount available to the Trustee from payments to be received under the Loan Agreement or in

any way arising due to the transactions contemplated by the Loan Agreement (including taxes and assessments assessed or levied by any public agency or governmental authority of whatsoever character having power to levy taxes or assessments); provided, however, that the Corporation shall have the right to protest any such taxes or assessments and to require the Trustee, at the Corporation's expense, to protest and contest any such taxes or assessments levied upon them and that the Corporation shall have the right to withhold payment of any such taxes or assessments pending disposition of any such protest or contest unless such withholding, protest or contest would adversely affect the rights or interests of the Trustee and the Corporation has provided the Trustee with security and indemnification reasonably deemed adequate by the Trustee in respect of such affected rights or interests;

(B) All reasonable fees and expenses of such accountants, consultants, attorneys and other experts as may be engaged by the Trustee to prepare audits, financial statements, reports, opinions or provide such other services required under the Loan Agreement or the Indenture;

(C) All amounts payable to the Trustee under the Loan Agreement; and

(D) All other reasonable and necessary fees and expenses attributable to the Bonds, the Loan Agreement, or related documents.

(iii) The Additional Payments to the Remarketing Agent shall be those set forth in the Remarketing Agreement.

(iv) The Additional Payments to the Bank shall be those set forth in the Reimbursement Agreement.

(c) In the event the Corporation should fail to make any of the payments required by the Loan Agreement, such payments shall continue as obligations of the Corporation until such amounts shall have been fully paid. Except as provided in the next sentence, the Corporation agrees to pay such amounts, together with interest thereon, from the date such payments were due, until paid, to the extent permitted by law, at the rate of 10% per annum.

Unconditional Obligations

The obligations of the Corporation to make the payments required by the Loan Agreement and to provide or cause to be provided the Letter of Credit and the Confirming Letter of Credit pursuant to the Loan Agreement, and to perform and observe the other agreements on its part contained in the Loan Agreement, shall be absolute and unconditional, irrespective of any defense or any rights of set-off, recoupment or counterclaim it might otherwise have against the Authority. During the term of the Loan Agreement, the Corporation shall pay absolutely all payments to be made on account of the Loan made to the Corporation from Bond proceeds pursuant to the Loan Agreement, as prescribed in the Loan Agreement, the obligation to provide or cause to be provided the Letter of Credit and the Confirming Letter of Credit, or an Alternate Letter of Credit, pursuant to the Loan Agreement, and all other payments required under the Loan Agreement, free of any deductions and without abatement, diminution or set-off. Until such time as the principal of, premium, if any, and interest on the Bonds shall have been fully paid, or provision for the payment thereof shall have been made as required by the Indenture, the Corporation (i) will not suspend or discontinue any payments required to be made by the Corporation pursuant to the Loan Agreement, including, without limitation, the payments provided for in the Loan Agreement and the obligation to provide or cause to be provided the Letter of Credit and the Confirming Letter of Credit, or an Alternate Letter of Credit, pursuant to the Loan Agreement; (ii) will perform and observe all of its other covenants contained in the Loan Agreement; and (iii) except as provided in the Loan Agreement, will not terminate the Loan Agreement for any cause, including, without limitation, the occurrence of any act or circumstances that may constitute failure of consideration, destruction of or damage to the Facilities, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State, or any political subdivision of either of these, or any

failure of the Authority or the Trustee to perform and observe any covenant, whether express or implied, or any duty, liability or obligation arising out of or connected with the Loan Agreement or the Indenture.

Corporation's Maintenance of its Existence

The Corporation covenants and agrees that it will maintain its existence as a California nonprofit public benefit corporation and an organization described in Section 501(c)(3) of the Code and will not dissolve, sell or otherwise dispose of all or substantially all of its assets, including the Facilities nor consolidate with or merge into another Person or permit one or more other Persons to consolidate with or merge into it; provided, that the Corporation may, without violating the covenants contained in the Loan Agreement, consolidate with or merge into another Person, or permit one or more other Persons to consolidate with or merge into it, or sell or otherwise transfer to another Person such assets, including the Facilities, if:

(i) the surviving, resulting or transferee Person, as the case may be: (A) assumes in writing, all of the obligations of the Corporation under the Loan Agreement and the Remarketing Agreement; (B) is not, after such transaction, otherwise in default under any provisions of the Loan Agreement and the Remarketing Agreement; (C) is an organization described in Section 501(c)(3) of the Code or a political subdivision under the Code; (D) is qualified to transact and is engaged in business in the State; and (E) qualifies as a "participating health institution" under the Act;

(ii) the Trustee and the Authority shall have received an opinion of counsel acceptable to the Authority that such merger, consolidation, sale, or other transfer will result in the surviving, resulting or transferee Person being an organization described in § 501(c)(3) of the Code and a participating health institution under the Act;

(iii) the surviving, resulting or transferee Person, as the case may be, shall deliver to the Trustee and the Authority a Statement of an Authorized Representative to the effect that it will continue to operate the Facilities in a manner which will allow it to continue to meet all of the Corporation's obligations under the Loan Agreement; and

(iv) the written consent of the Bank has been received by the Trustee, together with an acknowledgment that the Letter of Credit and the Confirming Letter of Credit will remain in effect.

