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U.S. State Housing Finance Agency Delinquency Rates Continued To Improve In The Second Quarter Of 2014

Primary Credit Analyst:
Lawrence R Witte, CFA, San Francisco (1) 415-371-5037; larry.witte@standardandpoors.com

Secondary Contact:
Mikiyon W Alexander, New York (1) 212-438-2083; mikiyon.alexander@standardandpoors.com

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As of June 30, 2014, U.S. housing finance agency (HFA) single-family loan delinquencies had fallen to their lowest level since the third quarter of 2009, signaling a downward trend that that may indicate HFA delinquencies will stay in a lower range. State delinquency rates continue to be lower than those for HFAs, but the gap continued to narrow in the second quarter of 2014. This was the second consecutive quarter in which HFA loan delinquency rates improved, and the difference between state loans and HFA loans was its smallest since the third quarter of 2012. The gap difference between HFA and state loans is an important consideration in that it addresses the influence of the state real estate market on HFA loans. By comparing HFA loans to state loans, one can better explain the performance of HFA loans. HFA loan delinquencies declined to 6.29% of the total outstanding loan balance (compared with 6.64% in the first quarter), and state prime loan delinquencies rose slightly, to 4.64% from 4.58% in the second quarter. A recovering housing market is probably the largest reason for the improved performance, but then again, the state rate nudged up a bit during the same time.

Despite the improvement in HFA loan performance, the same factors that have contributed to higher delinquencies for HFA loans since 2008 persist. Most HFAs are unable to add new loans to their balance sheets because of an inability to fund them in a mortgage revenue bond program. State pools, on the other hand, include newer loans with better performance. This means HFA pools are at a disadvantage compared with the respective pool of state loans with similar mortgage insurance characteristics. HFA loan performance has been generally stable during the past 17 quarters, with the average delinquency rate ranging between 6% and 8%. We believe that if HFAs were able to add new whole loans to their bond programs, their delinquency rates would be similar to or even below those of similar loan pools in the states. State subprime delinquencies, at 11.53% in second-quarter 2014, were nearly twice as high as delinquencies for HFA loans, which have subprime characteristics.

Overview

- The 1.65 percentage point gap between HFA and state loan pools' delinquencies in second-quarter 2014 is the smallest we've observed since the third quarter of 2012 and nearly a full percentage point less than the gap in the fourth quarter of 2013.
- The older average loan age in HFA portfolios remains the key to the delinquency rate differential, in our view.
- The 6.29% delinquency rate for HFA loans in the second quarter is at the low end of the roughly 6% to 8% range of the past five years.

Foreclosures remained low for both HFA and prime state portfolios, but, as with delinquencies, they were much more prevalent for subprime state portfolios. The foreclosure rate for HFA portfolios was 2.3% in the second quarter of 2014, compared with 1.7% for state prime loans and 4.5% for state subprime loans.

With this recent improvement, HFA loans continued to perform well within our stress test assumptions for the ratings, and we expect that loan delinquencies will remain within a range the agencies can manage. Furthermore, HFA loans continued to perform much better than subprime state loans even though the former share some characteristics with subprime loans, such as low borrower credit scores and high loan-to-value (LTV) ratios. Standard & Poor's Ratings Services' U.S. public finance (USPF) criteria assumes foreclosure rates that are comparable to our U.S. residential mortgage backed securities (U.S. RMBS) criteria, but market value decline assumptions in the USPF criteria are significantly lower. The result is a loss severity for USPF lower than that in U.S. RMBS. However, given the diverse vintage and seasoning of loans within HFA bond programs, the portfolios with varying amortization periods, varying pledged credit enhancements from issuers that we rate, and the mission-driven activities of the issuers, assumptions in USPF are consistent with those in U.S. RMBS.

