HFA: **Washington State Housing Finance Commission**

Entry Name: **PAMS - Purchase Agreement for MBS Warehousing**

IN A NUTSHELL - The challenge and the solution

The Washington State Housing Finance Commission (the "Commission") needed to quickly find a source of funds to implement a Mortgage-Backed Security ("MBS") warehouse for its Homeownership Bond Program. The capacity needed was an amount up to $100 million with reasonable borrowing terms.

The Commission entered into a Purchase Agreement ("Reverse Repo") with Banc of America Securities to finance the warehouse.

BACKGROUND:

In early 2010, Commission management saw an opportunity to warehouse some of its Homeownership Program MBSs both to earn positive spread and to minimize negative arbitrage. With the Commission's participation in the New Issue Bond Program, the problem of negative arbitrage was exacerbated. We had sold taxable bonds of $170 million that, when combined with the required 40% market-rate bonds would equate to a total lendable proceeds amount of $283 million during 2010.

Previously the Commission's strategy to mitigate negative arbitrage was to issue bonds frequently and in relatively small amounts. With the restriction of just three bond issues as part of NIBP, each would average $94 million, between two and three times the previously typical size. Instead of the usual 8 to 12 week origination period for the bond proceeds, we could expect to nearly double that, compounding the time negative arbitrage would accrue.

In addition, the reinvestment rate available on bond proceeds was at historic lows. While the NIBP did lower long-term interest rates compared to market, that spread, combined with the longer origination period, would result in a significant amount of negative arbitrage.

In consideration of these facts, the Commission began investigating ways that it could finance an MBS warehouse to allow us to originate more loans, get the loans pooled and MBSs purchased so that they could be quickly acquired once the bonds were issued.

We identified several liquidity raising options that other HFAs had used that we dismissed:

- ***Using Commission resources and reserves***

  The Commission did not have enough readily accessible, liquid resources to fund the warehouse in the size we expected to use, so we needed to find a source of external liquidity.

- ***Federal Home Loan Bank ("FHLB") letter of credit or other facility***

  Other HFAs have had success in negotiating favorable terms on Letters of Credit with their local FHLBs. We had recently approached our local FHLB and worked to secure funding for other purposes, but were not able to obtain reasonable terms, especially in regard to collateral requirements.

- ***Commercial Bank Letter of Credit***

  Some HFAs have used Commercial Bank Letters of Credit to finance their warehouse program. We felt that the process of working with a Commercial Bank would be difficult in the amount of time we had before we needed proceeds. We had also anecdotally heard that some HFAs negotiations with such entities had been quite tedious and up-front origination fees as well as legal fees could be high.

- ***Private investor financing***

  Greystone & Co. proposed a program where they would enter into a Reverse Repo and fund the warehouse on our behalf. This program eliminated the need for the Commission to post the amount of the haircut or any additional collateral that would be needed during the warehouse period, an attractive feature. However, Greystone retained 75% of the net earnings in the program and we dismissed this option as too expensive. Some issuers, particularly small, local ones, have used this facility.

PROGRAM SUMMARY - A new option is identified

In the course of our research, Bank of America Home Loans, our Master Servicer, introduced us to the possibility of using a Master Purchase Agreement provided by Banc of America Securities. One advantage of this strategy was that the agreement is based upon a standard International Swap and Derivatives Association ("ISDA") Master Purchase Agreement facilitating expedited documentation. We entered into negotiations with Banc of America Securities and were able to agree to reasonable terms in a short period of time:

Interest rate:	LIBOR + .75%
Haircut[1] percentage:	5%
Term:	through December 31, 2010
Maximum amount:	$100,000,000
Collateral posting:	Upon valuation changes greater than $250,000 from par (for administrative convenience)

RESULTS

We executed our first trade for three MBSs on May 6, 2010. By the time we issued our 2010 A Homeownership Programs bonds on June 29, 2010, we had achieved the following results in the 54 day period:

Average amount borrowed	$25,687,194
Average Commission investment (haircut) $'s	$758,131
Average Commission investment (haircut) %	2.95%[2]

[1] Haircut is defined by Investopedia.com as, "The percentage by which an asset's market value is reduced for the purpose of calculating capital requirement, margin and collateral levels."

Interest paid on borrowed funds	$53,785
Net earnings	**$185,519**
Rate of return on investment (annualized basis)	**165%**
Estimated negative arbitrage saved	**$122,596**

AWARD CRITERIA

Innovative:

- First HFA to enter into a Purchase Agreement to finance an MBS warehouse
- Only HFA to have used such a facility to date

Replicable:

- Several Purchase Agreement providers in the marketplace
- Low barriers of entry–any HFA should be able to enter in to such a facility

Responsive to a management challenge or opportunity

- Allowed quick action by the Commission
- Standardized ISDA Purchase Agreement
- Negotiations focused only on critical terms: amount, duration, haircut, interest rate

Achieve measurable improvements in agency operations:

- Earned $185 thousand in a six week period
- Estimated $123 thousand in negative arbitrage was saved
- Net positive impact of $308 thousand

Demonstrate effective use of resources:

- Low initial costs, less than $10,000 in legal fees
- No up-front issuance fees or charges, only agreed upon interest
- Haircut was less than 5% haircut due to premium on the securities
- Annualized rate of return of 165% on the amount of Commission funds invested

Achieve strategic objectives:

- Savings and earnings on the program allow the Commission to better serve the low- and moderate-income homeowners of Washington State.

[2] Average haircut percentage was less than 5% because MBSs were valued at a premium, reducing the needed Commission contribution.