NALHFA
National Association of Local Housing Finance Agencies

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Local Housing Finance Agency Participation in the Treasury/Government Sponsored Enterprises New Issue Bond Purchase Program (NIBP): A Tremendous Story of Success

This report was prepared in collaboration with Freddie Mac.

November 2011

Executive Summary

As documented in this report, the Treasury/Government Sponsored Enterprises New Issue Bond Purchase (NIBP) program (also known as the HFA Initiative) is a tremendous story of success. As of September 30, 2011, forty-four of forty-seven local Housing Finance Agencies (HFAs) have created nearly 17,000 affordable housing opportunities for first-time homebuyers and very low-income renters. This includes 33 of 35 local HFAs that have used $269,870,000 of a total $1,018,740,000 allocated for single-family to assist 7,540 homebuyers, 97% of whom are first-time homebuyers with average incomes that are 78% of the area median income, purchase affordable homes.

Several local HFAs reported that their NIBP programs helped builders clear some of their inventory of newly-constructed homes, while other local HFA NIBP programs have been used to purchase foreclosed homes. In addition, many local HFA's were able to use their initial NIBP allocation to leverage an additional $265,500,337 in funding to serve additional qualified borrowers.

For the multifamily portion of the program, as of September 30, 2011, 11 local HFAs have used $794,850,000 of $1,139,110,000 allocated for multifamily to finance 71 new construction or preservation projects containing 9,427 units, 91% of which are affordable to households with incomes at or below 60% of median income. The Total Development Cost for these projects is $2,007,146,082, with most using 4% Low-Income Tax Credits as equity. While not every agency surveyed was able to estimate the number of jobs created by NIBP, those that did reported at least 4,736 construction and/or permanent jobs.

Local HFAs anticipate using most of their NIBP allocations by the end of 2011.

NIBP has been a critical tool in expanding affordable homeownership and rental housing opportunities, stabilizing blocks and neighborhoods as well as generating significant economic activity in response to the Nation's housing crisis. Without it much of this economic activity would not have occurred. Its tremendous success is a clarion call for an additional round of NIBP, as NALHFA has proposed.

Key Findings as of September 30, 2011:

Single-Family Activity

- Thirty-three of thirty-five local Housing Finance Agencies (HFAs) participating in the New Issue Bond Purchase (NIBP) program have used $269,870,000 of a total $1,018,740,000 allocated for single-family to finance the purchase of a home for 7,540 homebuyers, 97% of whom are first-time homebuyers.
- The average purchase price of these homes was $133,927 to a family whose average income was $49,840 or 78% of the average area median income.
- The average household size was 2.08 persons and the average age of the borrower was 34.4 years.
- More than 95% of borrowers had their mortgages insured by the Federal Housing Administration (FHA).
- Several local HFAs reported that their NIBP programs helped homebuilders clear some of their inventory of newly-constructed homes. The percentage of loans used to purchase newly-constructed homes ranged from 27% to 53% depending on the local housing market. NIBP program funds have also been used to purchase foreclosed homes.
- Because of an extension of the program beyond 2010, the ability to relock program rates and the drop in market interest rates, many local HFAs were able to use their initial NIBP allocation to leverage an additional $265,500,337 to serve additional qualified buyers.
- The data clearly illustrate that local HFA NIBP programs are sharply targeted to first-time homebuyers of modest means who are purchasing affordable housing.

Multifamily Activity

- Eleven of twelve local HFAs have used $794,850,000 of the total allocation of $1,139,110,000 to construct or preserve 9,427 units of housing in 71 new construction or preservation projects.
- Of the 9,427 units 91% (8,595) are affordable to households at or below 60% of area median income (the restricted income ceiling under the Low-Income Housing Tax Credit program).
- Total development cost for these projects is $2,007,146,082, with most using Low-Income Housing Tax Credits to generate equity.
- While not every HFA was able to estimate the number of jobs created under their program, those that did reported at least 4,736 construction or permanent jobs.
- The data clearly illustrate that local HFAs have successfully used the NIBP program to greatly expand the number of affordable rental housing opportunities for low- and very low-income households, while creating thousands of jobs.

The Future of NIBP

Given the overwhelming success of the NIBP program, NALHFA hereby calls for a second round of the program. NALHFA submitted such a proposal to Treasury officials in May 2011 (see Appendix 3). Another potential approach is for the Federal Reserve to step into Treasury's shoes.

The proposal calls for two changes in a NIBP 2:

1. Permit Housing Finance Agencies to structure their bonds to include a premium to cover downpayment assistance;

2.Permit Housing Finance Agencies to shift single-family allocation to multifamily. On November 23, 2011 Treasury announced a change in NIBP 1 to provide for such a shift.

