

U.S. Municipal Bond Market

Housing Fundamentals Remain Solid and Our Housing (HFA) Sector Outlook Remains “Stable” to Begin 2021

- The national housing market was solid in 2020 and positive momentum in sales and property price appreciation is expected to continue in 2021.
- We are keeping a “Stable” sector outlook on the Housing sector to begin 2021.
- State Housing Finance Agency (HFA) single family program credit quality will remain strong despite COVID-19 related setbacks like higher rates of forbearance.
- The multifamily sector is on a path toward recovery and federal fiscal relief could boost loan performance.

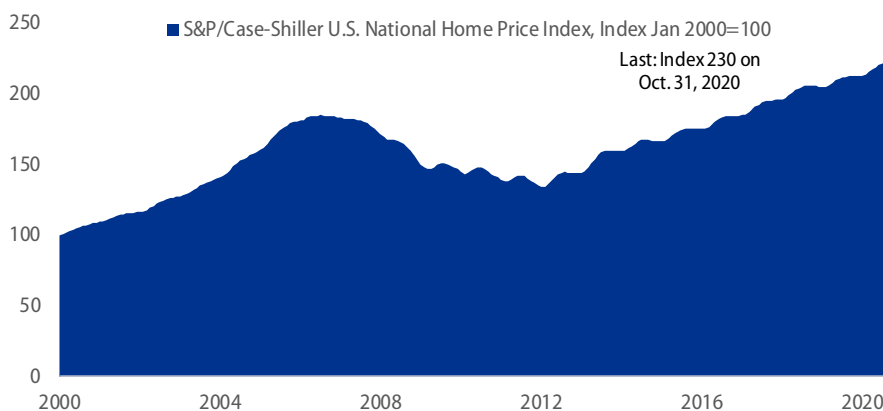
Tom Kozlik
Head of Municipal Strategy & Credit
214.859.9439
tom.kozlik@hilltopsecurities.com

Our Sector Outlooks

The last time we updated our sector outlooks was May 2020. The economic status and outlook around the world and in the U.S. were much different then. There was still a very high level of uncertainty about the path of COVID-19. We published this recent list of outlooks before the reopening rollback that occurred at the end of June. Uncertainty still exists, but there have been changes and steps taken that have shown us there is likely an end to COVID-19. The national labor market remains strained, but the sectors hardest hit are largely isolated. The unemployment rate has improved, although it is still high. The political backdrop has shifted with the Democrats now in the White House and in control of both chambers of Congress. Most important is the fact that the coronavirus is still the leading theme likely to impact events in 2021. To that end, we have written recently that COVID-19 is still spreading uncontrollably, despite the vaccine rollout.

State HFA single family program credit quality will remain strong despite COVID-19 related setbacks like higher rates of forbearance.

Home Prices Continue to Rise Even Through the Pandemic



Source: S&P/Case-Shiller U.S. National Home Price Index, FRED, HilltopSecurities.

U.S. Housing Market Backdrop

One of the sectors that has experienced only a minimal amount of negative influence

from the COVID-19 shutdowns is the housing sector. In fact, it can be said nationally and among many regions of the nation that housing has been solid. Home valuations have steadily risen.

The S&P/Case-Shiller National Home Price Index has risen to 230 (as of October 2020) from up from 215 (March 2020). Homebuyers took advantage of low interest rates in 2020 and are poised to do the same in 2021. Demand is not likely to drop anytime soon. As a result, many real estate market experts expect sales to continue rising and property prices to appreciate in 2021.

Housing (HFA) Sector Outlook Remains “Stable”

Our housing market sector outlook will remain “Stable” to start 2021. Please remember the details of this sector outlook refer to single- and multifamily housing mortgage revenue bonds sold by state housing finance agencies (HFAs). There are several other housing subsectors (student, military, public housing cap funds) but those generally include a different type and sometimes different levels of risk and should be considered individually.

We would have kept our housing sector outlook at “Stable” to begin 2021 even if Congress had not approved the fifth phase of COVID-19 relief at the end of 2020 and if the Democrats would have lost either of the two Georgia runoff elections.

The main reason we have kept a “Stable” outlook on the Housing sector (again with a concentration on state HFAs) is the very strong credit quality that still exists generally in the sector. State HFA credit quality remained resilient, even in the depths of the last recession, which significantly pressured housing markets across the country. We expect that state HFA credit quality will remain solid during and in the wake of the COVID-19 crisis.

Some Single-Family Housing Factors to Consider

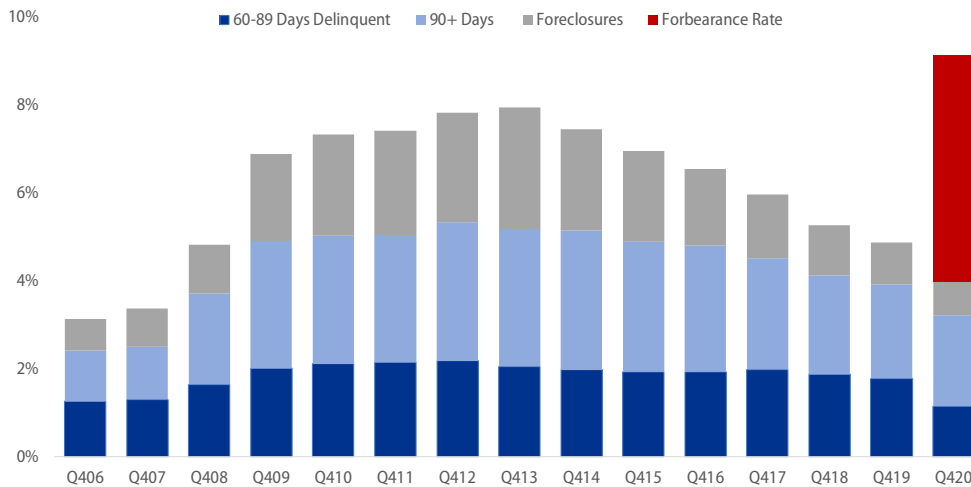
Loan forbearance is a common concern in the current environment. A closer look at the amount of loan forbearance activity in the second quarter of 2020 among HFA single family whole loan borrowers helps us get a better understanding of the broader picture. As of the second quarter of 2020, 9.13% of HFAs’ Moody’s-rated whole loans are considered in delinquency, foreclosure or forbearance (as of June 30, 2020 according to Moody’s). While the forbearance category rose substantially, the rating agency also notes, “Partially offsetting the increase in forbearance is the fact that many HFAs report that a portion of their borrowers on forbearance plans are still paying their loans in full.”

