Single Family Financing Essentials: MBS & TBA

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S&P Global
Ratings

S&P's Role in the TBA Market

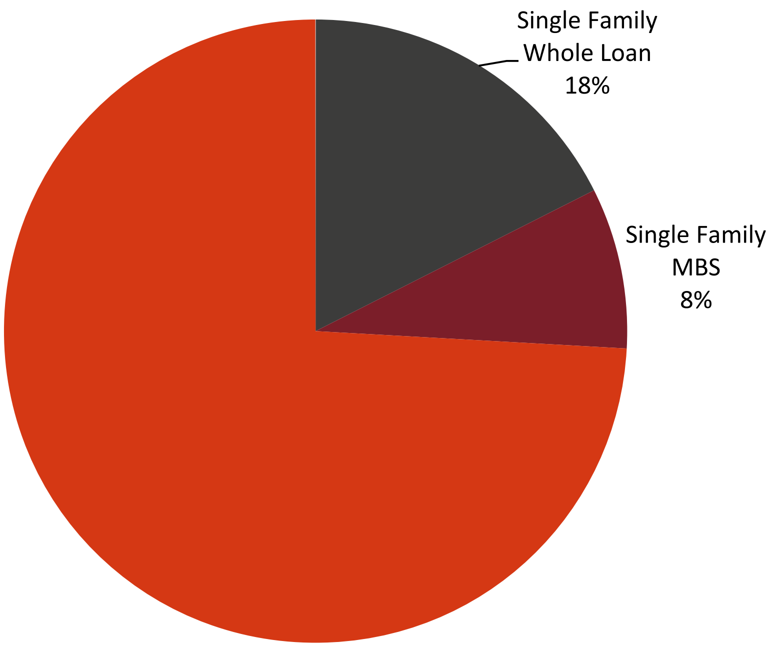
S&P Global Ratings

Single Family Credit Ratings

- S&P Global **does not** assign a rating to a TBA sale
  - Maintains 24 Issuer Credit Ratings (ICRs) that are impacted by TBA sales

- S&P Global rates:
  - Single-family mortgage revenue bonds backed by whole loans
  - Single-family mortgage revenue bonds backed by:
    - Ginnie Mae MBS
    - Fannie Mae MBS
    - Freddie Mac MBS

Distribution of USPF Housing Credit Ratings
December 2017



- Single family housing bonds make up **26%** of S&P Global's housing ratings

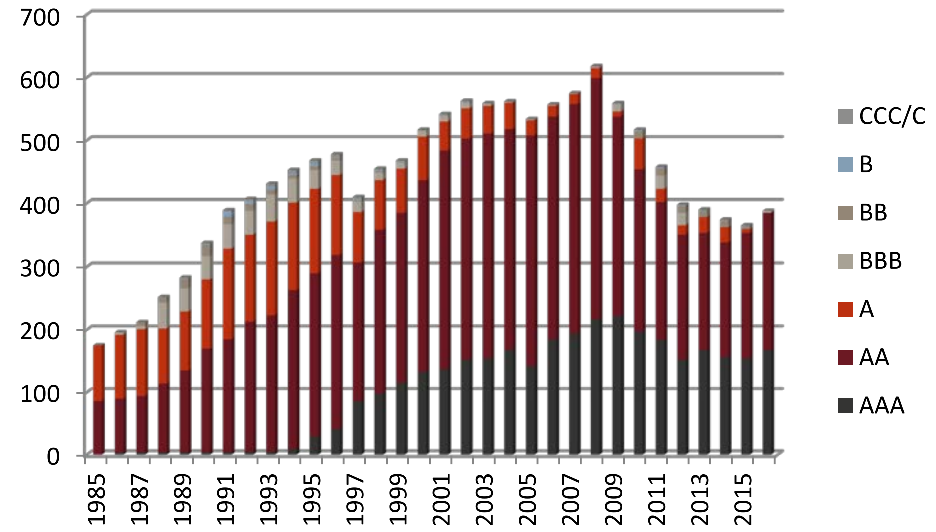
Source: S&P Global Ratings Fixed Income Research

S&P Global Ratings

Single Family Performance
2016 USPF Housing Default Study

- ❖ Single Family Whole Loans are highly rated
  - Most ratings in the ‘AA’ category
  - Ratings ‘BBB’ or lower represent <1% of total single family whole loan ratings
- ❖ Single Family Whole Loan Ratings are More Stable than Rest of Sector
  - >50% of the defaults in USPF housing have been by bonds secured by unenhanced multifamily properties (12% of total ratings)

