U.S. Municipal Bond Market

Single Family Housing, Durability Will Help Endure the New COVID-19 Normal

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Deteriorating Economic and Credit Backdrop

Extreme measures many state and city governments have taken to slow the spread of the coronavirus (COVID-19) are taking a tremendous financial toll. Overall, the U.S. economy has slowed to a crawl. Unemployment is rising at a record pace. Credit conditions are stressful for almost all sectors of the municipal bond market. Monetary and fiscal policy has tried to dampen the impact. Nonetheless, rating agencies are hitting municipal credit across almost all sectors with warnings in the form of lower sector and issuer outlooks. Rating downgrades are also beginning to emerge.

Near-Term Housing Sector Specific Pressure

The State Housing Finance Agency (HFA) single family bond sector is an area that will be less impacted from a credit and thus rating perspective compared to other municipal sectors. In the near-term, meaning within the next year or so, there is potential stress state HFA single family programs may need to endure as a result of mortgage forbearance or deferral policies championed in the 2020 CARES Act. Recent Mortgage Bankers Association data shows the amount of loans in forbearance has continued to increase.[1] Such policies would more likely impact HFA single family whole-loans, and not mortgage-backed securities (MBS) programs because MBS loans are guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac. About 70% of mortgages in (Moody's rated) HFA single family loan portfolios are whole loans.[2] The total amount of whole loans as a percentage of all outstanding single family loans, market-wide, is lower.

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HFA Single Family Advantages to Endure Near-Term Pressure

HFA single family programs are directed toward targeted income and first time homebuyers; these are groups recent federal relief often focused. This aspect could be a positive in the near- and short-term. In addition, whole-loan programs typically possess government or private insurance. Probably most notable is that state HFAs have generally built very strong financial positions in recent years, which should also help offset the near-term financial stresses such as mortgage forbearance policies. In the table below, we included the Moody's medians of selected metrics to illustrate this development. Accordingly, we would like to highlight:

- The Moody's median asset-to-debt ratio has steadily risen to 1.20x (FY18) from 1.13x (FY14).
- The Moody's median margin (a measure of program productivity or profitability) rose to 21.6% (FY18) from 15.8% (FY14).
- A stress analysis Moody's performed in March (then later in April) 2020 shows HFA cash balances have a "sufficient buffer to bridge a temporary cashflow disruption."[3] The combined sector asset-to-debt ratio only fell 2% in its worst-case scenario when Moody's assumed two-thirds of whole-loan portfolios were in forbearance for 12 months.

Please see disclosure starting on page 4.

Select Single Family Program Metrics and Moody's Medians

Name of HFA (Single Family Program)	SF Program Ratings/Outlook	Margins		Asset-to-Debt Ratio		Bonds Outstanding ($)		Cash and Investments as a % of Bonds Out	
		2017	2018	2017	2018	2017	2018	2017	2018
Median (of all Moody's rated Single Family Programs)		**17.7%**	**21.6%**	**1.20**	**1.20**	**$234,067**	**$208,480**	**19.5%**	**19.6%**
CalHFA - Home Mortgage Revenue Bond Program	A1 / Positive	39.1%	25.2%	1.23	1.40	1,399,130	842,368	35.3%	19.0%
CalHFA- Residential Mort Rev Bonds [MBS] (NIBP)	Aaa / Stable	2.6%	4.0%	1.03	1.06	69,094	53,285	5.6%	5.7%
CalHFA - Residential Mortgage Revenue Bonds (2009)	Aa2 / Stable	16.8%	31.0%	1.37	1.41	147,000	120,805	12.4%	12.7%
Colorado HFA - Single Family Program	Aaa / Aa2 / A1 / Stable	7.8%	10.8%	1.13	1.42	598,379	592,296	55.3%	93.2%
Colorado HFA- Single Family Program Bonds (NIBP)	Aaa / Stable	6.1%	18.9%	1.03	1.04	172,177	66,077	102.7%	103.3%
Florida HFC - Homeowner Mort Rev Bonds [MBS]	Aaa / Stable	-	-	1.24	1.15	469,718	686,257	114.8%	108.1%
Florida HFC - Homeowner Mort Rev Bds, Spec Pr (NIBP)	Aaa / Stable	24.7%	27.3%	1.14	1.14	534,791	426,373	115.0%	114.5%
MassHousing - Single Family Housing Revenue	Aa1 / Stable	17.1%	16.8%	1.17	1.15	922,559	985,571	78.3%	83.9%
Minnesota HFA - Residential Housing Fin Bonds	Aa1 / Stable	26.1%	22.6%	1.15	1.14	1,058,905	1,185,095	16.9%	13.2%
Minnesota HFA - Homeownership Finance Bds (NIBP)	Aaa / Stable	21.3%	22.1%	1.02	1.02	1,169,796	1,415,873	3.1%	3.0%
New Jersey H&MFA - Housing Revenue Bond Resolution	Aa3 / Positive	20.8%	44.3%	1.28	1.34	431,005	483,830	18.0%	37.9%
New Jersey H&MFA - Single Fam Home Mort Bds (NIBP)	Aa2 / Stable	13.2%	32.7%	1.02	1.06	326,845	283,146	8.2%	9.8%
Pennsylvania HFA - Single Family Mortgage Rev Bonds	Aa2 / Stable	-1.9%	9.2%	1.20	1.20	2,784,430	2,933,090	19.9%	23.0%
Texas DHCA - Residential Mort Rev Bond Prog [MBS]	Aaa / Stable	-14.1%	21.6%	1.72	1.68	148,390	131,270	126.5%	115.7%
Texas DHCA - Single Family Mortgage Rev [MBS]	Aaa / Stable	-3.7%	41.4%	1.30	1.19	374,800	340,008	125.6%	105.2%
Virginia HDA - Commonwealth Mortgage Bonds	Aaa / Stable	56.1%	63.9%	1.89	2.12	1,634,074	1,274,154	37.1%	36.9%
Virginia HDA - Homeownership Mort Bonds (NIBP)	Aa1 / Stable	36.5%	40.0%	1.31	1.42	233,424	189,744	6.4%	4.9%