Comparing The Portfolios

Our quarterly survey of HFA loans in single-family bond programs revealed the following key findings:

- The delinquency rate of loans in HFA bond programs was 6.29% in the second of quarter 2014, a significant improvement from 7.06% in the same period a year earlier and down considerably from 6.64% in the first quarter.
- The delinquency rate of comparable state prime loans was 4.64%, down from 5.26% in the previous-year period and lower than the 5.54% in the first quarter.
- Despite their subprime characteristics, such as high LTV ratios, HFA loan performance is more comparable to that of prime loans. The state subprime delinquency rate was 11.53% in the second quarter of 2014, and the state subprime foreclosure rate was 4.46%.
- Twenty-seven HFA bond programs had higher delinquencies in the second quarter of 2014 than did their respective prime state loans while six programs had lower delinquencies. Among HFA programs with higher delinquencies, six had higher rates than the respective state subprime portfolios.
- While state prime and subprime pools have reduced their foreclosure and delinquency rates in the past four years as HFA programs have maintained a generally steady rate, HFA rates are now at their lowest level in nearly five years.

How We Analyze The Programs

One of HFA portfolios' key strengths is that they generally have a higher proportion of Federal Housing Administration (FHA) loans than do state portfolios, affording them stronger security should a default occur. For loans with FHA insurance under our criteria, we assume a 100% mortgage insurance claim recovery on an 'AA' rated bond program and an 85% recovery on an 'AAA' indenture (given that the source of the payment is the U.S. federal government, which we rate 'AA+'). The major private mortgage insurance companies that back the loans in state pools don't provide the same level of security in accordance with our criteria. In fact, we rate three of the major private mortgage insurance companies as speculative grade ('BB+' or lower), which prevents us from assuming higher recoveries in the state pools. We rate the other three private mortgage companies 'A-' and 'BBB+', which qualifies them to receive no more than 65% credit for recovery for each claim in an 'AA' rated bond program. (For more information, see "Standard & Poor's Revises Methodology And Assumptions For Primary Mortgage Insurance In U.S. RMBS," published Feb. 6, 2009, on RatingsDirect.)

Our analytical process for examining delinquencies is comparable to that of the Mortgage Bankers Assn., which provides the data for the state loans. The MBA reports loans with private mortgage insurance as either prime or subprime. As the MBA does, we remove bank-owned real estate assets (also known as real estate-owned) from the delinquency figures. However, our analysis examines the total dollar amount of these loans instead of the number of loans because we base our reserve assumptions on the dollar amount of assets. Our method gives greater weight to larger loans because higher delinquency rates could result if the larger loans perform worse than smaller loans, the latter of which HFAs issued before the real estate market peaked and crashed.

HFA loans are typically for borrowers with not-as-strong credit, so if an HFA pool has a higher proportion of HFA loans, which is often the case, the HFAs will always have a worse-performing pool than the state market. Thus, we adjust the percentages of HFA loans to match the insurance of state loans to make a sound comparison. Although we make these adjustments, we believe that a few factors might cause selection bias that inflates the HFA loan delinquency rate compared with that of the states:

- Since early 2010, HFAs have originated most of their new loans under the New Issue Bond Program, under which the U.S. Treasury purchased bonds securitized by Fannie Mae and Freddie Mac, and most of these indentures are too small to include in this study. As a result, the loans in the bond programs in the sample tend to be older. Newer loans have briefer, and thus often better, repayment histories.
- HFAs' loss-mitigation efforts can extend the time that a loan is delinquent instead of in foreclosure.
- HFA loans have high LTV ratios.

