Management Innovation – Financial
MassHousing's Fannie Mae MBS Execution

Hockey great Wayne Gretsky, asked once the secret to his success in the game said simply, "I skate to where the puck is going to be not to where it's been." That's a hard task for a hockey player – and the concept is probably harder still for a large housing finance agency like MassHousing.

With a history in mortgage lending since 1966 and a large staff and successful business formula – it can be hard at times to anticipate where the next challenges will lie – and then steer the large bulk of the ship in a new direction. But that is exactly what has happened as MassHousing works to evolve its lending model to meet the challenges of a constantly changing mortgage market.

Background – MassHousing's Home Ownership division operated for the three decades as a wholesale lender, purchasing conventional loans funded solely by the proceeds from Mortgage Revenue Bonds (MRBs). Annual production was primarily limited by the tax exempt bonding authority allocated to MassHousing by the Commonwealth of Massachusetts and within MassHousing, the tax exempt bond authority allocation was shared between the Rental Development and Home Ownership business lines. As a result, the amount of lending that could be done annually by MassHousing's Home Ownership Division was essentially capped at $200 million.

The Problem – In the 1990's when the average MassHousing home mortgage was $100,000, the Agency's existing bond capacity of approximately $200 million enabled MassHousing to fund 2,000 loans a year. By 2005, however, the Agency's average loan had jumped to $200,000, thus reducing the unit capacity to 1,000 loans a year. Inflation in the cost of housing was incrementally reducing the Agency's lending capacity and with the existing model – there wasn't much that could alter that fact.

By the middle of the decade, the subprime market truly reached its apex and borrowers looking to refinance high LTV mortgages were often prey for subprime lenders. There was a critical need for a fixed rate refinancing product that could serve low and moderate income homeowners looking to secure favorable, safe, fixed-rate mortgages that would both lower their interest rates and reduce their monthly payments.

Another market need which emerged was for fixed rate, first mortgage refinancing for home improvement. Most home improvement loans were variable rate second mortgages or lines of credit, which generally made them costly and as well as high risk.

In considering new opportunities for the Agency, it became clear that the only way to expand MassHousing's lending capacity while at the same time solving these other affordable home financing challenges was to find a funding source outside of MRBs.

At the time, the financial guaranty market was also changing. As a conventional lender, MassHousing relied on private mortgage insurers for reinsurance for the Agency's Mortgage Insurance Fund and pool insurance for MRB issuances. But these financial guarantees were becoming more costly and difficult to secure.

The Solution – In 2006, MassHousing initiated a long-term and far-reaching discussion with Fannie Mae to become a Fannie Mae approved lender with the intention of selling affordable home mortgage loans to Fannie Mae as whole loans and eventually as Mortgage Backed Securities (MBS).

The advantage to this was that Fannie Mae could provide MassHousing with an alternative source of mortgage capital and their MBS could be used as collateral for an MRB and also eliminate the need for pool insurance. In this way, Fannie Mae whole loan and MBS executions provided MassHousing with an unlimited supply of capital to fund affordable home mortgages.

The Challenges – MRBs had traditionally provided HFAs with a price advantage over GSE execution through the benefits of issuing tax exempt debt. For MassHousing to use both MRB and MBS channels for funding home mortgages, the Agency would have to offer either two products and two different prices, or one product with optional delivery sources.

The first option made clear that there was a need to reengineer the Agency's mortgage platform entirely. This would require developing the secondary market expertise of a traditional mortgage banker, while maintaining MassHousing's financial capacity to originate MRBs. The second option would require giving up the historic price advantage of MRB execution. Both options presented their own unique set of challenges.

The Agency originally chose the two product option, offering MRB rates to borrowers who met MRB guidelines and Fannie Mae rates to all other borrowers. This opened the door to a new business model for the Agency and addressed the issues of limited funding, and what had been the Agency's inability to make mortgages that were MRB ineligible. The MRB loans were still securitized in Fannie Mae MBS but the MBS served as collateral for the MRB rather than whole loans. The loans that were MRB ineligible (refinancings, second-time homebuyers, home improvement first mortgages, borrowers above a prescribed income level) would go either to Fannie Mae as whole loan sales or be securitized as MBS and sold in the TBA market.