Background

Since the announcement of the Obama Administration's Housing Finance Agency (HFA) Initiative on October 19, 2009 a total of 47* local HFAs have been participating in the Treasury/Government Sponsored Enterprises New Issue Bond Purchase (NIBP) program(which is also known as the HFA Initiative). Under the Program, the U.S. Treasury committed to purchase $15.3 billion in tax-exempt single-family and multifamily housing bonds issued by local and state HFAs**. The bonds have been, or will be, bundled into securities by Fannie Mae and Freddie Mac and sold to the Treasury.

According to State Street Global Advisors, which is serving as Treasury's Financial Advisor for the program, the 47 local HFA participants have a combined total allocation of $2,157,850,000 in bond authority. Of this total, $1,018,740,000 was allocated to 35 local HFAs for single-family bonds (see Appendix 1 for a listing) and $1,139,110,000 was allocated to 12 local HFAs for multifamily projects (see Appendix 2 for a listing). In order to minimize negative arbitrage and the cost of converting the escrowed bonds from their short-term variable rate mode to their long-term fixed rate most local HFAs have been warehousing the Mortgage-Backed Securities (MBS) with the expectation that they will be purchased with NIBP proceeds when program funds are released from escrow by the end of 2011.

*State Street considers the Arizona HFA but not the District of Columbia HFA to be local HFAs. This analysis excludes Arizona as a local because it is a state HFA, but it includes the DC HFA because it is both a local and state HFA.

** Treasury also established a Temporary Credit and Liquidity Program as part of the HFA Initiative. One local HFA, the Montgomery County, MD Housing Opportunities Commission, participated in this portion of the Initiative.

According to data compiled by NALHFA, as of September 30, 2011 eight local HFAs -- Brevard County Housing Finance Authority, Escambia County Housing Finance Authority, Housing Finance Authority of Hillsborough County, Housing Finance Authority of Miami Dade County, Jacksonville Housing Finance Authority all in Florida, Lafayette Public Trust Financing Authority, LA and El Paso Housing Finance Corporation and Tarrant County Housing Finance Corporation, both in Texas -- have fully utilized their single-family allocation.

Single-Family Activity

Nearly all local HFAs used the "small issue," $25 million single-family program. The small issue program provided an exception to the requirement that 40% of a single-family issue be market bonds sold to investors and 60% be program bonds sold to the Treasury. NALHFA strongly advocated for the exception in order for local HFAs to avoid interest rate risk while the program was being marketed.

As of September 30, 2011, NALHFA has collected demographic information on 33 of the 35 local HFA single-family programs into order to determine who is benefitting from the NIBP program.

Of the 33 local HFA programs analyzed, a total of 7,540 loans have been made to qualified households. More than 97% of these loans were made to first-time homebuyers, who likely would otherwise not have had the ability to become homeowners. The average purchase price of these homes was $133,927 to a family whose average income was $49,840 or 78% of the average area median income. The average household size was 2.08 and the average age of the borrower was 34.42 years. More than 95% of the borrowers had their mortgages insured by the Federal Housing Administration (FHA). A handful used mortgage guarantee programs

offered by the Department of Agriculture's Rural Development Administration and the Veteran's Administration.

The range of incomes served was 53% of the jurisdiction's median income at the low end and 109% of the jurisdiction's median income at the high end. Average purchase prices varied from a low of $76,764 to a high of $279,903.

Every local HFA whose data has been analyzed by NALHFA provided the option of down payment assistance (DPA) to their borrowers. Most provided that assistance from the HFA's own funds, although one used as many as five sources including federal HOME funds and Neighborhood Stabilization Program funds, one used federal Community Development Block Grant funds, one used funds from a real estate surtax and another used funds from the proceeds of a General Obligation Bond. Some HFAs provided the DPA in the form of a grant, but most provided a second mortgage loan of approximately $5,000 to $7,500 often at 0% that was either due at sale or refinancing or forgiven if a borrower remained in the house for a given period of time such as 10 years. All local HFAs have indicated to NALHFA that using their agency funds for DPA was a one-time occurrence. NALHFA has advocated for the use of a premium bond structure in NIBP, whereby the downpayment is structured into the bond. The provision of downpayment assistance by a public agency, such as through premium bonds, is the only form of such assistance permitted by the FHA.

The mortgage rates charged borrowers under the local NIBP ranged from a low of 3.25% to a high of 5.375% and tended to be higher for those receiving DPA. That rates as low as 3.25% could be offered demonstrates the value of HFAs being able to borrow at the Treasury's cost of funds, a key feature of the NIBP.