(b) If a merger, consolidation, sale, or other transfer is effected, as provided in the Loan Agreement, the provisions of the Loan Agreement shall continue in full force and effect and no further merger, consolidation, sale or transfer shall be effected except in accordance with the provisions of the Loan Agreement.

Insurance

The Corporation agrees to insure the Facilities or cause the Facilities to be insured during the term of the Loan Agreement for such amounts and for such occurrences as are customary for similar facilities within the State, or as may be required by the Bank, by means of policies issued by reputable insurance companies qualified to do business in the State. Upon the written request of the Trustee, the Corporation shall deliver to the Trustee, within 60 days of the receipt of such request, memorandum copies of the insurance policies or certificates of insurance which memorandum copies of insurance policies or certificates of insurance shall evidence that all insurance required to be in effect under the Loan Agreement is then currently in full force and effect. Neither the Trustee nor the Authority are responsible for the adequacy or sufficiency of the coverage evidenced by such policies or certificates.

Maintenance and Repair; Taxes; Utility and Other Charges

The Corporation agrees to maintain the Facilities, or cause the Facilities to be maintained, during the term of the Loan Agreement (a) in a safe condition; and (b) in good repair and in good operating condition, ordinary wear and tear excepted, making from time-to-time all necessary repairs thereto and renewals and replacements thereof.

The Corporation agrees to pay or cause to be paid during the term of the Loan Agreement all taxes, governmental charges of any kind lawfully assessed or levied upon the Facilities or any part thereof, including any taxes levied against the Facilities which, if not paid, will become a charge on the Facilities, all utility and other charges incurred in the operation, maintenance, use, occupancy and upkeep of the Facilities and all assessments and charges lawfully made by any governmental body for public improvements that may be secured by a lien on the Facilities; provided that with respect to special assessments or other governmental charges that may lawfully be paid in installments over a period of years, the Corporation shall be obligated to pay only such installments as are required to be paid during the term of the Loan Agreement. The Corporation may, at the Corporation's expense and in the Corporation's name, in good faith, contest any such taxes, assessments, and other charges and, in the event of any such contest, may permit the taxes, assessments, or other charges so contested to remain unpaid during that period of such contest and any appeal therefrom unless by such nonpayment the Facilities or any part thereof will be subject to loss or forfeiture.

Alternate Credit Facility

If the Corporation exercises its option to convert the interest rate borne by the Bonds from the Weekly Interest Rate to the Fixed Interest Rate pursuant to the terms and provisions of the Indenture, the Corporation may cause to be delivered to the Trustee an Alternate Credit Facility, effective as of the Fixed Rate Date, in lieu of keeping the Letter of Credit and the Confirming Letter of Credit in place as required by the Loan Agreement. At least 30 days prior to the Fixed Rate Date, the Corporation shall provide the Authority, the Trustee, the Bank, the Tender Agent and the Remarketing Agent with a written notice of its intention to provide an Alternate Credit Facility pursuant to the Loan Agreement. Such notice shall include the proposed Fixed Rate Date and identify the provider of the Alternate Credit Facility.

Such Alternate Credit Facility must meet the following conditions:

(a) the terms of the Alternate Credit Facility must provide an unconditional obligation of the Authority of the Alternate Credit Facility to pay all amounts with respect to the principal of, premium, if any, and interest on the Bonds when the same shall become due; and

(b) the term of the Alternate Credit Facility must extend to the final maturity of the Bonds.

On or prior to the date of the delivery of an Alternate Credit Facility to the Trustee, the Corporation shall cause to be furnished to the Authority and the Trustee (a) an Opinion of Bond Counsel stating that the delivery of such Alternate Credit Facility to the Trustee is authorized under the Loan Agreement and complies with the terms of the Loan Agreement; (b) such opinions regarding the validity of the Alternate Credit Facility as the Authority, the Trustee and any rating agency then rating the Bonds may reasonably require; and (c) written evidence from Moody's, if the Bonds are then rated by Moody's, Fitch, if the Bonds are then rated by Fitch and S&P, if the Bonds are then rated by S&P, to the effect that such rating agency has reviewed the proposed Alternate Credit Facility and that the substitution of the proposed Alternate Credit Facility for the Letter of Credit will not, by itself, result in a reduction of its long-term rating of the Bonds below "A-" if the Bonds are rated by S&P, below "A-" if the Bonds are rated by Fitch, or below "A3" if the Bonds are rated by Moody's (or such lower ratings as may be permitted by the Authority's policies or guidelines then in effect).

