Entry Form
2017 Annual Awards for Program Excellence
Entry Deadline: Thursday, June 15, 2017, Midnight ET

Each entry must include a completed entry form. Please complete a form for each entry your HFA is submitting. The completed entry form will become the first page of your entry.

This form is a fillable PDF. Type your information into the entry form and save it as a PDF. Please do not write on or scan the entry form. **Questions: Call 202-624-7710 or email awards@ncsha.org.**

Entry Title: Enter your entry's title exactly as you wish it to be published on the NCSHA website and in the awards program.

MassHousing - Leveraging Assets for Multi-Family Loan Production

Category: Management Innovation

Subcategory: Financial

Entry Summary: A 15-word (max) summary of the program, project, or practice you are entering.

MassHousing leverages the assets of its Multi-Family Housing Bond Indenture to bring down financing costs.

HFA: MassHousing

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Visual Aids:
Are you mailing to NCSHA 10 copies of any visual aids that cannot be included in your entry PDF? ☐ Yes ☑ No

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MassHousing
Leveraging Assets for Multi-Family Loan Production
Management Innovation – Financial

Overview

The Management Challenge – MassHousing, like all other HFAs, has faced the problem of how to competitively finance new loan production with long-term tax-exempt bonds. This need is particularly acute for new multi-family lending. MassHousing has been the most active FHA Risk-Share lender in the country and financing new multi-family projects with 4% tax credits has been its single highest priority and largest program. However, with its Risk-Share loans having 35 or 40 year maturities, the Agency had to consider how could it could finance such vitally needed projects throughout the Commonwealth, and at the same time earn at least a modest spread in so doing. The challenge was, how could MassHousing establish loan rates that would be competitive with GNMA rates and conduit 17-year balloon lending by the GSEs and major banks? These financing problems continue to confront all HFAs using FHA Risk-Share for new tax-exempt production. MassHousing, along with Barclays and CSG Advisors, has used its collective lending expertise and innovative ideas to create a program that the Agency believes can leverage indenture assets to meet this highest priority.

The Solution – Working with Barclays and CSG Advisors, MassHousing finance staff designed an innovative program to finance at least $250 million of new 40-year multi-family loans, which reflected an entire year's worth of pipeline lending. The program has proven more effective than anticipated and to date has financed $414 million of new lending without needing to access any of the Agency's limited subsidy funds.

The approach was to leverage the assets of MassHousing's Multi-Family Housing Bond Indenture in effective and creative ways in order to bring down the cost of financing for new loans. To finance its new lending production, MassHousing would use a combination of cash equity that had to remain in the indenture, a very limited amount of new swapped variable rate bonds, and new fixed-rate bonds.

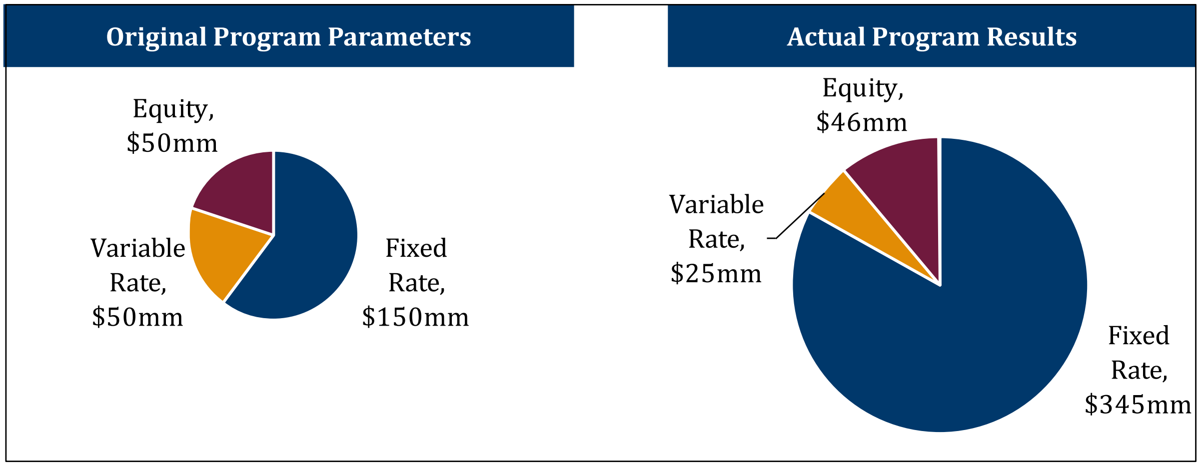
The idea was a simple but powerful tool. The key was to be willing to reinvest $50 million of cash equity currently in very low-yielding money market funds on a long-term basis in the very loans that MassHousing wanted to make. In this way, the equity would fund the longest portion of the new multi-family loans. This would eliminate the need for the longest maturity, 40-year, highest cost bonds. This would also substantially lower the yield on the remaining bonds MassHousing would need to issue.

