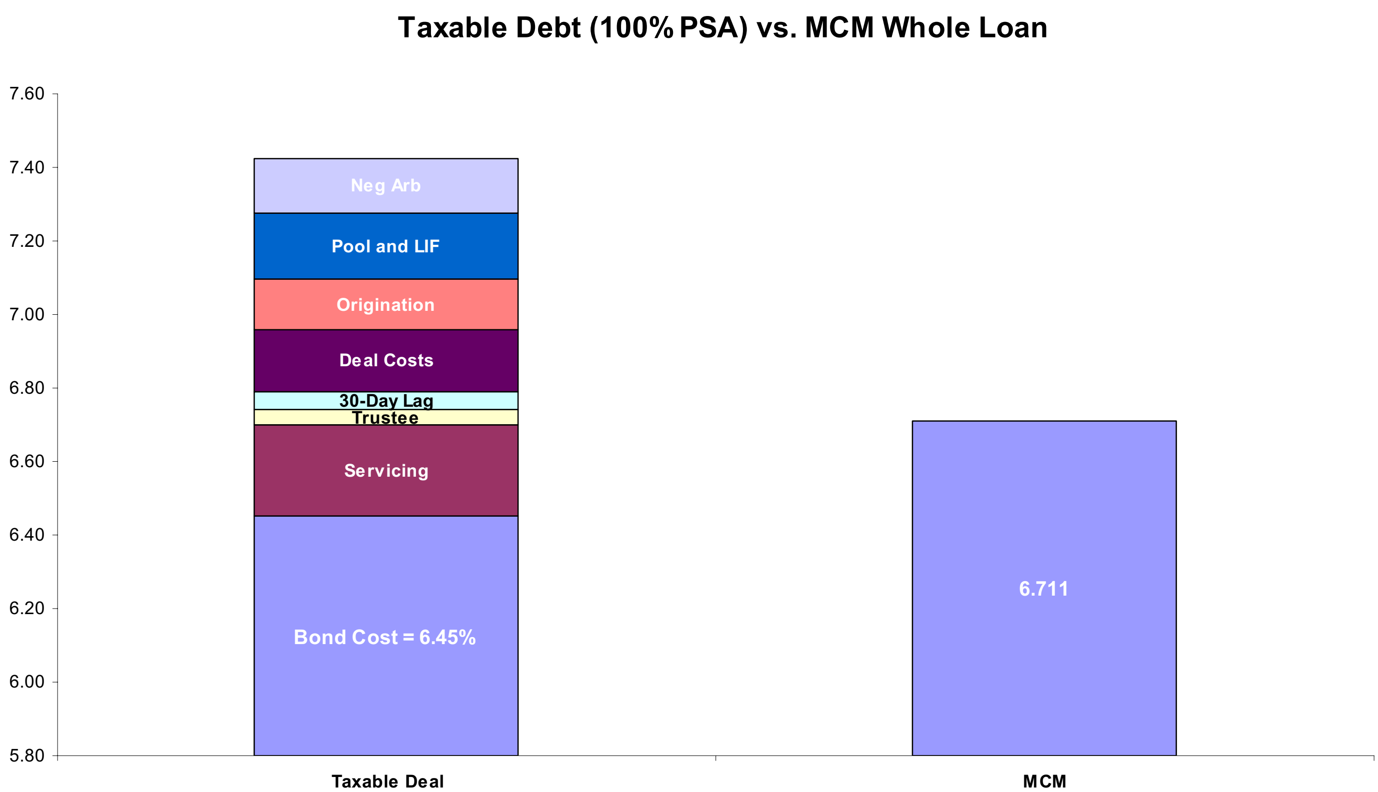
Management Innovation: Financial
MassHousing – Innovative Whole Loan Sale Stretches the Volume Cap Resource

Overview

MassHousing, like other HFAs, has a limited amount of bond volume cap each year. Once the cap was distributed across MassHousing's multiple business lines, the Home Ownership business line had, on average over the past seven years, less than $70 million of new volume cap.

Based on the latest NCSHA fact book, this allocation ranked as the second lowest of the entire HFA population. Even so, MassHousing was able to supported more than $200 million annually of loans to low and moderate-income first-time homebuyers across the Commonwealth between 2002 and 2006. Over these years, MassHousing executed a series of leveraging techniques to expand its homeownership lending, and in particular the use of recycled repayments under its bond program. This worked quite successfully in the early years of this decade as historically low interest rates provided massive loan repayments and ample recycling opportunities. In more recent years, however, prepayments have slowed considerably threatening the Agency's ability to lend. Beginning in 2005, the Agency implemented a lending program that augmented the traditional mortgage revenue bond financing with whole loan sales through the Fannie Mae My Community Mortgage Program. The program provided several attractive features to the Agency, all of which could be readily implemented by other HFAs. This program was also significantly enhanced through the work of NCSHA and its Affinity Agreement with Fannie Mae.