Single Family Whole Loan Program Ratings 1985-2016



Source: S&P Global Ratings Fixed Income Research

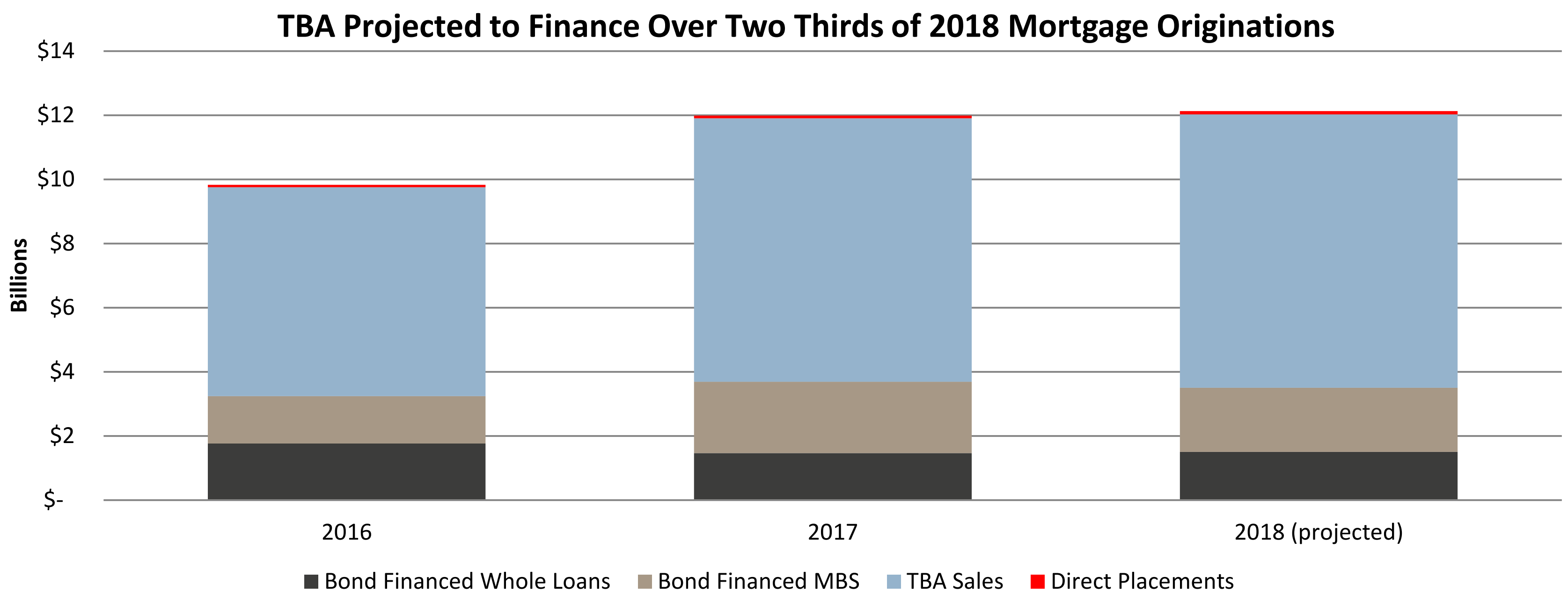
S&P Global Ratings

Single Family Issuance

Recent Trends

❖ TBA dominates S&P rated new issuance according to Sept. 2017 survey

- 14 of 25 S&P rated State HFAs project $8.5B of TBA
- TBA sales represented 68% of new originations over last two years



S&P Global Ratings

TBA Benefits, Risks & Ratings Impact

S&P Global
Ratings

TBA

Benefits of TBA

- ❖ Ginnie Mae securities are backed by the full faith and credit of the U.S. government, which will cover the loan in the event that the mortgagor defaults.

- ❖ Sales to the TBA market, which are taxable, also allow HFAs to earn a larger spread on premiums associated with the sale.

- ❖ HFAs can also fund down payment assistance and provide refinancing options through TBA sales.
  - Can reach beyond first-time homebuyers

TBA

Benefits of TBA (continued)

- TBA does not require the use of volume cap.
- Complements and can be operated in conjunction with a mortgage revenue bond program which fulfills the HFAs' mission.
- HFAs with their own servicing arms can retain the loan servicing function for loans, which provide additional ongoing fee revenue for the HFA.
- Generally, lower cost of issuance compared to bonds.