Unfortunately, the price issue was still a problem. The main issue became why would lenders sell loans to MassHousing when they could get equal or better price execution on their own with Fannie Mae for the same product? At that time, Fannie Mae was still under considerable pressure to fulfill its public mission goals for low- and moderate-income borrowers and MassHousing saw this as an opportunity to pitch a new direction for the two agencies' cooperative agreement. So MassHousing went directly to Fannie Mae and sold them on the idea that specific underwriting variances and price concessions for MassHousing would generate significant "goal-rich" business volume for them. This was a persuasive argument for Fannie Mae and it ultimately agreed to this new arrangement. In this way, MassHousing was able to offer niche affordable housing programs at interest rates better than most lenders in the Massachusetts market. This not only set MassHousing apart in the affordable lending arena in Massachusetts but also created tremendous new opportunities for low and moderate income homebuyers and homeowners.

The Result – As a committed Fannie Mae affordable mortgage conduit, MassHousing developed the pipeline management skills and disciplines of a traditional mortgage banker.

For loans that could go to both the MRB and TBA markets, MBS provided the perfect hedge for MRBs. Those loans could be aggregated and then, depending upon market movement and pricing available in each market, MBS could be moved from MRB to TBA or from TBA to MRB depending upon which outlet offered the best price execution on any given day. As a result, because MassHousing was able to use both MBS *and* MRB funding, its funding capacity expanded considerably.

Market Changes – These changes in mortgage funding options proved prescient, as several changes in economic and market conditions gave MassHousing financing options unavailable to other HFAs.

The first flashpoint was the crash of the mortgage revenue bond and tax-exempt debt markets. As risk adverse investors moved away from mortgage related investment, the price advantage of MRBs disappeared, if buyers were available at all. Because MassHousing already had a model for MBS – these sales provided MassHousing with continuous funding for conventional mortgage loans when the MRB market dried up entirely and kept MassHousing in business when other Agencies had to suspend their mortgage lending programs.

The reality was that there were other HFAs using MBS securities for collateral for MRBs but few if any were selling MBS into the TBA market, or doing non-MRB eligible loans as MBS loans sold in the securities market. This enabled MassHousing to grow its volume and make money selling MBS when other HFAs were struggling to find a market for MBS secured MRBs.

Ultimately, MassHousing joined a collaborative group of 26 HFAs that negotiated with Fannie Mae to secure a more broad-based affinity agreement that was modeled after the existing business model that MassHousing already enjoyed with Fannie Mae. The underwriting and product variances, which included a 100% LTV loan with no mortgage insurance, along with price concessions on guaranty fees, gave all 26 HFAs the ability to take advantage of the Fannie Mae whole loan and MBS model already established by MassHousing.

With the support of this national agreement with Fannie Mae and its expertise as a Fannie Mae originator, MassHousing also generated record production and fee income from loan sales and servicing fees, when many HFAs were out of the market altogether.

At around the same time, when the US Treasury was coming to the rescue of the mortgage market, in collaboration with NCSHA, state housing agencies were able to aggregate and sell loans using GSE MBS at attractive rates using the New Issuance Bond Program (NIBP). Already aggregating, selling, and servicing Fannie Mae MBS, MassHousing was one of the first HFAs able to take advantage of this opportunity. MassHousing's market share in Massachusetts jumped by 100% during the time Treasury was purchasing MBS from HFAs.

As part of these circumstances, HFAs clearly identified themselves as preferred business partners of Fannie Mae. Wishing to rebound from its own financial crises and generate high quality, goal rich mortgage production, with good lenders with proven track records Fannie Mae once again turned to HFAs. It negotiated a new affinity agreement that allowed MassHousing and other HFAs to be in the market with products (a No MI 97% LTV loan) and pricing that was superior to any other product offering in the market.

Again enabled by its prior experience as a Fannie Mae MBS lender, active in the TBA market as well as the original affinity agreements and NIBP, MassHousing was fast out of the gate and is generating record volumes of production. MassHousing went from originating $300 million in residential mortgage loans in calendar 2011 to taking weekly registrations averaging over $30 million per-week in the first four months of 2012! This dramatic increase demonstrates the importance of HFAs working to remain alert and nimble in changing markets. Being poised to do so has not only made MassHousing stronger but has made the dream of homeownership possible for even more families in Massachusetts.