Letter of Credit and Confirming Letter of Credit

The Corporation shall at all times throughout the term of the Loan Agreement maintain or cause to be maintained the Letter of Credit and, subject to the provisions of the Loan Agreement, the Confirming Letter of Credit with respect to the Bonds. The Letter of Credit shall be an obligation of the Bank to pay to the Trustee, against presentation of sight drafts and certificates required by the Bank, up to (a) an amount equal to the aggregate principal amount of the Bonds then Outstanding as necessary to pay the principal of such Bonds, whether at maturity, redemption, acceleration or otherwise or upon the purchase of such Bonds upon the optional tender of the Bonds pursuant to the Indenture and on the Mandatory Tender Date, and (b) an amount equal to 35 days (or such other number of days as may be required to obtain a rating on the Bonds if the Bonds are then rated) of interest on the Bonds calculated at an interest rate of ten percent (10%) per annum on the basis of a 365- or 366-day year, as applicable, for the number of days actually elapsed while the Bonds bear interest at the Weekly Interest Rate and an amount equal to 210 days (or such other number of days as may be required to obtain a rating on the Bonds if the Bonds are then rated) of interest on the Bonds calculated at the actual interest rate or rates on the Bonds on the basis of a 360-day year of twelve 30-day months while the Bonds bear interest at the Fixed Interest Rate to pay interest on the Bonds when due. Any Confirming Letter of Credit shall be an obligation of the Confirming Bank to pay to the Trustee, against presentation of sight drafts and certificates required by the Confirming Bank, the principal of and interest on the Bonds (but not exceeding the stated amount of the Confirming Letter of Credit) due to the Registered Owners under the Indenture in the event that the Bank has failed to honor a properly presented drawing under the Letter of Credit or in the event the Bank has repudiated the Letter of Credit.

On any Business Day, the Corporation may, at its option, provide or cause to be provided to the Trustee an Alternate Letter of Credit (which may be issued by the Bank) and the Corporation shall, in any event, cause to be delivered to the Trustee an extension of the Expiration Date of the Letter of Credit and the Confirming Letter of Credit or an Alternate Letter of Credit at least (a) twenty-three (23) days before the Expiration Date of the then-existing Letter of Credit and any then-existing Confirming Letter of Credit while the Bonds bear interest at the Weekly Interest Rate, or (b) forty-five (45) days before the Expiration Date of the then-existing Letter of Credit and any then-existing Confirming Letter of Credit while the Bonds bear interest at the Fixed Interest Rate. At least thirty (30) days prior to the Letter of Credit Substitution Date, the Corporation shall provide the Authority, the Trustee, the Bank, the Tender Agent and the Remarketing Agent with a written notice of its intention to provide an Alternate Letter of Credit pursuant to the Loan Agreement. Such notice shall include the proposed Letter of Credit Substitution Date and identify the provider of the Alternate Letter of Credit. An Alternate Letter of Credit shall be an irrevocable direct-pay letter of credit, and may include an irrevocable confirming or support letter of credit or other irrevocable credit facility delivered to the Trustee on the Letter of Credit Substitution Date, issued by a commercial bank or other financial institution, the terms of which shall in all material respects be the same as the Letter of Credit and/or the Confirming Letter of Credit, as applicable. On or prior to the date of the delivery of an Alternate Letter of Credit to the Trustee, the Corporation shall cause to be furnished to the Authority and the Trustee (i) an Opinion of Bond Counsel stating that the delivery of such Alternate Letter of Credit to the Trustee is authorized pursuant to the Loan Agreement, complies with the terms hereof, (ii) such opinions regarding the validity of the Alternate Letter of Credit as the Authority, the Trustee and any rating agency then rating the Bonds may reasonably require, and (iii) written evidence from Moody's, if the Bonds are then rated by Moody's, S&P, if the Bonds are then rated by S&P, Fitch, if the Bonds are then rated by Fitch, to the effect that such rating agency has reviewed the proposed Alternate Letter of Credit and that the substitution of the proposed Alternate Letter of Credit will not, by itself, result in a reduction of its long-term rating of the Bonds below "A-" if the Bonds are rated by S&P, below "A3" if the Bonds are rated by Moody's or below "A-" if the Bonds are rated by Fitch.

It is understood and agreed that with proper notification to the Trustee and the Corporation, the Bank can declare that a default has occurred under with the Corporation and such default will cause a mandatory redemption of Bonds pursuant to the Indenture.

Covenants of the Corporation

The Corporation represents, warrants and agrees as follows:

(a) to use due diligence to cause the Project to be operated in all material respects in accordance with all applicable laws, rulings, regulations and ordinances;

(b) to comply in all material respects with all written conditions imposed by any State or local agency in its approval of the 2014 Project;

(c) to fully and faithfully perform all the duties and obligations which the Authority has covenanted and agreed in the Indenture to cause the Corporation to perform and any duties and obligations which the Corporation is required in the Indenture to perform;

(d) the rights, duties and obligations imposed on the Corporation pursuant to the Indenture are hereby acknowledged, approved and accepted;

(e) to faithfully perform at all times any and all covenants, undertakings, stipulations and provisions to be observed or performed by the Corporation contained in the Indenture, in the Bonds, and in all proceedings of the Authority pertaining thereto, or otherwise required of the Corporation to be observed or performed, whether express or implied;

(f) to not become a Registered Owner of the Bonds, and to not directly or indirectly purchase Bonds from the Remarketing Agent or permit any Related Party to directly or indirectly purchase Bonds from the Remarketing Agent;

(g) the 2014 Project is consistent with any existing local or regional comprehensive plan;

(h) the 2014 Project and the issuance of the Bonds shall comply with the requirements of the Act and other applicable State laws; and

(i) to maintain its status as a 501(c)(3) organization under the Code.