MassHousing, like many HFAs, has a limited willingness to issue new variable rate debt. However, under this program, MassHousing included up to a maximum of $50 million to be used but under stringent conditions. These are initially floating rate notes with approximately 30-35 year maturities. Thus, the fixed-rate bonds the HFA would need to issue would be the shorter maturities, at the lowest interest rates. To date, MassHousing has only issued $25 million of the variable rate debt.

What It Has Accomplished – The program has exceeded expectations. MassHousing has so far financed 25 projects, with more than 2,693 tax credit units. The aim was to finance 12 months of pipeline production; this has expanded to what is expected to be 24 months of production.

In order to finance $414 million of new loans, MassHousing has sparingly invested its equity, averaging approximately 11% rather than 20% of new lending, or approximately $46 million, has only issued $25 million of variable rate debt, averaging 6% of new lending, and it has exceeded its target of earning at least 50 basis points spread; its aggregate spread is 60 basis points, in addition to its servicing fee.

The program still has $3.9 million of equity and $25 million of capacity for variable rate debt, and the Agency expects to be able to complete at least $100 million of further new lending. Below are charts showing the program parameters and actual results to date.



Innovative – The key innovation was the idea of investing equity as the long-term portion of each loan. The aim wasn't merely to invest indenture cash as a portion of the program to lower the average cost of funds. Rather, it would replace the need for 40 year bonds and thus dramatically lower the cost of the bonds that did need to be financed.

In implementing this approach, the finance team made further innovations. Taking advantage of cash flow strengths of the indenture, the Agency structured swap and bond terms to conserve some of its equity for future deals. Thus, each of the seven bond transactions to date was carefully structured so that MassHousing could complete additional future financings. This is how the initial $250 million has grown to $414 million so far.

Replicable – HFAs that are Risk-Share lenders almost always have parity indentures that are similar to MassHousing's Housing Bond Indenture and that often have cash balances that could be used in precisely the same way. At least one other HFA is considering using MassHousing's approach.

Moreover, MassHousing like virtually all other HFAs that are Risk-Share lenders, has only a limited interest in variable rate debt and wants to minimize any risks involved in that type of financing structure. Because of the variable rate component, the program had to be approved both by MassHousing's Board and the state's independent Finance and Governance Board. MassHousing demonstrated that the amount of variable rate debt would be modest, that it would more than offset by paydown of other variable rate debt of the Agency, and that the indenture rating agency stress cash flows would be improved. MassHousing used a 10-year floating rate note and assured that swaps could be terminated at par when that initial liquidity facility expired. This helped the Agency ensure that if replacement liquidity facilities became more expensive or unavailable (as happened during the financial crisis), it could exit the swap at no cost.

This same approach, of using modest amounts of equity and variable rate debt, could be used by HFAs across the country to provide competitive multi-family lending that is profitable to the HFA.

Respond to a management challenge or opportunity – Multi-family lending is a core part of MassHousing's mission. Without an ongoing way to finance production and assure staff and developers that the Agency could provide attractive loan rates, the program would have been drastically reduced. This leveraging approach enabled MassHousing to continue and in fact increase its pipeline.

Achieve measurable improvements in agency operation – The leveraging program enabled MassHousing to:

- Reduce the average bond yield on these financings by approximately 51 basis points compared to traditional fixed rate financing. Attached as Exhibit A is the most recent transaction reflecting such comparison.
- Significantly increase spread to cover MassHousing's long-term operations. The average spread of 60 basis points (in addition to servicing) was more than six times what the Agency would have achieved with traditional tax-exempt financing.
- Maintain and increase multi-family production, by providing attractive financing and transparency in the formula of how loan rates are set.
- Increase the return on cash in the indenture.
- Help make the successful case to S&P and Moody's to upgrade the ratings of the indenture, which have increased from AA- to AA, and from Aa3 to Aa2.