Several local HFAs reported that their NIBP programs helped builders clear some of their inventory of newly-constructed homes. The percentage of loans used to purchase newly constructed homes in these programs ranged from 27% to over 53% depending on the housing market and represents another, perhaps unintended highlight of the NIBP program. In addition, local HFA NIBP program funds have been used for the purchase of foreclosed homes.

One of the most important findings uncovered by NALHFA in its data collection is that many local HFAs were able to use their initial NIBP allocation to leverage an additional $265,500,377 in funding to serve additional qualified borrowers. This was made possible because of the extension of the program, the ability to relock program rates and the drop in market interest rates that enabled them to sell into the market the MBS made up of their older, higher-interest rate mortgage loans.

These data clearly illustrate that local HFA programs are sharply targeted to first-time borrowers of modest means who are purchasing affordable housing. It also has allowed local HFAs to leverage Treasury's NIBP investment - a key outcome that Treasury was looking for. The NIBP program has also had a very favorable impact on job creation, both for the local HFAs who had to staff up to administer the program, as well as the real estate industry. This includes mortgage lenders, Realtors, builders, appraisers, construction workers and home inspectors.

NIBP has been a critical tool in helping expand affordable homeownership opportunities, stabilizing blocks and neighborhoods as well as generating significant economic activity. It may be the most successful program that the Obama Administration has created to address the Nation's housing crisis.

Multifamily Activity

Local HFAs have had a very positive experience with the NIBP multifamily program. As reported earlier, 12 local HFAs received a total of $1,139,110,000 in allocation to use for affordable multifamily housing. The allocations ranged from $3,450,000 million to the Health, Educational and Housing Facility Board of Memphis to $500,000,000 to the New York City Housing Development Corporation (HDC). As of September 30, 2011 local HFAs had used a total of $794,850,000 of their allocations to finance 71 new construction or preservation projects containing 9,427 units, 8,595 (91%) of which are affordable to households with incomes at or below 60% of area median income (the restricted income ceiling under the Low-Income Housing Tax Credit program). The Total Development Cost for these projects is $2,007,146,082, with most using 4% Low-Income Housing Tax Credits as equity. While not every agency that NALHFA surveyed was able to estimate the number of jobs created, those that did reported at least 4,736 construction and/or permanent jobs.

As an example, by September 30, 2011 the HDC has used $263,730,000 of its $500,000,000 allocation for 29 projects containing 4,023 units, 100% of which are affordable to households at either 50% or 60% of area median income. Eleven of these projects are new construction and 18 are preservation of existing housing. Total development costs are $957,168,817. HDC estimates that this activity has generated a total of 2,295 jobs based on a model developed by New York City's Economic Development Corporation. Each of the projects financed will provide sustainable, affordable housing, while helping to strengthen the neighborhoods within which they located. According to HDC every $1of NIBP has leveraged on average $2.63.

HDC anticipates releasing the $233 million of its remaining NIBP proceeds to finance 15 developments with approximately 2,800 units of affordable housing by December 2011.

The District of Columbia Housing Finance Agency (DC HFA) is another example of an active local participant in the multifamily portion of the NIBP program. DC HFA received an allocation of $168,000,000. As of September 30, 2011 the Agency had used $135,000,000 to finance 11 new construction or preservation projects, creating an estimated 797 construction or permanent jobs. These projects contain 1,244 units, 100% of which are affordable to households at 50% or 60% of area median income. Total development cost of these projects is $320,743,779, including $51,462,043 in Low-Income Housing Tax Credits, $18,566,436 in market/subordinated bonds, local funds and developer funds. The Agency expects to commit an additional $13,440,000 in NIBP by the end of 2011.

The Montgomery County, MD Housing Opportunities Commission (HOC) has used its $46,490,000 in NIBP allocation for two projects containing a total of 291 units, 185 of which are affordable to a range of incomes from 30% to 60% of area median income. The two new construction projects have total development costs of $80,808,530, including $25,129,812 in Low-Income Housing Tax Credits and soft second mortgages from Montgomery County. HOC estimates that these two projects have resulted in the creation of 63 construction and 9 permanent jobs.

As of September 30, 2011, the Orange County, FL Housing Finance Authority has used $12,570,000 of its $47,000,000 allocation for two projects, one new construction and one preservation project. The projects, with total development cost of $27,787,707 including an additional $15,217,706 in equity from Low-Income Housing Tax Credits, contain 444 units, 185 of which are affordable to households at or below 60% of area median income. The HFA plans to use the balance of its allocation of $34,430,000 for two new and two preservation projects for 740 affordable units by the end of 2011.