Indenture

The Corporation agrees to all of the terms and provisions of the Indenture and accepts each of its obligations thereunder. Without limiting the foregoing, the Authority may assign its rights under the Loan Agreement as set forth in the Indenture. The Corporation approves the initial appointment under the Indenture of the Trustee, and agrees to appoint and maintain, at all times while the Bonds bear interest at a variable rate, a remarketing agent and a tender agent for the Bonds.

Delivery of Reports and Records

(a) The Corporation will furnish the following to the Authority so long as any Bonds remain Outstanding:

(i) its audited financial statements certified by an independent public accountant selected by the Corporation as of the end of each of its fiscal years, as soon as accepted by its Board of Directors but in any event within 270 days after the end thereof; and

(ii) promptly upon the request of the Authority or the Trustee, such other information regarding the financial position, results of operations, business or prospects of the Corporation as such party may reasonably request from time to time;

(b) In addition to the foregoing, the Corporation shall, at any reasonable time and from time to time, upon prior written notice, permit the Authority and the Trustee, and their respective representatives and agents, to (i) inspect the premises and the accounting records and the books of the Corporation for the purpose of verifying compliance by the Corporation with the covenants contained in the Loan Agreement and all of the terms of the Act, (ii) examine and make copies of and abstracts from the accounting records and books of account of the Corporation, (iii) discuss the affairs, finances and accounts of the Corporation with any of its officers or directors and (iv) upon notice to the Corporation, communicate with the Corporation's independent certified public accountants.

No Prevailing Party

Nothing in the Loan Agreement shall be construed to provide for award of attorneys' fees and costs to the Authority or the Corporation for the enforcement of the Loan Agreement as described in section 1717 of the California Civil Code. Nothing in the Loan Agreement affects the rights of the Trustee provided in the Loan Agreement.

Prohibited Uses

No portion of the proceeds of the Bonds will be used to finance or refinance any facility, place or building used or to be used (i) primarily for sectarian instruction or study or as a place for devotional activities or religious worship; or (ii) by any person that is not an organization described in Section 501(c)(3) of the Code or by a 501(c)(3) organization, including the Corporation, in an "unrelated trade or business" (as such term is defined in Section 513 of the Code), in such manner or to such extent as would result in any of the Bonds being treated as an obligation not described in Section 103(a) of the Code. This covenant shall survive payment in full or defeasance of the Bonds.

Application of Net Proceeds

The Corporation shall be entitled to the Net Proceeds, if any, of any insurance or condemnation awards resulting from the damage, destruction or condemnation of the Facilities or any portion thereof for application as provided in the Loan Agreement and in the Reimbursement Agreement. All Net Proceeds shall be deposited by the Corporation in an escrow account with the Bank pursuant to the Reimbursement Agreement and shall be applied in one or more of the following ways at the election of the Corporation, with the written consent of the Bank, by written notice to the Authority and the Trustee:

(a) The prompt repair, restoration, relocation, modification or improvement of the damaged, destroyed or condemned portion of the Facilities to enable such portion of the Facilities to accomplish at least the same function as such portion of the Facilities was designed to accomplish prior to such damage or destruction or exercise of such power of eminent domain. If the Corporation elects to proceed as provided in the Loan Agreement, it shall give the Authority and the Trustee written notice thereof, and evidence of the Bank's written consent, within 90 days of the deposit of the Net Proceeds with the Bank. Any balance of the Net Proceeds remaining after such work has been completed shall be deposited in the Revenue Fund to be applied, with the written consent of the Bank, to the payment of principal of and premium, if any, and interest on the Bonds, or, if the Bonds have been fully paid (or provision for payment thereof has been made in accordance with the provisions of the Indenture), any balance remaining in the Revenue Fund shall be paid in accordance with the requirements of the Indenture.

(b) The prepayment of all or a portion of the Loan in accordance with the Loan Agreement and redemption of Bonds. If the Corporation fails to give the notice and evidence of the Bank's written consent required by the Loan Agreement within 90 days of the deposit of the Net Proceeds with the Bank, the Corporation shall be deemed to have elected to apply the Net Proceeds to the prepayment of all or a portion of the Loan as provided in the Loan Agreement, the Bank shall be deemed to have consented to such application, and the Authority shall be deemed to have received written notice thereof for purposes of the Loan Agreement.

Loan Default Events

Any one of the following which occurs and continues shall constitute a Loan Default Event:

- (a) failure of the Corporation to pay any Loan Repayment when and as the same shall become due and payable pursuant to the Loan Agreement;
- (b) failure of the Corporation to pay any amounts payable under the Loan Agreement, other than Loan Repayments, when and as the same shall become due, which failure continues for a period of 30 days after written notice delivered to the Corporation and the Bank, which notice shall specify such failure and request that it be remedied, given by the Trustee or the Authority;
- (c) failure of the Corporation to observe and perform any covenant, condition or agreement on its part required to be observed or performed by the Loan Agreement, other than a certain covenants described in the Loan Agreement, which failure continues for a period of 30 days after written notice delivered to the Corporation and the Bank, which notice shall specify such failure and request that it be remedied, given by the Trustee or the Authority, unless the Trustee and the Authority shall agree in writing to an extension of such time; provided, however, that if the failure stated in the notice cannot be corrected within such period, the Authority and the Trustee will not unreasonably withhold their consent to an extension of such time if corrective action is instituted within such period and diligently pursued until the default is corrected; or
- (d) existence of an Event of Default under and as defined in the Indenture.

