Management Innovation – Financial
MassHousing's TCLP Payback

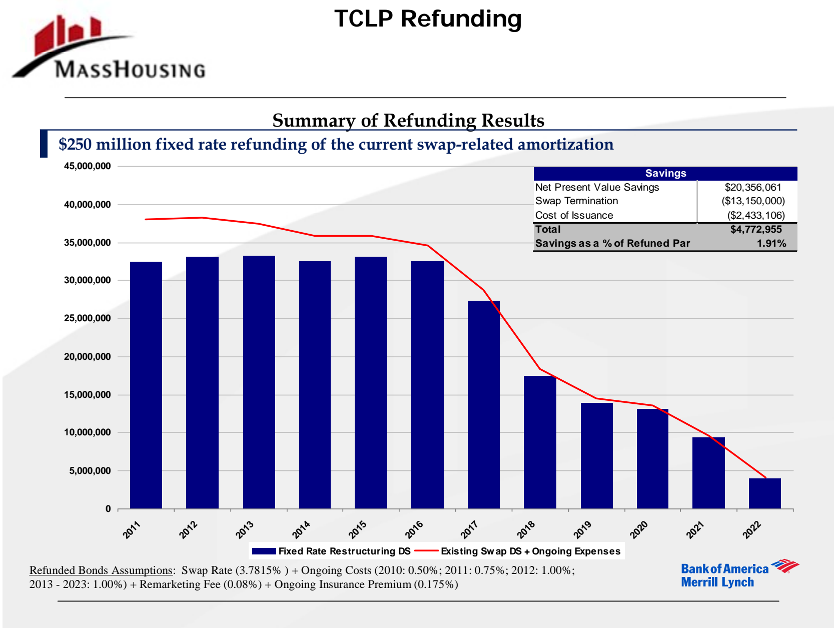
Overview

While MassHousing, like a number of other HFAs, utilized the federal Temporary Credit and Liquidity Program (TCLP) to improve poorly-performing variable rate debt, the Agency is unique in that a mere five months later, it became the first HFA in the country to replace TCPL supported variable rate bonds with fixed rate bonds. MassHousing used the TCLP to replace the liquidity on $319 million of variable rate bonds in one series of variable rate debt. This represented MassHousing's largest series of variable rate debt by far.

Along with providing the liquidity under TCLP, the Treasury initiative also imposed substantial limitations on activity in the bond programs that utilized this federal resource. Among the new rules imposed by the TCLP were: prohibiting the issuance of any new variable rate debt; limiting the amount of proceeds that could be taken from bond programs to support the mission and operation of the Agency; and a requirement to monitor the market cooperatively for fixed rate refunding opportunities to remove TCLP. Since the TCLP was used on MassHousing's largest and most profitable bond program, the Agency was anxious to remove TCLP, and the limitations associated with it, as soon as possible.

MassHousing's May 2010 $250 million fixed-rate refunding deal generated almost 2% present-value savings. MassHousing was able to take advantage of very low interest rates and used several new financing strategies to help market this large transaction.

MassHousing used its TCLP funds to support variable rate debt (and the associated swap) on bonds that amortize by 2022. As part of its original financing strategy, MassHousing purchased a ten-year optional call on the underlying swap when the deal was originally financed in 2003. Since rates are substantially lower than they were in 2003, the value of terminating the swap has "gone against" MassHousing. The purchase of the option, however, mitigated this cost such that the termination payment of $13.15 million, along with associated costs, will be more than offset by the new fixed-rate debt service savings. MassHousing is the only state to remove TCLP bonds successfully since the inception of the program.



Savings	
Net Present Value Savings	$20,356,061
Swap Termination	($13,150,000)
Cost of Issuance	($2,433,106)
Total	**$4,772,955**
Savings as a % of Refuned Par	**1.91%**

Refunded Bonds Assumptions: Swap Rate (3.7815%) + Ongoing Costs (2010: 0.50%; 2011: 0.75%; 2012: 1.00%; 2013 - 2023: 1.00%) + Remarketing Fee (0.08%) + Ongoing Insurance Premium (0.175%)

In order to make this transaction financially feasible, it was essential that MassHousing be able to generate as low an interest rate as possible on the new bonds. Since the bonds consisted of maturities of twelve years and less, these were ideal candidates to market to retail investors. While the markets deteriorated in 2008 for long-term bondholders, retail investors have maintained their active presence in the housing bond market. Still, $250 million of multifamily bonds is a significant pool to market to retail investors. To give the relative size of this transaction some scale, consider that:

- this transaction alone accounted for almost 10% of the entire HFA bond market for the first six months of 2010; and
- a new money multifamily transaction that has $250 million of bonds maturing within the first twelve years would likely total in excess of $1 billion in its total size.