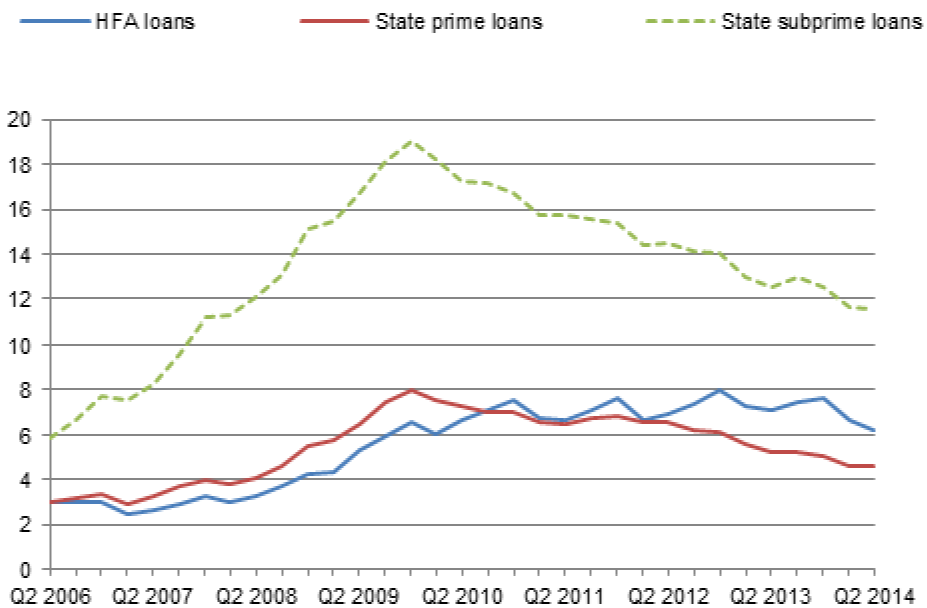
The delinquency rate is just one factor we track when rating HFA pools. We also look at the HFA bonds' debt profiles, counterparties, and mortgage insurers, which have been the major factors in recent rating actions.

Given that the delinquency rate is at a level we consider manageable, foreclosures remain low, and selection bias is probably contributing to the higher delinquency statistics for HFA programs, we do not believe there is significant risk for weaker HFA loan performance in the next two years.

HFA Loans Continued To Perform More Like State Prime Than Subprime Loans

HFA loans have had higher delinquencies than comparable state prime loans for 15 straight quarters (see chart). We believe the gap will persist but will fluctuate instead of continuing to grow.

HFA Loan Versus State Loan Delinquency Rates



On the other hand, state subprime loans had a delinquency rate of 11.53% in the second quarter and a foreclosure rate of 4.46%, both of which were well above the respective HFA rates. Fifteen states had subprime delinquency rates of more than 10%, and four had rates of more than 20%. Meanwhile, just three HFA portfolios out of 33 had a delinquency rate of more than 10%, and one of more than 20%. Six HFA bond programs -- Kentucky Housing Corp.; Tennessee Housing Development Agency; Utah Housing Corp.'s 2000, 2007, and 2009 indentures; and Wyoming Community Development Authority's 1994 indenture -- had higher delinquency rates than the comparable portfolios of state subprime loans.

Delinquency rates for HFA loans in bond programs we rate remain high by historical measures but have been stable for the past five years. In 2006, when Standard & Poor's began monitoring loan performance for these 33 whole-loan bond programs, the delinquency rate was 3.01%. The rate has exceeded 6% since the fourth quarter of 2009 but has never surpassed 8%. However, we also believe that the steady, rather than rising, delinquency rate is a positive sign for HFA portfolios and our ratings on the bonds that they support.

On the other hand, if an HFA originates a loan in a form that does not go into one of these whole-loan bond programs, as has been occurring lately, the stronger performance of that loan helps the state delinquency rate because of how it's classified, but it does not improve that of the loans in the HFA indentures. When an HFA finances a loan that becomes active but is not a whole loan, it is included in the state figures because it is financed through an MBS. The loan's performance is recorded in state totals, and because MBS are a different asset type than whole loans, they are not included in this survey of whole loan indentures. Furthermore, if an HFA employs a loan origination platform under which it sells the loan or packages the loan into an MBS that it sells, those loans also become part of the state pool but not part of the whole-loan indentures that this survey covers. Thus, a loan originated in recent years may not be part of a whole-loan indenture, but it will contribute to state loan statistics, which have been improving in recent quarters. The benefits that HFA loans bring to state delinquency averages vary by state but generally are very small. Still, they present further challenges when comparing HFA loans with state loans.