The provisions of the Loan Agreement above are subject to the limitation that the Corporation shall not be deemed in default if and so long as the Corporation is unable to carry out its agreements under the Loan Agreement by reason of strikes, lockouts, or other industrial disturbances; acts of public enemies; orders of any kind of the government of the United States or of the State or any of their departments, agencies or officials, or any civil or military authority; insurrections, riots, epidemics, landslides, lightning, earthquake, fire, hurricanes, storms, floods, washouts, droughts, arrests, restraint of government and people; civil disturbances; explosions; breakage or accident to machinery, transmission pipes or canals; partial or entire failure of utilities; or any other cause or event (whether similar or dissimilar to the foregoing) not reasonably within the control of the Corporation; it being agreed that the settlement of strikes, lockouts, and other industrial disturbances shall be entirely within the discretion of the Corporation, and the Corporation shall not be required to make settlement of strikes, lockouts, and other industrial disturbances by acceding to the demands of the opposing party or parties when such course is, in the judgment of the Corporation, unfavorable to the Corporation. This limitation shall not apply to any default under (a), (b), or (d) above. Notwithstanding any other provision of the Loan Agreement to the contrary, so long as the Bank is not in default under the Letter of Credit, the Trustee shall not without the prior written consent or direction of the Bank exercise any remedies under the Loan Agreement in the case of any Loan Default Event described in (a), (b), or (c) above. Nothing in the Loan Agreement shall be deemed to limit any rights of the Authority to enforce or waive any of its rights specifically retained under the Indenture.

Remedies on Default

Subject to the Loan Agreement, whenever any Loan Default Event shall have occurred and shall be continuing:

- (a) The Trustee, by written notice to the Corporation, the Confirming Bank and the Bank, shall declare all unpaid amounts payable under the Loan Agreement to be due and payable immediately, provided that concurrently with or prior to such notice the unpaid principal amount of the Bonds shall have been declared to be due and payable under the Indenture. Upon any such declaration such amount shall become and shall be immediately due and payable in the amount set forth in the Indenture;

(b) the Trustee shall have access to and may inspect, examine and make copies of the books and records and any and all accounts, data and federal income tax, and other tax returns of the Corporation;

(c) the Authority and the Trustee may take whatever action at law or in equity as may be necessary or desirable to collect the payments and other amounts then due and thereafter to become due or to enforce performance and observance of any obligation, agreement or covenant of the Corporation under the Loan Agreement; and

(d) The Trustee shall immediately draw upon the Letter of Credit or the Confirming Letter of Credit, if permitted by their terms and required by the terms of the Indenture, and apply the amount so drawn in accordance with the Indenture and may exercise any remedy available to it thereunder.

In case the Trustee shall have proceeded to enforce its rights under the Loan Agreement and such proceedings shall have been discontinued or abandoned for any reason or shall have been determined adversely to the Trustee, then, and in every such case, the Corporation, the Trustee and the Authority shall be restored respectively to their several positions and rights under the Loan Agreement, and all rights, remedies and powers of the Corporation, the Trustee and the Authority shall continue as though no such action had been taken.

The Corporation covenants that, in case a Loan Default Event shall occur and all unpaid amounts payable under the Loan Agreement shall have been declared due and payable immediately pursuant to the Loan Agreement, then, upon demand of the Trustee, the Corporation will pay to the Trustee the whole amount that then shall have become due and payable under the Loan Agreement, with interest on the amount then overdue at the rate of 10% per annum until such amount has been paid or, if 10% is greater than the rate then permitted by law, at the greatest rate then permitted.

In case the Corporation shall fail forthwith to pay such amounts upon such demand, the Trustee shall be entitled and empowered to institute any action or proceeding at law or in equity for the collection of the sums so due and unpaid, and may prosecute any such action or proceeding to judgment or final decree, and may enforce any such judgment or final decree against the Corporation and collect in the manner provided by law the moneys adjudged or decreed to be payable.

In case proceedings shall be pending for the bankruptcy or for the reorganization of the Corporation under the federal bankruptcy laws or any other applicable law, or in case a receiver or trustee shall have been appointed for the property of the Corporation or in the case of any other similar judicial proceedings relative to the Corporation, or the creditors or property of the Corporation, then the Trustee shall be entitled and empowered, by intervention in such proceedings or otherwise, to file and prove a claim or claims for the whole amount owing and unpaid pursuant to the Loan Agreement and, in case of any judicial proceedings, to file such proofs of claim and other papers or documents as may be necessary or advisable in order to have the claims of the Trustee allowed in such judicial proceedings relative to the Corporation, its creditors or its property, and to collect and receive any moneys or other property payable or deliverable on any such claims, and to distribute such amounts as provided in the Indenture after the deduction of its reasonable charges and expenses. Any receiver, assignee or trustee in bankruptcy or reorganization is hereby authorized to make such payments to the Trustee, and to pay to the Trustee any amount due it for reasonable compensation and expenses, including reasonable expenses and fees of counsel incurred by it up to the date of such distribution.