Source: Moody's and HilltopSecurities.

Short- to Medium-Term Pressures to HFA Single Family Programs

Another important question is how will single family programs be able to weather the storm of the potential financial strain that some are anticipating could be more severe than the Great Recession of around 10 years ago? More specifically in the short- to medium-term, or in the next two to five years, what are the notable potential stresses that could impact single family HFA programs as a result of deteriorating economic conditions?

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We have seen 30+ million individuals lose their jobs in just weeks. Economic growth has been and could remain challenged. The national and regional housing markets could become disrupted as well, although a recent Wall Street Journal article does note that prices have not dipped as of yet.[4] That being said, it is quite possible that we could see delinquencies, and foreclosures increase in the short- to medium-term. The question is: how are state HFAs credits prepared to handle this potential obstruction?

We think they are positioned very well. The strong credit metrics we mentioned above are surely positives. The strong financial positions the state HFAs possess going into this health and financial crisis should be an advantage. In addition, we saw in the wake of the Great Recession state HFAs dip into their general resources to support their single family program ratings. This offers flexibility as well. We use the New Jersey Housing and Mortgage Finance Agency (NJHMFA) Single Family Housing Revenue Bond (SFHRB) resolution as an example.

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Case Study: Breadth of Credit Profile, Management Tactics, Use of Resources

In the wake of the 2008 World Financial Crisis and the U.S. Great Recession NJHMFA SFHRB mortgage delinquencies and foreclosures rose sharply. Foreclosures were 16.3% as of May 2014. At the time, these numbers were worse than New Jersey and national FHA fixed rate MBA results. The NJHMFA SFHRB results were also worse than Florida, the state with the highest percentage of loans in foreclosure.[5]

During this time the NJHMFA SFHRB actual program asset-to-debt ratio (PADR) fell to 1.15x from 1.17x. When Moody's ran its most aggressive stress scenario the PADR fell to just over 1.00x. Moody's downgraded the NJHMFA SFHRB rating to Aa3 from Aa2 in July 2014, and the outlook remained "Negative." However, the next year the PADR rose to 1.19x, supported by a September 2014 cash infusion of $25 million management added from the Agency general fund. In addition, foreclosures began to decline. The rating outlook was revised back to "Stable" in October 2017 as the PADR reached about 1.22x and it is 1.34x as of FY18. In July 2018, the outlook was upped to "Positive."

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Durability of Credit, Example Only Downgraded to Aa3

We believe this example illustrates durability in that even the state HFA single family program experiencing among the worst foreclosure rates, was still only downgraded to Aa3. Active and experienced management and issuer resources contributed to the tactic, adding some cushion and allowing the resolution to strengthen and potentially recover its Aa2 underlying rating.