High Delinquency Rates For Individual HFA Pools Are Still Infrequent

Eight HFA bond programs had delinquency rates exceeding 10% in the fourth quarter of 2013 (see table 1). Now, only three do. The New Jersey Housing & Mortgage Finance Agency had the highest delinquency rate for the 10th consecutive quarter, at 22.38%, lower than in the previous three quarters but exceeding the 16.63% rate for in the second quarter of 2013. The Connecticut Housing Finance Authority (10.15%) and the Kentucky Housing Corp. (10.14%) had the only other delinquency rates above 10%. Ten HFA bond programs recorded delinquency rates of less than 4% in the second quarter, an increase from the same quarter in 2013, when eight were below this benchmark. In addition, three other HFAs recorded delinquency rates of about 4%: the California Department of Veterans Affairs, the Massachusetts Housing Finance Agency, and the Wyoming Community Development Authority (1978 indenture). The Alaska Housing Finance Corp. had four indentures below 4%; the Wisconsin Housing & Economic Development Authority had two, and the Montana Board of Housing, South Dakota Housing Development Authority, and the West Virginia Housing Development Fund each had one. California Housing Finance Agency's delinquency rate in the second quarter of 2014 remained below 8%, at 7.55%. It had the highest delinquency rate in the first quarter of 2010, at 13.98%, but now ranks 10th.

Table 1

HFA And Respective State Delinquency Rates

	HFA delinquency rate	State delinquency rate	HFA delinquency higher or lower than state
New Jersey Housing and Mortgage Finance Agency--single-family housing revenue bonds	22.38	12.73	Higher
Connecticut Housing Finance Authority--housing mortgage finance program bonds	10.15	9.07	Higher
Kentucky Housing Corp.--housing revenue bonds	10.14	7.06	Higher
Illinois Housing Development Authority--homeowner mortgage revenue bonds	9.56	4.61	Higher
Tennessee Housing Development Agency--homeownership program bonds	9.18	6.97	Higher
Georgia Housing and Finance Authority--single-family mortgage bonds	8.37	8.69	Lower
Maine State Housing Authority--mortgage purchase program	8.04	7.60	Higher
Colorado Housing and Finance Authority--single-family mortgage bonds	7.91	3.67	Higher
Michigan State Housing Development Authority--single-family mortgage revenue bonds	7.87	5.20	Higher

Table 1

HFA And Respective State Delinquency Rates (cont.)			
Pennsylvania Housing Finance Agency--single-family mortgage revenue bonds	7.67	6.98	Higher
California Housing Finance Agency--home mortgage revenue bonds	7.55	2.70	Higher
Utah Housing Corp.--single-family mortgage bonds 2000 series	7.41	5.44	Higher
Wyoming Community Development Authority--housing revenue bonds (1994 indenture)	6.91	2.74	Higher
Minnesota Housing Finance Agency--residential housing finance bonds	6.39	2.79	Higher
North Carolina Housing Finance Agency--home ownership revenue bonds -1998 resolution	6.35	5.19	Higher
Rhode Island Housing and Mortgage Finance Corp.--homeownership opportunity bonds	6.05	5.20	Higher
Utah Housing Corp.--single-family mortgage bonds 2009 series	5.82	7.19	Lower
Utah Housing Corp.--single-family mortgage bonds 2007 series	5.48	5.45	Higher
Montana Board of Housing--single-family program bonds (1977 indenture)	5.31	3.19	Higher
Virginia Housing Development Authority--commonwealth mortgage bonds	5.30	3.87	Higher
Vermont Housing Finance Agency--single-family housing bonds	5.18	3.67	Higher
California Department of Veterans Affairs	4.05	2.18	Higher
Wyoming Community Development Authority--single-family mortgage bonds (1978 indenture)	4.01	2.86	Higher
Massachusetts Housing Finance Agency--single-family housing revenue bonds	4.00	3.78	Higher
West Virginia Housing Development Fund--housing finance bonds	3.95	3.99	Lower
South Dakota Housing Development Authority--homeownership mortgage bonds	3.83	2.66	Higher
Wisconsin Housing & Economic Development Authority--1988 homeownership revenue bonds	3.58	2.56	Higher
Wisconsin Housing & Economic Development Authority--1987 homeownership revenue bonds	3.53	2.56	Higher
Alaska Housing Finance Corp.--general mortgage revenue bonds	2.61	1.81	Higher
Montana Board of Housing--single-family mortgage bonds (1979 indenture)	2.56	3.66	Lower
Alaska Housing Finance Corp.--home mortgage revenue bonds fixed rate	2.46	2.24	Higher
Alaska Housing Finance Corp.--mortgage revenue bonds	2.24	2.38	Lower
Alaska Housing Finance Corp.--veterans mortgage program bonds	1.57	2.42	Lower
Average	6.29	4.64	
Particulars	24		
Number of indentures with delinquencies that are "higher" than state's delinquency	27		
Number of Indentures with delinquencies that are "lower" than state's delinquency	6		

