

**SF NIBP Policy Issues for Treasury Input/Decision**  
**3/12/2010**

**Introduction:** In recent discussions some HFAs have emphasized the challenges they face in launching their loan programs and coordinating the administration of those programs with the issuance of Market Bonds and withdrawal of escrowed Program Bond proceeds. In general these HFAs are attempting to balance the interest rate risk present in originating loans ahead of Market Bond issuance/Program Bond escrow release and the negative arbitrage and non-origination risk present to the extent originations occur only after Market Bond issuance/Program Bond escrow release. The following are approaches to addressing those risks which the GSEs find reasonable and consistent with the goals of the NIBP.

**Issue 1: Timing Between Market Bond Pricing and Closing**

**Discussion:**

Depending upon market conditions HFAs have utilized a range of time periods between bond pricing and bond closing. In today's market (reinvestment rates very low) it would be more typical to price a bond issue and then schedule closing 4-6 weeks later versus 2-3 weeks. This saves the HFA a month of negative arbitrage.

Questions have arisen if this 4-6 week period is within the requirements for the NIBP program.

**Policy Guidance for HFAs:**

Purchase Agreements may specify any bond sale and delivery date consistent with the related Release Date. Pricing may precede the issue date of Market Bonds by up to 6 weeks.

**Issue 2: Forward Sale of Market Bonds with Delay of Program Bond Draw from Escrow**

**Discussion:**

As with Issue 1, another approach has been requested to manage negative arbitrage and costs of issuance. This approach involves selling Market Bonds in advance of the Release Date, primarily to avoid market interest rate risk with respect to the Market Bonds. This also helps establish a warehousing facility for the MBS (which permits bond proceeds to remain in escrow and thus avoid negative arbitrage) by eliminating the risk that Market Bonds could not be priced subsequently and the warehoused MBS could not be purchased with bond proceeds.

This request requires Market Bonds to be priced on a "forward basis", i.e., approximately 5 or more months before the related Release Date via a Bond Purchase Agreement (BPA) while a warehouse line is available to the HFA to originate mortgages and better manage short term financing costs and negative arbitrage. The HFA and its underwriter would execute a BPA pursuant to which the underwriter agrees to purchase Market Bonds (for

resale to one or more investors) on a date approximately 2 to 5 months forward. The agreement would set the interest rate and purchase price of the Market Bonds. It is expected that the HFA will have to agree to an interest rate somewhat above prevailing rates to account for the longer than usual period between pricing and delivery of bonds. The amount of Market Bonds to be sold and delivered under the agreement would not be permanently established at the time of the forward pricing; rather, such amount would be based on the actual loan origination. Otherwise, the BPA would resemble a traditional BPA, including HFA representations and covenants and conditions to the underwriter's obligation to perform. A supplemental BPA would then be executed to coincide with the related Permanent Rate Calculation Date in order to confirm the exact amount of Market Bonds to be sold. This supplemental BPA would be treated as the final BPA for the Market Bonds by bond counsel for purposes of the tax analysis of the Bonds (permitting the Program Bonds and the Market Bonds to be treated as a single issue for tax purposes).

If required to more efficiently market the Market Bonds on a forward basis, the Market Bonds could be priced in 2 or 3 "tranches", with each tranche being finalized on the related Permanent Rate Calculation Date

**Policy Guidance For HFAs:**

HFAs may forward sell Market Bonds, without restriction as to the duration of the period between the forward sale and delivery of Market Bonds. However, such forward sale must be structured in a manner that enables the HFA to comply with the mechanics for the related release of escrowed Program Bond proceeds and conversion of such Program Bonds as set forth in the Indenture.

**Issue 3: Hedging Interest Rate Risk on Market Bonds**

**Discussion:**

In an effort to manage non-origination risk and reduce negative arbitrage many HFAs plan to originate mortgages and warehouse mortgage loans before issuing Market Bonds and releasing Program Bond proceeds. In lieu of entering into forward trades with investors for Market Bonds, certain HFAs propose to hedge the interest rate risk on their Market Bonds by executing hedge agreements which will enable them to issue Market Bonds at specified yields and fix the interest rate on mortgage loans prior to the sale of Market Bonds. Such hedges will terminate upon issuance of the Market Bonds and payments made or received with respect to such hedges will be reflected as an adjustment in the calculation of the yield on the Market Bonds for federal tax purposes.

**Policy Guidance For HFAs:**

HFAs may enter into interest rate hedging arrangements relative to Market Bonds and/or mortgage loan rates provided such hedging arrangements do not modify the terms or adversely impact the rating of the Program Bonds.

## **Issue 4: Amendments to NIBP Indentures Regarding Downpayment Assistance Programs**

### **Discussion:**

The Supplemental Indenture, Section 5.2 (a) states the HFA shall not amend, supplement or otherwise modify in any material respect the Indenture, the Appendix thereto or any other related Document without the prior written consent of the GSE's. The GSE's shall determine if any amendment is material.

An issuer (the "Issuer") of small issue program single family bonds, would like to use its own moneys to fund down payment assistance grants to home buyers. The grants would pay up to 4% of the purchase price and closing costs. In return for such grant, the home buyers would pay a mortgage rate of .50% above the 4.75% rate paid by home buyers not using the down payment assistance. The extra .50% loan rate would be paid to the Issuer as part of its "Issuer Fee" due under the bond indenture. The requested indenture amendments divide the description of Issuer Fee and Mortgage Loan Rate between the amounts paid based upon assisted loans and unassisted loans. The cash flows, bond rating and payments on the bonds will not be affected by the proposed amendments.

### **Policy Guidance to HFAs:**

HFAs shall be permitted to enact down payment assistance programs, funded with the HFA's own funds not derived from bond proceeds. HFAs shall be permitted to recover the costs of such programs through an increased mortgage loan rate for assisted mortgage loans, provided that the funding and operations of such programs do not affect the security for and terms of the Program Bonds.