Homebuyers took advantage of low interest rates in 2020 and are poised to do the same in 2021. Demand is not likely to drop anytime soon.

We would have kept our housing sector outlook at “Stable” to begin 2021 even if Congress had not approved the fifth phase of COVID-19 relief at the end of 2020 and if the Democrats would have lost either of the two Georgia runoff elections.

While the forbearance category rose substantially, the rating agency also notes, “Partially offsetting the increase in forbearance is the fact that many HFAs report that a portion of their borrowers on forbearance plans are still paying their loans in full.”

Loan Forbearances Rose Substantially Among Moody’s Rated Whole Loan Housing Programs



Source: Moody’s and HilltopSecurities.

Near-term HFA revenue deterioration could occur but it is not likely to be significant enough to materially impact credit quality.

Near-term HFA revenue deterioration could occur but it is not likely to be significant enough to materially impact credit quality. Moody’s Investor Service reported in their Dec. 9 housing sector outlook that, “Our [Moody’s] stress tests of HFA programs show that they have enough of a financial cushion to absorb the reduced revenue from forbearance and lower investment income. HFAs’ cash balances will provide a sufficient buffer to withstand the cash flow disruption caused by the pandemic. Even in a very stressful scenario – which assumes mortgage forbearance for 50% of the HFA single-family programs for one year and a drop in sector-wide investment income reflecting low interest rates – HFAs’ cash balance on a sector-wide basis would remain very strong.”

Secondary market financed loans, like forward-settling To Be Announced (TBA) loans are likely to continue to be well-utilized mortgage products for state HFAs in the near term.

In addition, secondary market financed loans, like forward-settling To Be Announced (TBA) loans are likely to continue to be well-utilized mortgage products for state HFAs in the near term. For almost two years between 2018 and into the beginning of 2020, tax-exempt bond financed mortgage rates were competitive. After COVID-19 began, and interest rates fell, TBA financed rates became viable again. It is important to note that income from the TBA financing strategy could help offset some of the near-term revenue lost from loan forbearances.

On the Multifamily Side

During 2021, the multifamily sector will continue its path to recovery. The multifamily sector (generally, not just municipal) weathered 2020 better than other property related sectors according to CBRE. “CBRE forecasts a return to pre-COVID vacancy levels and a 6% increase in net effective rents next year, with a full market recovery occurring in early 2022. . . Demand levels in 2021 likely will fall short of pre-COVID peaks in 2018 and 2019 but should rise significantly from 2020,” according to the real estate company’s sector outlook.

During 2021, the multifamily sector will continue its path to recovery. The multifamily sector (generally, not just municipal) weathered 2020 better than other property related sectors according to CBRE.

The HFA multifamily sector is an area where additional fiscal support is likely to help loan performance. Expanded unemployment benefits renewed at the end of 2020

and additional relief and stimulus that may materialize could add to the upside for some multifamily bonds. The fifth phase of relief approved by Congress at the end of 2020 was an important step in support. An even larger sixth phase would be an even bigger boost to HFA multifamily credit quality.

Recent HilltopSecurities Municipal Commentary

- [State and Local Government Job Losses in Three of Last Four Months Illustrate Continued Budget Pressures](#), January 11, 2021
- [Democrats' Legislative Agenda Could Begin With \\$2K Payments, Relief, & Infrastructure Totaling \\$3 Trillion](#), January 8, 2021
- [COVID-19 Spread Remains Out of Control to Begin 2021](#), January 6, 2021
- [Georgia Run-Offs Begin New Year, Important to Watch for Credit Quality](#), January 4, 2021
- [Fifth Phase of Fiscal COVID-19 Relief is No State and Local Government Windfall](#), December 23, 2020

Readers may view all of the HilltopSecurities Municipal Commentary [here](#).

The paper/commentary was prepared by Hilltop Securities (HTS). It is intended for informational purposes only and does not constitute legal or investment advice, nor is it an offer or a solicitation of an offer to buy or sell any investment or other specific product. Information provided in this paper was obtained from sources that are believed to be reliable; however, it is not guaranteed to be correct, complete, or current, and is not intended to imply or establish standards of care applicable to any attorney or advisor in any particular circumstances. The statements within constitute the views of HTS as of the date of the document and may differ from the views of other divisions/departments of affiliate Hilltop Securities Inc. In addition, the views are subject to change without notice. This paper represents historical information only and is not an indication of future performance. This material has not been prepared in accordance with the guidelines or requirements to promote investment research, it is not a research report and is not intended as such. Sources available upon request.

Hilltop Securities Inc. is a registered broker-dealer, registered investment adviser and municipal advisor firm that does not provide tax or legal advice. HTS are wholly owned subsidiaries of Hilltop Holdings, Inc. (NYSE: HTH) located at 1201 Elm Street, Suite 3500, Dallas, Texas 75270, (214) 859-1800, 833-4HILLTOP