Risks of TBA

- TBA sales provide one-time cash infusions (fee income) but don't offer the long-term annuity payments associated with bond programs.
  - Cash flow analysis discussion with management

- TBA sales require a receptive market of competitive bidders to benefit from lucrative premiums on the loans.
  - Federal Reserve is deleveraging its balance sheet

- Loan pipeline management risk.
  - Review of historical performance

TBA- Rating Agency Impact

Credit Ratings

- ❖ There are no TBA ratings.

- ❖ We see TBA impact on an HFA's Issuer Credit Rating (ICR).

- ❖ TBA has an impact on the Income Statement.

TBA- Rating Agency Impact

Issuer Credit Rating (ICR) Financial Ratios

- **Leverage**: improved due to lower asset and liability levels

- **Profitability**: if premium sales continue, these ratios will strengthen from strong current income but net interest margins expected to fall as annuity stream declines.
  - Importance of cash flow analysis

- **Asset Quality**: no impact since no asset added to balance sheet

- **Liquidity:** reserve cash/short-term investments to meet fallout risk or interest rate movements

S&P Single Family MBS Criteria Overview

S&P Global Ratings

Single Family MBS
Overview

- Transactions which use *Ginnie Mae, Fannie Mae, and Freddie Mac* to securitize pools of single-family mortgage-backed securities (MBS) are eligible for ratings up to (and in some cases above) the sovereign rating of the U.S.

- The loans carry four types of insurance:
  - Private mortgage insurers
  - Government guarantee programs
    - Federal Housing Administration
    - USDA Rural Development
    - Veteran’s Administration

- Our criteria evaluates two key factors:
  - Cash flows
  - Legal documents

Single Family MBS
Cash Flows

- S&P Global looks to see that cash flows show assets under program at least equal to liabilities and sufficient revenues to meet all scheduled debt payments.

- Cash Flow Projections:
  - Full delivery of MBS on the least desirable origination date permitted under bond documents
  - Non-origination of all mortgages, assuming full redemption of bonds
  - Full origination of mortgage loans with 0% prepayment, 100% prepayment & 3-year average life
  - Rapid prepayment scenario – only if the program is rated AAA

Single Family MBS

Cash Flows (continued)

- S&P Global Ratings looks for assumptions for all cash flow runs to include appropriate monthly mortgage payment lags.
  - GNMA I program guarantees payments on the 15th of the month
  - GNMA II guarantees on the 20th
  - FHLMC on the 15th
  - FNMA on the 25th
    - It is important that the form and source of coverage for credit shortfalls be outlined in the indenture

Single Family MBS
Legal Provisions

- All MBS typically should be registered in the name of trustee, held in its possession, and assigned as a first perfected security lien, free and clear of third party claims.

- Selling MBS securities at a loss should be with majority bondholder approval, and this provision cannot be changed without majority bondholder approval.

- Lenders and servicers are approved by GNMA, FNMA, or FDMC, as applicable.

Single Family MBS
Ratings Above the Sovereign

- ~~S&P views the~~ US Government as a AA+ counterparty with only 85% capacity to pay.

- Programs that are above 115% DSC and can survive AAA cash flow runs would be eligible for a AAA rating.

Credit Given To Capacity To Pay Based On The ICR Of Providers Of Insurance, Asset Guarantees, And Supports (%)

	Issuer Credit Rating On Providers Of Insurance, Asset Guarantees, And Supports															
Ratings on securities	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-
AAA	100	85	75	65	55	45	35	25	15	5	-	-	-	-	-	-
AA+	100	100	90	80	70	60	50	40	30	20	-	-	-	-	-	-
AA	100	100	100	90	80	70	60	50	40	30	-	-	-	-	-	-
AA-	100	100	100	100	90	80	70	60	50	40	-	-	-	-	-	-
A+	100	100	100	100	100	90	80	70	60	50	30	10	-	-	-	-
A	100	100	100	100	100	100	90	80	70	60	40	20	-	-	-	-
A-	100	100	100	100	100	100	100	90	80	70	50	30	10	-	-	-
BBB+	100	100	100	100	100	100	100	100	90	80	60	40	20	-	-	-
BBB	100	100	100	100	100	100	100	100	100	90	70	50	30	10	-	-
BBB-	100	100	100	100	100	100	100	100	100	100	80	60	40	20	-	-

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