Redemption of Bonds With Prepayment Moneys

By virtue of the assignment of the rights of the Authority under the Loan Agreement to the Trustee, the Corporation agrees to and shall pay directly to the Trustee any amount permitted or required to be paid by it under the Loan Agreement. The Indenture provides that the Trustee shall use the moneys so paid to it by the Corporation, pursuant to the written instructions of the Corporation, to redeem the Bonds on the date set for such redemption pursuant to the Loan Agreement.

Options To Prepay Loan

The Corporation shall have the option to prepay the Loan by paying to the Trustee the amount set forth in the Loan Agreement, for deposit in the Revenue Fund, to be applied to the redemption of Bonds as set forth below on the earliest date such Bonds are subject to redemption pursuant to the Indenture and as to which notice of redemption can be given in accordance with the Indenture, at the redemption prices set forth below, under the following circumstances:

(a) The Corporation may, with the Bank's prior written consent, which consent will not be unreasonably withheld, prepay such amounts in whole, and cause all of the Outstanding Bonds to be redeemed at the redemption price set forth in the Indenture, if any of the following shall have occurred:

(i) the Facilities shall have been damaged or destroyed, in whole or in part, by fire or other casualty and the Authority and the Trustee receive a Certificate of the Authorized Representative of the Corporation to the effect that: (A) it is not practicable or desirable to rebuild, repair or restore the Facilities within a period of six consecutive months following such damage or destruction; (B) the Corporation is or will be thereby prevented from carrying on its normal operations at the Facilities for a period of at least six consecutive months; or (C) the cost of restoration of the Facilities would substantially exceed the Net Proceeds of insurance carried thereon; or

(ii) title to, or the temporary use of, all or substantially all of the Facilities shall have been taken by any governmental authority, or any Person acting under governmental authority, exercising the power of eminent domain and the Authority and the Trustee receive a Certificate of the Authorized Representative of the Corporation to the effect that: (A) the Corporation is thereby prevented from carrying on its normal operations at the Facilities for a period of at least six consecutive months, or (B) the Facilities is unsuitable for use by the Corporation.

(b) The Corporation may prepay all or any part of the Loan from any available funds and cause all or any part of the Outstanding Bonds to be redeemed at the redemption prices set forth in the Indenture, as applicable, but subject to any additional requirements of the Reimbursement Agreement.

Mandatory Prepayment

The Corporation shall have and hereby accepts the obligation to prepay in full the Loan by paying to the Trustee the amount set forth in the Loan Agreement for deposit to the Revenue Fund to be used to redeem all the Outstanding Bonds (or such Bonds as required under the Loan Agreement) on the earliest date such Bonds are subject to redemption pursuant to the Indenture and as to which notice of the redemption can be given in accordance with the Indenture, at the redemption prices set forth the Indenture with respect to the Loan Agreement:

(i) if and when as a result of any changes in the Constitution of the United States of America or the California Constitution or as a result of any legislative, judicial or administrative action, the Loan Agreement shall have become void or unenforceable or impossible of performance in accordance with the intention and purposes of the parties hereto, or shall have been declared unlawful; and

(ii) if mandatory redemption is required by the Indenture.

The amount payable by the Corporation in the event of a prepayment required by the Loan Agreement shall be determined as set forth in the Loan Agreement and shall be deposited in the Revenue Fund upon written demand by the Trustee.

The Corporation shall prepay all or any part of the Loan from Net Proceeds under the circumstances described in the Loan Agreement, and cause all or any part of the Outstanding Bonds to be redeemed at the redemption price set forth in the Indenture.

Amount of Prepayment

In the case of a prepayment in full of the Loan by the Corporation under the Loan Agreement, the amount to be paid shall be a sum sufficient, together with other funds deposited with the Trustee and available for such purpose, to pay (a) the redemption price specified in the Loan Agreement, for all Outstanding Bonds, plus all interest accrued and to accrue to the redemption date; (b) all Additional Payments and reasonable and necessary fees and expenses of the Authority, the Trustee and any Paying Agent allowable pursuant to the Loan Agreement and the Indenture accrued and to accrue through final payment of the Bonds; and (c) all other liabilities of the Corporation accrued and to accrue under the Loan Agreement.

In the case of partial prepayment of the Loan by the Corporation under the Loan Agreement, the amount to be paid shall be a sum sufficient, together with other funds deposited with the Trustee and available for such purpose, to pay the redemption price specified in the applicable subsections of the Loan Agreement, for the Bonds to be redeemed, plus all interest accrued and to accrue to the redemption date, and to pay expenses of redemption of such Bonds. All partial prepayments of the Loan made by the Corporation under the Loan Agreement shall be applied in inverse order of the due dates thereof, or as otherwise provided in the Indenture.