As of September 30, 2011 results for some of the other local HFAs participating in the multifamily portion of NIBP include:

- Association of Bay Area Governments Financing Authority, CA - $65,780,000 in allocation, $63,950,000 which has been used for 3 new construction projects containing 333 units, 174 of which are affordable to lower income households;
- California Statewide Communities Development Authority - $299,820,000 in allocation, $205,310,000 for 10 new construction and 7 preservation projects containing 1,834 units, 1,645 of which are affordable to lower income households;
- Hillsborough County, FL Housing Finance Authority - $22,090,000 allocation, all of which has been used for four new construction projects containing 472 units, all of which are affordable to lower income households.

Here is a sampling of the specific financing for several local HFA projects:

Lindenguild Hall, Bronx, NY

Project Description:

Lindenguild Hall will be a 105-unit low-income residence primarily serving formerly homeless veterans and will be located in the Bronx neighborhood of Crotona Park. Developed by The Lantern Group, this $34.3 million project financed by HDC and the New York City Department of Housing Preservation and Development (HPD) will feature onsite services such as case management, health counseling, PTSD support, job readiness and employment services. This project has been accepted into NYSERDA's Green Affordable Housing Program, which is available for new construction affordable housing projects that pursue LEED Silver certification or higher and has received an award letter for $229,000 for the use of energy efficient technology.

Based on the construction costs, it is anticipated that the project will generate approximately 148 jobs, helping to strengthen the neighborhood's and the City's economy.

Unit Income Distribution:

Low-Income (60% AMI)	103
Superintendent	1
Total Units:	104

Financing Plan:

- Total Development Cost: $34.3M
- First Mortgage Amount: Construction – $17.7M
  Permanent - $4.2M
- HDC Subsidy $6.76M
- Credit Enhancement Construction: Bank of America Stand by Letter of Credit
- Tax Abatement/Exemption: 420c
- HDC Funding Source: Tax-Exempt Fixed-Rate Bonds
- Non-HDC Financing Sources:
- $5.8M HPD City Capital
- $1.4M Federal Home Loan Bank Grant
- $13.5M Tax Credit Equity
- $2.4M Developer Loan
- Leverage Ratio: 15.30:1

Webster Gardens, Washington, DC

Project Description:

Located in Northwest Washington, DC, Webster Gardens is a preservation project of 52 units in four 3-story buildings. Rehabilitation took place with the tenants in place. The rehabilitation converted large bedrooms with dens into 2-bedroom units, along with a community room, computer lab and on-site management office. The project created an estimated 79 jobs.

Unit Income Distribution:

Low-Income 60% AMI)	52
Total Units	52

Financing Plan –

- Total Development Cost: $13,368,682
- Credit Enhancement: Freddie Mac

- $ 3,280,000 NIBP Bonds
- $2,786,000 Market Bonds
- $1,314,843 4% Low - Income Housing Tax Credit Equity
- $ 4,193,839 Local funds and other funds
- $ 1,800,000 Tax Credit Assistance Program

The Galaxy, Silver Spring, MD

Project Description:

Located in Silver Spring, MD, the Galaxy is a 195-unit, 5-story wood framed affordable housing project. The project includes 368 parking spaces, 208 of which will be used by residences and 150 for use by Montgomery County, tripling the amount of public parking available to the community. The building features a green roof and solar panels to generate electricity. The project also includes a playground area and an Art Walk to replace an existing pedestrian alley to connect two parallel streets.

The project is estimated to create 60 construction jobs and 6-8 permanent (on-site) jobs.

Unit Income Distribution:

At or below 30% of AMI	6
At or below 50% of AMI	16
At or below 60% of AMI	60
Market Rate	113
Total Units	195

Financing Plan:

- Total Development Cost: $57,364,920
- Credit Enhancement: FHA 221(d)(4)GNMA
- Program Bonds- $38,450,000
- Low-Income Housing Tax Credit Equity Raised (4%) - $2,929,812
- Montgomery County Government Support- $5,000,000

