NCSHA

2013 Annual Awards Entry Form
(Complete one for each entry.)

Entry Name **Multifamily Portfolio Preservation and Pass-Through Structure**

HFA **MassHousing**

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Entry form with description, check(s), and visual aids (optional) must be received by NCSHA by **Monday, July 1, 2013.**

Use this header on the upper right corner of each page.

HFA ____________________

Entry Name ____________________

Communications	**Homeownership**	**Legislative Advocacy**	**Management Innovation**
☐ Annual Report ☐ Promotional Materials and Newsletters ☐ Creative Media	☐ Empowering New Buyers ☐ Home Improvement and Rehabilitation ☐ Encouraging New Production	☐ Federal Advocacy ☐ State Advocacy	☒ Financial ☐ Human Resources ☐ Operations ☐ Technology
Rental Housing	**Special Needs Housing**	**Special Achievement**	**Are you providing visual aids?**
☐ Multifamily Management ☐ Preservation and Rehabilitation ☐ Encouraging New Production	☐ Combating Homelessness ☐ Housing for Persons with Special Needs	☐ Special Achievement	☐ YES ☒ NO

Management Innovation – Financial
MassHousing
Multifamily Portfolio Preservation and Pass-Through Structure

Overview

As the capital markets have stalled since the onset of the Great Recession, many states have found a limited ability to utilize private activity bond allocations (also known as "volume cap"). Massachusetts took this as an opportunity to convert a once scarce resource into a compelling program aimed at preserving and rehabilitating affordable rental housing. As recently as the mid-2000s, the state did not allow volume cap to be allocated for rental preservation transactions because of the relative scarcity of the resource. Since then, MassHousing has worked proactively to preserve and rehabilitate its considerable stock of existing rental housing, leading to record lending of almost $1.2 billion over the past three fiscal years. To put this in perspective, MassHousing's entire rental portfolio consists of a little more than $3 billion, so the past three years of lending represents almost 40% of the Agency's rental lending portfolio.

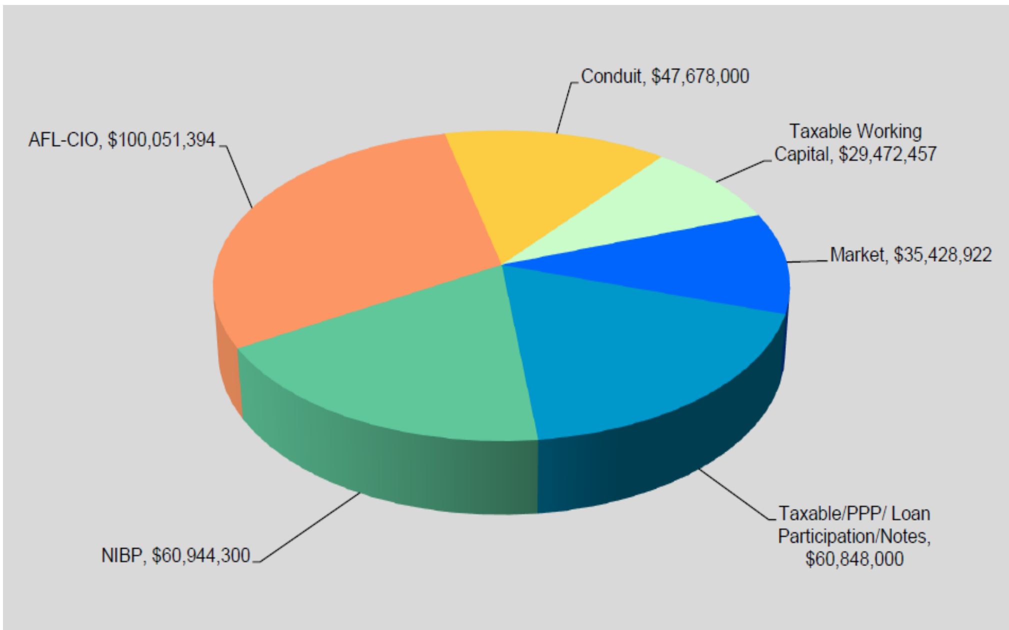
To accomplish these financings, MassHousing used resources made available under the New Issue Bond Program (NIBP) but more recently has developed innovative financing techniques and relationships that have led to some of the largest transactions in the Agency's history. These accomplishments are remarkable given that they occurred after the end of NIBP and in a still difficult capital market that has, according to Moody's Investor Services, resulted in a more than 60% drop in annual HFA bond issuance since 2007. With this financing program MassHousing leverages some of the benefits seen in the Single-Family pass-through structures that have grown so significantly over the past year, and was highlighted in a panel at the NCSHA Annual Conference based on it ability to be replicated by other HFAs.