Nonliability of Authority

The Authority shall not be obligated to pay the principal of, premium, if any, or interest on the Bonds, including any prepayments, except from Revenues. Neither the faith and credit nor the taxing power of the State or any political subdivision thereof, nor the faith and credit of the Authority is pledged to the payment of the principal of or interest on the Bonds. The Authority shall not be liable for any costs, expenses, losses, damages, claims or actions, of any conceivable kind on any conceivable theory, under or by reason of or in connection with the Loan Agreement, the Bonds or the Indenture, except only to the extent amounts are received for the payment thereof from the Corporation under the Loan Agreement.

The Corporation acknowledges that the Authority's sole source of moneys to repay the Bonds will be provided by the Loan Repayments made by the Corporation pursuant to the Loan Agreement, together with investment income on certain funds and accounts held by the Trustee under the Indenture, and hereby agrees that if the Loan Repayments to be made under the Loan Agreement shall ever prove insufficient to pay all principal of or interest on the Bonds as the same shall become due (whether by maturity, redemption, acceleration or otherwise), then upon notice from the Trustee, the Corporation shall pay such amounts as are required from time to time to prevent any deficiency or default in the payment of such principal, Redemption Price or interest, including, but not limited to, any deficiency caused by acts, omissions, nonfeasance or malfeasance on the part of the Trustee, the Corporation, the Authority or any third party, subject to any right of reimbursement from the Trustee, the Authority or any such third party, as the case may be, therefor.

Expenses and Indemnification

The Corporation covenants and agrees to pay and to indemnify the Authority, the Treasurer of the State (the "Treasurer") and the Trustee against all costs, fees and charges, including reasonable fees and expenses of attorneys (including the Attorney General of the State), accountants, consultants and other experts, incurred in good faith or arising out of or in connection with the Loan Agreement, the Indenture or the Reimbursement Agreement. These obligations shall remain valid and in effect notwithstanding repayment of the Loan made under the Loan Agreement or the termination of the Loan Agreement or the termination or defeasance of the Indenture.

The Corporation, to the fullest extent permitted by law, shall indemnify, hold harmless the Authority, the State Treasurer and their members, officers, employees and agents (each an "Authority Indemnified Party") and the Trustee and its officers, directors, employees and agents (each, a "Trustee Indemnified Party" and, together with each Authority Indemnified Party, an "Indemnified Party") from and against any and all Indemnifiable Losses arising out of, resulting from or in any way connected with:

(i) the Facilities, including the Project, to be financed or refinanced, or the conditions, occupancy, use, possession, conduct or management of, work done in or about, or from the planning, design, acquisition, installation or construction, of the Facilities or any part thereof, including, without limitation, Indemnifiable Losses resulting from or in any way relating to any generation, processing, handling, transportation, storage, treatment or disposal of solid wastes, Hazardous Materials or any other Hazardous Material Activity relating to the Facilities including, but not limited to, any of those activities occurring, to occur or having previously occurred on the Facilities and any Releases on, under or from the Facilities to the extent occurring or existing prior to the execution and delivery of the Loan Agreement;

(ii) the issuance, sale or remarketing of the Bonds or the carrying out of any of the transactions or undertakings contemplated by the Bond Indenture, the Bonds, the Loan Agreement, the Continuing Disclosure Certificate or any document delivered by the Corporation pursuant to, or in connection with, any of the foregoing;

(iii) any untrue statement or misleading statement or alleged untrue statement or alleged misleading statement of any material fact in any official statement, offering statement, offering circular or continuing disclosure document for the Bonds or any statement made in connection with the purchase or sale of the Bonds (other than any such statement in the Official Statement under the caption “THE AUTHORITY” or “ABSENCE OF MATERIAL LITIGATION—The Authority” or any similar statement provided by the Authority expressly for use in any other official statement, offering statement, offering circular or continuing disclosure document for the Bonds), or any omission or alleged omission to state a material fact necessary in order to make the statements made therein, in the light of the circumstances under which they were made, not misleading;

(iv) the Trustee’s acceptance or administration of the trust of the Bond Indenture or the exercise or performance of any of its powers or duties thereunder or under any of the documents relating to the Bonds to which it is a party;

(v) the refunding, retirement, tender for purchase and/or redemption, in whole or in part, of the Bonds;

(vi) any misrepresentation or breach of warranty by the Corporation of any representation or warranty in the Loan Agreement, the Bond Indenture, the Continuing Disclosure Certificate or any document delivered by the Corporation pursuant to, or in connection with, any of the foregoing or the Bonds; or

(vii) any breach by the Corporation of any covenant or undertaking set forth in the Loan Agreement, the Bond Indenture or any document delivered by the Corporation pursuant to, or in connection with, any of the foregoing or the Bonds; provided that such indemnification pursuant to the Loan Agreement shall not apply to Indemnifiable Losses resulting because of the negligence or willful misconduct of any Trustee Indemnified Party or the gross negligence or willful misconduct of any Authority Indemnified Party.