We Expect Seasonal Deterioration In The Second Half Of 2014

HFA loans typically perform worse in the third quarter than in the second quarter, and even worse in the fourth quarter. We expect to see the same pattern through the end of the year. Nevertheless, delinquencies in the second quarter of 2014 fell below the levels we've seen for the quarter for the past five years, so we anticipate that HFA delinquencies for the rest of the year will be lower than they were in the second half of 2013.

Should loans perform as we expect, they will remain manageable, and their delinquency and default rates will fall well below our stress-test assumptions. For instance, a loan pool in a large state (as our criteria define the term) should be able to withstand a foreclosure rate of 32% to maintain a 'AA' rating, and just one bond program in this survey has a delinquency rate that surpasses even half that level. Furthermore, because most of these indentures are partly or completely inactive (that is, the HFA isn't adding new loans or issuing new bonds under them), loan prepayments that result in early bond redemptions build asset-to-liability parity. This equity represents reserves that support bond ratings. If the equity increases faster than the loan foreclosure losses, a bond program's credit quality can improve even if delinquencies rise.

Although a stronger economy could influence HFA portfolio performance, we believe it might have more impact on state loan portfolios. Standard & Poor's base-case scenario calls for improvement in unemployment, real GDP, the number of households, existing home prices, and home sales (but a decline in new home prices -- see table 2). Improving economic conditions could lead to better loan performance, but with little influx of new loans into HFA indentures, the impact would likely be small. However, state loan performance should improve with a better economy. And continuing economic improvement would help mitigate one source of stress -- higher defaults -- from HFA indentures.

Table 2

2014-2015 Economic Outlook For U.S. Public Finance Housing

	Forecast/Scenarios						Actual
	Downside		Baseline		Upside		
	Sept. 30, 2014		Sept. 30, 2014		Sept. 30, 2014		
	2014	2015	2014	2015	2014	2015	2013
Macroeconomic indicators							
30-year fixed mortgage rate (%)	4.18	4.45	4.24	5.03	4.62	6.28	3.98
10-year Treasury note yield (%)	2.41	2.38	2.62	3.38	3.20	4.59	2.35
Unemployment rate (%)	6.37	6.63	6.25	5.75	6.11	5.37	7.35
Real GDP (% change)	1.74	1.03	2.23	2.97	2.38	3.94	2.22
Total nonfarm payrolls (% change)	1.68	0.66	1.84	1.86	1.95	2.31	1.69
CPI (% change)	1.75	0.91	1.87	1.42	2.03	1.67	1.46
Households (mil.)	122.81	124.20	122.89	124.48	122.94	124.60	121.41
Multifamily housing starts (mil. units)	0.37	0.38	0.38	0.46	0.38	0.48	0.31
Federal government spending (% change)	(3.70)	(1.80)	(2.40)	(0.60)	(2.10)	0.01	(5.70)

Standard & Poor's U.S. economic team's forecasts are constructed using the Global Insight model of the U.S. economy.