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Protecting NIFA's Assets Under a Team Umbrella

When the most significant financial eruption in the past half century occurred, because of established practices and procedures, NIFA was able to nimbly navigate through developing financial events, making decisions and choosing courses of action armed with knowledge and feasible alternatives.

Introduction

We've all heard the saying, "When it rains, it pours!" But when the rain turns to a downpour, will you be outside, unprepared and unprotected in the face of the storm? Or did you check the weather report, grab an umbrella and are now sheltered under its protective cover? Often, the extra time spent preparing for the "what-ifs" can make a huge difference when the storm hits.

The Storm

There is no need to set the stage for what happened in the fall of 2008. While blame for this financial typhoon cannot be assigned to any one industry, institution or person, its debilitating effects hampered the businesses of organizations across the country. What we can do is tell you how it affected NIFA and the actions we took to seek shelter from this storm.

As of September 12, 2008, the senior manager and remarketing agent for NIFA's single family variable rate bonds, Lehman Brothers Inc. (Lehman) was rated investment grade by Standard and Poor's. Three days later, Lehman Brothers Holdings Inc., the parent of Lehman, and thereafter Lehman itself, sought the protection of the bankruptcy court. This had the potential to severely disrupt the operations of NIFA, particularly its single family program. But having closely monitored events over the preceding weeks, NIFA's team leaders put into action early Monday morning a strategy to protect NIFA's assets and agreements against the storm.

Together with the members of our finance team, we quickly examined the various alternatives of action we were about to embark upon. Without the efforts and advice of the entire team, NIFA would have been severely hampered in its ability to hold a protective umbrella over our assets and programs. Keeping NIFA relatively dry during the financial storm became the goal.

Holding an Umbrella

NIFA's protective umbrella actually began forming years before the storm. Establishing a practice of meeting on a regular basis (at least weekly) with its finance team, made up of both NIFA staff and outside professionals, NIFA continually reviews existing financial arrangements, takes stock of the state of the single family program and considers and analyzes the "what-ifs" of developments occurring in the housing market.

In order to better track the broader mortgage market and manage interest rate risk, NIFA adopted a dynamic rolling mortgage rate setting strategy in 2003. Mortgage loan rates are reviewed and set weekly through a conference call involving NIFA single family and finance staff, the senior investment banking manager and bond counsel. This strategy allows NIFA, at a relatively low cost, to hedge against the movement of market interest rates. As a result, NIFA is able to delay the sale of bonds until the pool of mortgage loans grows to a meaningful bond size with loans further along in the origination/closing pipeline, thereby reducing the period of negative arbitrage between bond sale and mortgage loan/MBS delivery.

The Financing/Pipeline Management Process gives NIFA the ability to respond quickly to changing market conditions, managing and reducing interest rate risk, minimizing negative arbitrage and enabling NIFA to continuously offer competitive funding for our low and moderate income customers. With these internal processes and procedures in place for almost 10 years, we were able in February 2008 to successfully maneuver through a market of previously unheard of tender activity for variable rate bonds. Through early and regular conversations with its senior manager (Lehman and thereafter, JP Morgan), trustee and tender agent and liquidity provider, NIFA was able to ensure that all of its single family variable rate bonds tendered for purchase were, in fact, successfully remarketed and that the trades settled on a timely basis.

The urgency of the situation in the fall of 2008 was immediately appreciated by NIFA and its finance team, now poised to address some of the biggest challenges ever presented to NIFA. The team moved quickly to assess the impact on NIFA and put together a plan of action. One of the first items was to bring to our team "reinforcements." We engaged an experienced swap financial advisor to begin the process of preparing, should the need arise, to replace all of the existing interest rate swaps entered into to date by NIFA. Additionally, to guard against a disruption in the trading of NIFA's single family variable rate bonds, we asked a member of the existing investment banking team to consider stepping in, if need be, to act as remarketing agent for those bonds. Documents and agreements were reviewed to ensure all contractual obligations would be satisfied in the event of any change in parties or procedures. NIFA intended to be a survivor of the storm.