Select Single Family HFA Whole-Loan Delinquencies and Foreclosures (% of total loans)

Name of HFA (Single Family Program)	SF Program Ratings/ Outlook	As of 12/31/18				As of 12/31/17			
		60+	90+	Foreclosure	Total	60+	90+	Foreclosure	Total
CalHFA - Home Mortgage Revenue Bond Program	A1 / Positive	1.24%	0.49%	1.39%	**3.13%**	1.48%	0.52%	1.34%	**3.34%**
CalHFA - Residential Mortgage Revenue Bonds (2009)	Aa2 / Stable	1.02%	0.47%	1.02%	**2.50%**	1.35%	0.57%	1.28%	**3.20%**
Colorado HFA - Single Family Program	Aaa / Aa2 / A1 / Stable	2.48%	0.91%	0.57%	**3.96%**	1.76%	2.10%	1.01%	**4.87%**
MassHousing - Single Family Housing Revenue	Aa1 / Stable	2.03%	1.32%	1.17%	**4.52%**	1.70%	1.33%	1.50%	**4.52%**
Minnesota HFA - Residential Housing Fin Bonds	Aa1 / Stable	1.74%	1.69%	1.32%	**4.76%**	1.86%	2.22%	1.02%	**5.09%**
New Jersey H&MFA - Housing Rev Bond Resolution	Aa3 / Positive	1.89%	4.75%	2.93%	**9.56%**	2.31%	3.84%	6.44%	**12.59%**
Pennsylvania HFA - Single Family Mortgage Rev Bds	Aa2 / Stable	3.17%	3.02%	1.75%	**7.95%**	3.16%	3.59%	2.48%	**9.22%**
Virginia HDA - Commonwealth Mortgage Bonds	Aaa / Stable	2.08%	3.00%	0.68%	**5.75%**	2.41%	2.62%	0.84%	**5.87%**
Virginia HDA - Homeownership Mortgage Bonds	Aa1 / Stable	3.06%	5.12%	0.85%	**9.04%**	3.50%	4.92%	1.42%	**9.83%**

Source: Moody's and HilltopSecurities.

HFA Housing Market, Credit and Program Outlook

Total housing market issuance rose steadily from $15 billion in 2015 to $25 billion in 2019, according to Thomson Reuters data published by The Bond Buyer. During this period, and especially in the last few years we saw state HFAs increasingly incorporate the use of bonds to finance their single family mortgage programs as these numbers suggest.

We saw about $100 billion of total municipal bond market issuance for the first four months of 2019, with $6.9 billion in housing specific bond sales. In comparison, some are surprised to hear that issuance year-to-date has actually been higher in the entire municipal market so far this year. In 2020, we have seen more total issuance at $116 billion through the first four months (despite the frozen market conditions in March), but we have seen less housing issuance than we saw last year through four months at $5.8 billion. In the coming months we expect bond housing bond financings could continue, but perhaps not quite at the pace that we saw in 2018 and 2019.

But, HFA mortgage demand has continued to be strong. In fact, our numbers are showing that March was the month HilltopSecurites' to-be-announced (TBA) housing clients locked-in the highest monthly volume ever. April was the fourth-highest month. This is also telling considering the economic and labor market deterioration we have witnessed in recent weeks.

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[1] MBA: Share of Mortgage Loans in Forbearance Increases to 7.54%; Mortgage Bankers Association; May 4, 2020.
[2] Coronavirus leads to potential mortgage payment deferrals, but HFAs can weather the negative cash flow impact; Moody's Investor Service; March 30, 2020; page 1.
[3] Ibid, page 3.
[4] Friedman, Nicole; Why Home Prices Are Rising During the Pandemic; The Wall Street Journal; May 5, 2020.
[5] Moody's Downgrades to Aa3 $757m of New Jersey Housing and Mortgage Finance Agency Housing Revenue Bonds; Moody's Investor Service; July 14, 2014.

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- March 16 Market Activity: Hilltop Securities Lowers Credit Outlooks Due to Unprecedented Steps Taken to Contain COVID-19, March 16, 2020.
- Small Increase for HUD Public Housing Capital Fund, Dec. 19, 2019.
- CRA Reform is on the Table, Regulatory Update, Dec. 13, 2019.
- Social Impact Investing Through CDFIs, Sept. 6, 2019.
- Municipal Bond Sector Outlooks, Aug. 26, 2019.

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