The Authority agrees to notify the Corporation promptly, but in no event later than twenty (20) business days, after written notice to the Authority that any third party has brought any action, suit or proceeding against an Indemnified Party that may result in an Indemnifiable Loss (a “Third Party Action”). Upon such notice or other notice from an Indemnified Party of a Third Party Action, the Corporation shall assume the investigation and defense thereof, including the employment of counsel selected by the Indemnified Party and reasonably acceptable to the Corporation (which may be the Attorney General of the State of California), and shall assume the payment of all Litigation Expenses related thereto, with full power to litigate, compromise or settle the same in its discretion; provided that the Indemnified Party shall have the right to review and approve or disapprove (in its sole and absolute discretion) any such compromise or settlement and the Indemnified Party has no liability with respect to any

compromise or settlement of any Third Party Claim effected without its written approval. Each Indemnified Party shall have the right to employ separate counsel in any Third Party Claim and participate in the investigation and defense thereof, and the Corporation shall pay the reasonable fees and disbursements of such separate counsel; provided, however, that a Trustee Indemnified Party may only employ separate counsel at the expense of the Corporation if in the reasonable judgment of such Trustee Indemnified Party a conflict of interest exists by reason of common representation or if all parties commonly represented do not agree as to the action (or inaction) of counsel. If the Indemnified Party fails to provide such notice to the Corporation, the Corporation is still obligated to indemnify the Indemnified Party for Indemnifiable Losses.

The rights and undertakings set forth in the Loan Agreement do not terminate and survive the final payment or defeasance of the Bonds and the termination or defeasance of the Loan Agreement.

For purposes of the Loan Agreement “Indemnifiable Losses” means the aggregate of Losses and Litigation Expenses.

For purposes of the Loan Agreement “Losses” means any liability, loss, claim, settlement payment, cost and expense, interest, award, judgment, damages (other than punitive damages to the extent they may not, under law, be indemnified), diminution in value, fine, fee and penalty, and other charge, of every conceivable kind, character and nature whatsoever, contingent or otherwise, known or unknown, except Litigation Expenses.

For purposes of the Loan Agreement “Litigation Expenses” means any court filing fee, court cost, witness fee, and each other fee and cost of investigating and defending or asserting a claim, including, without limitation, in each case, attorneys’ fees, other professionals’ fees and disbursements.

Amendments, Changes and Modifications

Except as otherwise provided in the Loan Agreement or the Indenture, subsequent to the initial issuance of Bonds and prior to their payment in full, or provision for such payment having been made as provided in the Indenture, the Loan Agreement may not be effectively amended, changed, modified, altered or terminated without the written consent of the Trustee and the Bank.

APPENDIX G

BOOK-ENTRY-ONLY SYSTEM

The following information concerning DTC and DTC's book-entry system has been obtained from DTC and contains statements that are believed to accurately describe DTC, the method of effecting book-entry transfers of securities distributed through DTC and certain related matters, but the Authority, the Corporation and the Underwriter take no responsibility for the accuracy of such statements.

The Depository Trust Company, New York, New York, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered Bonds 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 certificate will be issued for each maturity, and will be deposited with DTC.

DTC, the world's largest depository, 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 assets 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 Standard & Poor's rating of: AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information can be found at www.dtcc.com and www.dtc.org.

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

To facilitate subsequent transfers, all 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 the Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct Participants 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. Beneficial Owners of the Bonds may wish to take certain steps to augment transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults and proposed amendments to the security documents. Beneficial Owners of the Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, or in the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Redemption notices will be sent to DTC. If less than all of the 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 Bonds to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Trustee 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 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the 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 Trustee or Trustee on a payable date in accordance with their respective holdings shown on DTC's records. Payments by Direct Participants or 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 Direct Participant or Indirect Participant and not of DTC, the Trustee, the Authority or the Corporation, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Trustee, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct Participants and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, definitive certificates are required to be printed and delivered.

The Authority or the Corporation may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event definitive certificates will be printed and delivered.

THE AUTHORITY, THE CORPORATION, THE UNDERWRITER AND THE TRUSTEE WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATION TO ANY DTC PARTICIPANT, INDIRECT DTC PARTICIPANT OR ANY BENEFICIAL OWNER OR ANY OTHER PERSON WITH RESPECT TO: (I) THE BONDS; (II) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DTC PARTICIPANT OR INDIRECT DTC PARTICIPANT; (III) THE PAYMENT BY DTC, ANY DTC PARTICIPANT OR INDIRECT DTC PARTICIPANT OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL OR REDEMPTION OR PURCHASE PRICE OF AND PREMIUM, IF ANY, AND INTEREST ON THE BONDS; (IV) THE DELIVERY OR TIMELINESS OF DELIVERY BY DTC, ANY DTC PARTICIPANT OR INDIRECT DTC PARTICIPANT OF ANY NOTICE TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE INDENTURE TO BE GIVEN TO BENEFICIAL OWNERS; (V) THE SELECTION OF BENEFICIAL OWNERS TO RECEIVE PAYMENTS IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE BONDS; OR (VI) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC OR ITS NOMINEE, CEDE & CO., AS THE REGISTERED OWNER OF THE BONDS.