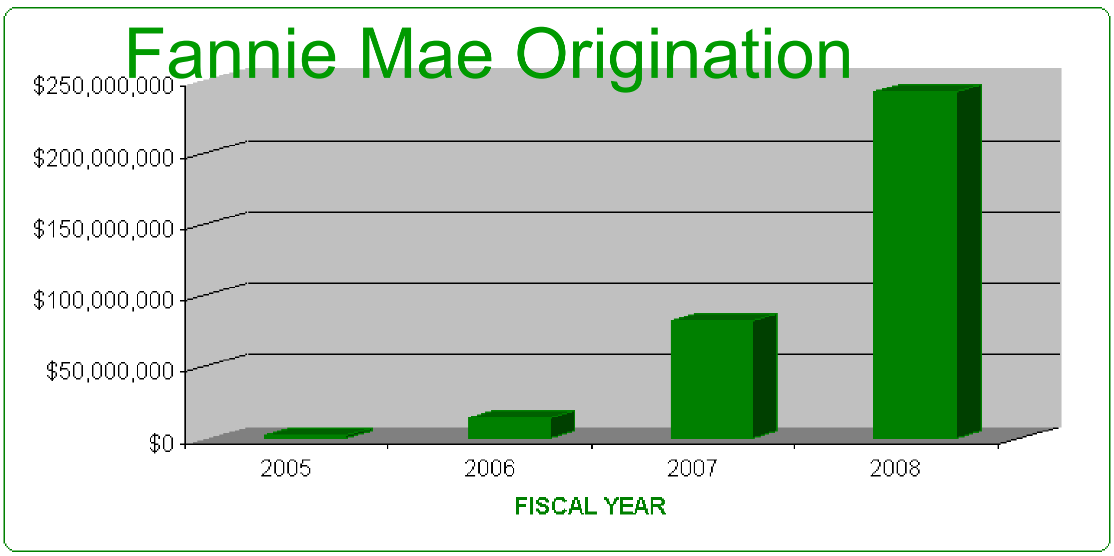
The main premise of the program is that through aggressive business development, the Agency could utilize Fannie Mae financing as an alternative to taxable bond financing and help extend its lending



production. A July 2007 analysis by MassHousing, summarized in the chart above, demonstrated that that the Fannie Mae My Community Mortgage generated a lending rate that was 70 bps less than taxable bond financing alternatives.

After accounting for the yield of taxable bonds (at that time 175 bps over the comparable Treasury analysis) as well as the cost of servicing, issuance costs, origination costs, pool insurance and associated loan insurance funding, and negative arbitrage, the Fannie Mae alternative was simply a much better deal for borrowers than would a taxable loan execution.

The results have been dramatic. In just three years, MassHousing increased its Fannie Mae lending to almost $250 million, see chart below. This level of lending was more than the annual average lending under the mortgage revenue bond program before the Fannie Mae program. When combined with the limited volume cap lending, MassHousing was able to produce more than $400 million of loans in both 2007 and 2008; a level of lending that has never been even closely approached in the history of the Agency. When put in the context of new volume cap, the results are even more impressive. In all, MassHousing leveraged $150 million of volume cap into almost $900 million of lending in 2007 and 2008.



MassHousing's ability to leverage new lending opportunities was critically important to performing its mission. Due to the increased cost of homes in Massachusetts, MassHousing has seen a large increase in the average loan amount sought by our borrowers. These increasing loan amounts coupled with static volume cap allocation mean, quite simply, that the Agency is not able to assist as many homebuyers as it has in years past. A simple analysis illustrates this fact. In 1996, MassHousing helped 2,000 homebuyers. The average loan amount for a typical borrower at that time was $100,000. Just ten years later, the average loan amount had doubled to around $200,000 and the number of homebuyers MassHousing served was just 1,000. Our production was cut in half. By 2008, this level had again returned to over 2,000 borrowers and our market share had almost doubled in just three years.

In similar situations, many HFAs have turned to taxable bond transactions. MassHousing's approach is different because it capitalizes on the innovative agreement HFAs have signed with Fannie Mae – known as the Affinity Agreement. This agreement is already proving to be a much more efficient means of funding loans. Unlike the taxable bond market, the secondary mortgage market is one of the largest, most liquid and efficient markets in the world. Accessing this mortgage market allows MassHousing to originate loans at record levels and optimize its potential funding sources without relying solely on bond proceeds. Indeed, since MassHousing implemented this program, the disruption in the capital markets has made taxable bond financing near impossible to execute. The whole loan sale structure, through the Fannie Mae My Community program, has more than doubled production of loans with no additional volume cap.