The unprecedented tender activity of municipal bonds and the real possibility that millions of dollars in interest rate swap contracts hedging NIFA's variable rate bonds would need to be replaced were not the only issues faced by NIFA last fall. AIG and its creditworthiness was now a concern. With the news of a further ratings downgrade of AIG, the team was now engaged in fighting the storm on two separate fronts. Immediately, NIFA staff and advisors proceeded, in accordance with the terms of NIFA's various AIG-guaranteed investment contracts, to reduce the balances invested in those agreements to relatively minimal amounts. This was accomplished through a focused use of invested proceeds for the redemption of bonds and, where possible, a recycling of funds to finance additional mortgage loans. It was a critical step that our expert systems and rapid management response team was able to readjust NIFA's portfolio of investments in such a timely manner.

Faced with the news of the liquidation of the investment banking arm of Lehman, NIFA's Board of Directors took action to realign the single family investment banking team. J.P. Morgan Securities Inc. was appointed as the senior manager for the single family program. The goal was to insure that NIFA's bonds would continue to be actively managed, traded and remarketed in the capital markets. NIFA's local co-managers and selling group members helped to insure that local investors had access to NIFA's bonds and served to strengthen the Nebraska-based bond market.

Having begun the process of identifying a group of potential swap counterparties, on September 23rd, 2008, NIFA concluded a two-day series of market trades with highly rated counterparties to replace its interest rate swap agreements terminated by Lehman Brothers Derivative Products (LBDP). Upon the filing, on October 5, 2008, of Lehman Brothers Financial Products (LBFP) for bankruptcy protection, NIFA again called the team to action and notified LBFP of NIFA's election to terminate the interest rate swap contracts previously entered into with LBFP. Swap agreements replacing the LBFP swaps were entered into with a new counterparty. The replacement of the LBDP and LBFP swap agreements was carried out on a timely basis due to the close coordination and cooperation between NIFA staff and its finance team.

Another tool that was quickly-deployed and proved to be invaluable was NIFA's internal and external Communications Strategy. First, a series of Executive Briefings were circulated to NIFA staff explaining the financial crisis and putting the complicated subject matter into context. The quick release of these briefings to staff ensured that fears were allayed and communication was consistent concerning NIFA's financial well-being.

Once internal communications were addressed, NIFA turned its attention outward and posted the Executive Briefings and news releases on the NIFA website for the educational benefit of NIFA's constituents, customers, partners, bondholders and the general public. It was paramount to inform these parties that the disruptions in the capital markets had not affected NIFA's ability to pay principal and interest on its single family bonds. In a Question & Answer portion of the Briefing, we noted that the NIFA single family bonds continued to enjoy an "AAA" rating by S&P and that the general obligation rating of NIFA remained at "AA-". The timeliness of these news releases and Executive Briefings was a key element in ensuring that our business partners had current and factual information about NIFA. This was crucial as we sought the support of those partners in executing our realignment strategy.

Summary

An internal market review process, the retaining of expert professionals, an understandable communications policy and most importantly, the advice and support of our finance team members (both internal and external), greatly reduced the adverse financial consequences that might have befallen NIFA. This collaboration minimized the financial storm damage, assisting NIFA in obtaining successful results.

The realignment of NIFA's financial relationships and agreements was substantially complete by mid-December 2008. Our partners, who battled this financial typhoon with us, remain part of our team today. Although some restructuring has taken place, we maintain a viable team relationship, strengthened and seasoned, ready to weather future storms. The NIFA reputation, upon which we rely heavily when we seek to borrow in the financial market, was neither tarnished nor tattered by the rain and wind occurring in the fall of 2008. In the face of extraordinary market confusion, with the aid of our partners, NIFA was able to do our best work, forming a protective team umbrella to shelter us from the storm.