The POAH Portfolio

In late 2011, MassHousing was approached by Preservation for Affordable Housing (POAH), a Boston-based not-for-profit about the possibility of acquiring, preserving and rehabilitating six "at-risk" properties from a developer-entity that was leaving the industry. Three of the six transactions were in Boston, and were located in some of the most attractive neighborhoods in the city, including the Kenmore Square area next to Boston University, and nearly adjacent to the Massachusetts General Hospital. Comparable market rental transactions in the area commanded some of the highest rents in Boston and the three deals were within two to seven years of the maturity of their mortgages and the end of their Section 8 contracts. Given the desirable locations, the imminence with which affordability restrictions could be lost and the potentially strong opportunity to convert these to market-oriented housing, the ability to preserve these properties as affordable housing ahead of mortgage maturity was critical. Equally critical was the need to move quickly, as the seller was interested in selling its portfolio, and these six deals represented the remainder of that portfolio. Given the end of the NIBP Program, MassHousing needed to find a way to create a competitive loan product that it could underwrite in a relatively short period of time.

New Multifamily Bond Structure

MassHousing quickly identified an opening when it learned that the borrower intended to use union labor in its rehabilitation work on the Boston deals. The Agency immediately contacted the AFL-CIO Housing Investment Trust (HIT) to gauge its interest in purchasing debt for the transaction. Historically the HIT was an active purchaser of short-term debt, but given their interest in maximizing return for its pension-fund recipients, it was not an active purchaser of tax-exempt long-term debt. Working with the HIT, MassHousing developed a pass-through structure wherein the bonds would fund loans that were fully insured under FHA Risk-Share Insurance, insurance only available to HFAs. MassHousing modeled the structure comparably to its Moody's Aaa-rated NIBP structure with the Agency funding debt service and negative arbitrage reserves. In this manner, the end investor could look directly at the assets that secured its bonds, in this case the FHA-Insured mortgages in this preservation transaction, with added security coming in the form of cash pledged to the bonds. Given the ultra-low rate environment and the high Aaa rating of the bonds utilizing this structure, the AFL-CIO decided to become a “cross-over” buyer and purchase the long-term tax-exempt bonds at very attractive levels. Historically MassHousing has issued debt in parity indentures that, while highly-rated, do not always offer the investor the transparency on the specific assets that secure their bonds. This structure, a closed-ended debt offering of exclusively pre-identified FHA-Insured mortgages, is very attractive to investors. Through this offering, MassHousing was able to successfully bridge its financings to a post-NIBP world, and ultimately the AFL-CIO HIT was MassHousing’s single largest bond investor in FY2012 (see chart below).



The Benefits of Risk Share

The AFL-CIO HIT had actually expressed frustration at the processing speed on some of its traditional FHA mortgages, and this supply of new bonds was quite attractive to them. One of the tremendous benefits of the Risk-Share Program is the relative speed with which the underwriting can take place. MassHousing closed the POAH transactions in about seven months, whereas a traditional FHA underwriting, or tax credit pilot transaction, could easily take twice that long.

Finally, Risk Share Insurance proved very valuable to POAH as it sought tax-credit investors. Given the high market value of the properties, and high Section 8 rents that the Boston deals received, many investors were unwilling to underwrite the so-called "Section 8 overhang risk" should HUD not fund Section 8 at those rent levels, which would cause the development to revert to much lower tax credit rents. By aligning this risk with potential claims liability by HUD should Section 8 be non-appropriated to these deals, tax credit investors were able to get comfortable that HUD would take particular care not to create a massive claim on these transactions.

MassHousing further bridged this potential gap by funding about $2 million of subordinate loans, to be paid from Section 8 cash flows. Risk Share insurance requires underwriting at the lower of market or Section 8 rents. In some cases, the POAH deals had established Section 8 rents, with new 20 year contracts, at higher levels than the appraised market rent. MassHousing provided subordinate loans against this revenue stream that mitigated the need for scarce state soft debt. With a Section 8 contract in hand, MassHousing expects these loans to be re-paid in ten years at a 5% interest rate, a very favorable return given the low-interest rate environment and relatively large cash balance many HFAs, including MassHousing, are experiencing.

Program Replication for HFAs:

1. Multi-family pass-through structures: HFAs should continue to develop pass-through structures that allow investors, even atypical long-bond investors like the AFL-CIO HIT, to look directly to high quality loan assets, insured with FHA Risk Share Insurance. These structures will lower yields on HFA bonds and increase demand for HFA loans;

2. The value of Risk-Share, especially on high-end Section 8 transactions, should be leveraged to drive better interest rates and stronger tax-credit investor interest;

3. “Hard” debt subordinate loans supported by Section 8 rents is an innovative way for HFAs to both help fill deal gaps while at the same time generating favorable returns;

4. Portfolio preservation transactions provide sufficient scale to attract non-traditional investors. They also leverage the relative processing speed benefits of risk-share versus traditional FHA loans. HFAs should capitalize on these attributes in seeking out new investors.