To help ensure the successful marketing of the transaction, MassHousing undertook several first-time initiatives to help drive interest in the deal. First, MassHousing partnered with the Commonwealth of Massachusetts's www.buymassbonds.com website and undertook an extensive marketing effort. Second, MassHousing assembled its traditional investment banking team and stressed that performance on the transaction would be an important metric for awarding future business. Third, MassHousing added eight "selling group" members to its team. This marks the first time MassHousing has used selling group members, that were not part of the formal deal team but who have access to sell bonds as party of the Agency's primary offering. Finally, MassHousing spent $25,000 on direct marketing for 11 radio stations, two newspapers and internet banner advertisements.

The results of the transaction far exceed MassHousing's expectations. For a traditional bond financing, selling 30% of the deal via retail distribution would be considered tremendous performance. Given the relatively short nature of this transaction, MassHousing set a goal of selling $100 million, or 40% of the transaction to retail investors. This would far surpass the volume of retail sales for any recent MassHousing bond sale. As it turns out, the marketing efforts for the deal paid off impressively. MassHousing directed its retail marketing effort to a two-day, retail-only sales effort. After only the first hour of retail sales order, MassHousing received more than $63 million in bids. In all, MassHousing received $250 million in direct retail orders, of which about $200 million were ultimately used to finance the transaction. The rates were incredibly low and produced a bond yield in the low 3%-range. In all, and net of costs, the transaction generated almost $5 million in present value savings. All members of the investment banking team, and especially the book-running senior Manager Bank of America Merrill Lynch (BOAML), sold substantial amounts of retail bonds. Even the selling group members sold approximately $25 million.

While significant in and of itself, it is the $5 million in present-value savings really understates the true value of the transaction to MassHousing. The refunding numbers compare the new fixed-rate debt service payments to the prior synthetic fixed-rate payments under the variable-rate debt and swap. Since the swap and variable rate-debt present a series of risks to MassHousing (such as credit risk, basis risk, rapid amortization risk, etc.) that the fixed-rate refunding does not, the refunding savings also brings with it substantial risk reduction and mitigation. Finally, the refunding removes the restrictive covenants associated with the TCLP, allowing MassHousing greater financial flexibility in its biggest bond program.

The TCLP Refunding is the most important piece of a larger strategy by MassHousing to reduce variable rate debt risk. Variable rate demand bonds ("VRDBs") expose the Agency to a number of risks, including basis risk, credit risk, remarketing and rollover risk, and "bank bond" rapid amortization. At the height of the credit crisis, MassHousing had approximately $700 million, or 20% of its total debt, as VRDBs. The bonds that utilized the TCLP represented almost half of this amount. As a result of the TCLP Refunding, MassHousing has about $160 million in VRDBs, or about 3% of its debt. In essence, over the past 2 ½ years MassHousing has virtually eliminated its variable rate debt risk. The TCLP Program helped provide stability to MassHousing's largest bond program and its TCLP Refunding delivered debt service savings and certainty, while also increasing flexibility to the Agency.

The TCLP Refunding by MassHousing can be replicated by other HFAs. It requires reviewing existing VRDBs with TCLP funds versus the cost of a fixed rate refunding. The deals that will work the best are ones where the call option on the swap is not too far in the distant future and where a good portion of the refunding bonds are serial bonds (15 years and less). This will allow HFAs to take advantage of the extremely low rates at the front end of the "yield curve" without suffering too costly a penalty for unwinding the swap. The ability of HFAs to unwind TCLP will be a good indicator to the markets that HFAs have withstood the credit market disruptions of the past two years and have stabilized their debt portfolios.