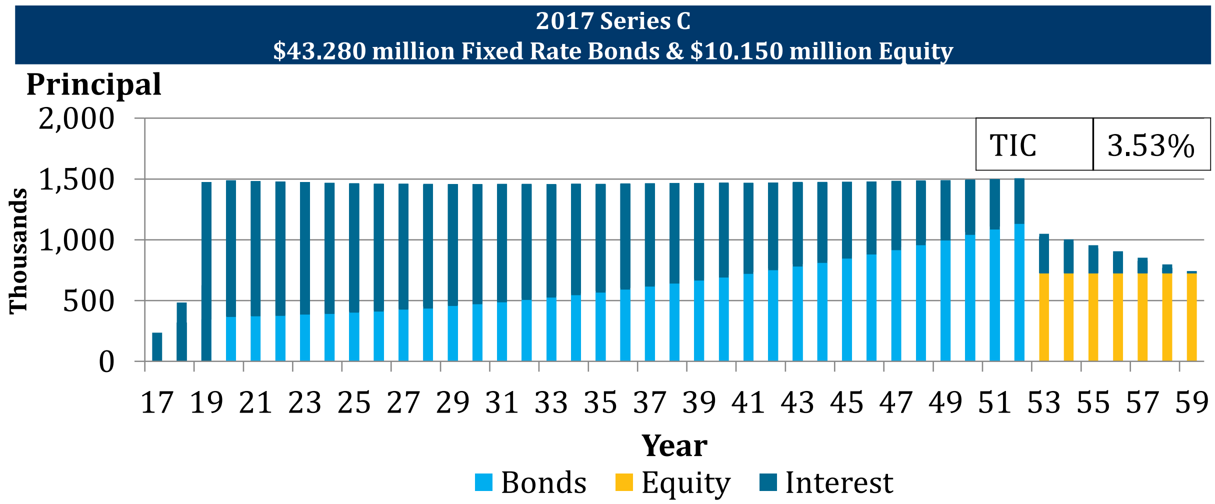
Provide benefits that outweigh costs – The cost and staff resources required to develop the leveraging program were relatively minor when compared to the benefit. The approach was developed over three months, as different combinations of funding were tested and evaluated, to assure net benefits to the indenture and MassHousing. Benefits include major growth in volume and profitability, added transparency in establishing loan rates, and assurance that the entire pipeline could be financed.

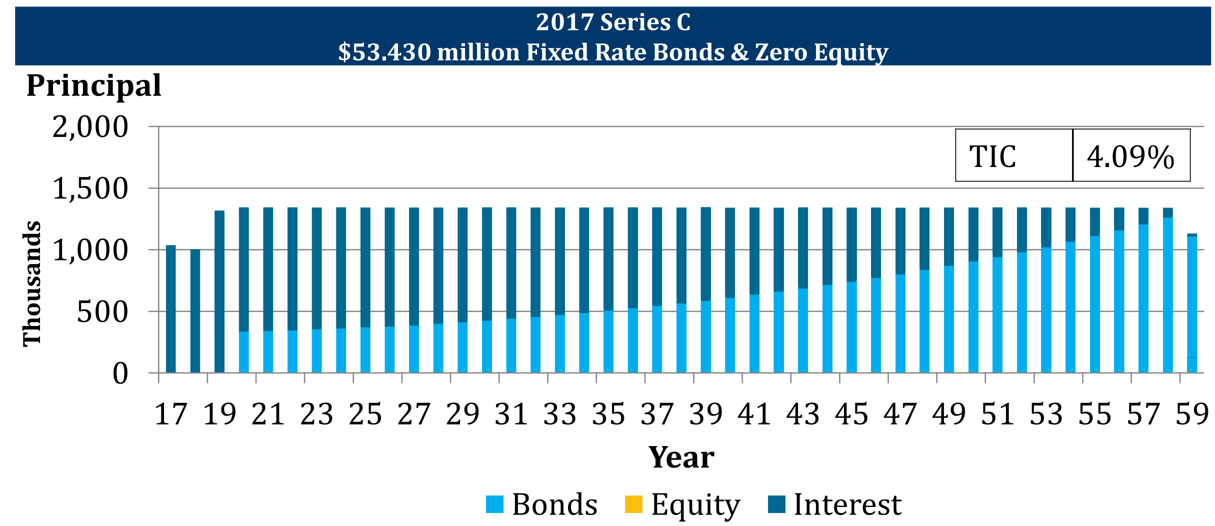
Demonstrate effective use of resources – Cash flows showed that this approach strengthened the present value of the indenture under high and low rate management scenarios, different prepayment assumptions and rating agency tests. MassHousing did not have to put any resources from its Working Capital Fund into the indenture.

Achieve strategic objectives – The leveraging program has enabled MassHousing to meet a core programmatic mission, of vital importance to the Commonwealth and to finance 2,693 of affordable units, while at the same time, improving returns to the Agency.

Conclusion – The program has provided a successful, creative and relatively simple way for MassHousing to leverage its existing indenture to improve its financial results dramatically and overall its ability to fulfill its mission.

EXHIBIT A


2017 Series C
$43.280 million Fixed Rate Bonds & $10.150 million Equity
Principal
Thousands
2,000
1,500
1,000
500
0
TIC
3.53%
17 19 21 23 25 27 29 31 33 35 37 39 41 43 45 47 49 51 53 55 57 59
Year
Bonds
Equity
Interest


2017 Series C
$53.430 million Fixed Rate Bonds & Zero Equity
Principal
Thousands
2,000
1,500
1,000
500
0
TIC
4.09%
17 19 21 23 25 27 29 31 33 35 37 39 41 43 45 47 49 51 53 55 57 59
Year
Bonds
Equity
Interest