Appendix 1 – Local HFAs NIBP Single-Family Allocations

Tucson/Pima County IDAs	**AZ**	$50,000,000
Southern California Home Financing Authority	**CA**	$25,000,000
El Paso County, Colorado	**CO**	$25,000,000
DC HFA	**DC**	$25,000,000
Brevard County HFA	**FL**	$20,770,000
Escambia County HFA	**FL**	$25,000,000
Hillsborough County HFA	**FL**	$20,000,000
Jacksonville HFA	**FL**	$15,000,000
Lee County HFA	**FL**	$20,770,000
Manatee County HFA	**FL**	$16,610,000
Miami-Dade County HFA	**FL**	$25,000,000
Orange County HFA	**FL**	$30,000,000
Pinellas County HFA	**FL**	$39,000,000
Urban Residential Finance Authority of Atlanta	**GA**	$25,000,000
Sedgwick and Shawnee Counties	**KS**	$120,000,000
E. Baton Rouge Mortgage Finance Authority	**LA**	$25,000,000
Finance Authority of New Orleans	**LA**	$25,000,000
Jefferson Parish Finance Authority	**LA**	$25,000,000
Lafayette Public Trust Financing Authority	**LA**	$25,000,000
Montgomery County HOC	**MD**	$55,000,000
Dakota County CDA	**MN**	$25,000,000

Minneapolis/St. Paul HFB	**MN**	$25,000,000
Nevada Rural Housing Authority	**NV**	$25,000,000
Cleveland County HLA	**OK**	$20,000,000
Tulsa County HLA	**OK**	$25,000,000
Allegheny County RFA	**PA**	$24,330,000
Capital Area HFC	**TX**	$25,000,000
Central Texas HFC	**TX**	$15,000,000
El Paso County HFC	**TX**	$24,540,000
Heart of Texas HFC	**TX**	$15,000,000
Houston HFC	**TX**	$15,000,000
Nortex HFC	**TX**	$24,540,000
Southeast Texas HFC	**TX**	$24,540,000
Tarrant County HFC	**TX**	$20,000,000
Texas State Affordable Housing Corporation	**TX**	$73,640,000
		$1,018,740,000

Appendix 2 – Local HFA Multifamily Allocations

Name of Agency	MF Allocation
ABAG Finance Authority	$65,780,000
CA Statewide Comm. Dev.	$299,820,000
DC HFA	$168,000,000
HFA of Hillsborough Co, FL	$22,090,000
Jacksonville HFA, FL	$29,700,000
Orange Co HFA, FL	$47,000,000
HA of Newnan, GA	$5,060,000
HA of Union City, GA	$10,120,000
HOC of Montgomery Co, MD	$46,490,000
NYC HDC	$500,000,000
H,E,HFB of Nashville, TN	$11,500,000
H,E,HFB of Memphis, TN	$3,450,000
	$1,139,110,000

Appendix 3 – Proposal to Treasury on NIBP - 2

To: Theo Polan

Sarah Apsel

From: John C. Murphy

Executive Director

Date: May 10, 2010

Subject: Possible Approach to NIBP 2

As you know, local and state Housing Finance Agencies are currently participating in the Treasury/Government-Sponsored Enterprises New Issue Bond Purchase program. As I've indicated earlier, that program is proceeding very well with the expectation that most of the authority allocated to HFAs expected to be used by the end of 2011, including for MBS' currently being warehoused by localities. Thus, from NALHFA's point of view NIBP has been a huge success and without cost to the federal government. Because of continued extremely low interest rates, the private market for long-term tax-exempt single-family and multifamily housing bonds has not returned and is not expected to return in 2012.

Because of this fact, a Round 2 of NIBP is urgently needed to advance the Administration's desire to respond to the housing crisis in a comprehensive manner. This is especially true because housing markets nationally have remained weak and in the majority of areas have weakened further.

After analyzing possible methods of achieving a Round 2 – seeking congressional action on reinstating the HERA Authority, or seeking to have the Federal Reserve step into Treasury's shoes – we believe the simplest and most direct approach is what's outlined below.

Treasury – MBS Swap

The purpose of this approach is to provide a way for Treasury to provide a future round of NIBP funding, within the constraints established by HERA and without requiring Congressional extension of HERA. The approach is based on the portfolio and ability to manage its portfolio of GSE securities that Treasury already undertook under HERA.

Specifically, in addition to its current NIBP portfolio, Treasury as you know also purchased a significant amount of Fannie and Freddie MBS in 2008 and 2009 under its HERA authority. That portfolio is currently about $140 billion. In March Treasury officials announced that they were planning to gradually sell these MBS' (about $10 billion a month) over the next year primarily because they did not see themselves as long-term investors in MBS. HERA gives them the continuing ability after Dec. 31, 2009 to hold, manage and dispose of securities they acquired from Fannie and Freddie, including actions with respect to those securities.

In the Treasury announcement and the accompanying questions and answers, one question was whether it would permit substitutions or rate rolls (e.g. substituting one set of existing Fannie/Freddie securities for another). Treasury indicated that for policy reasons and because they did not see a need to continue owning MBSs , it saw no need for substitutions as opposed to direct liquidation.

What this suggested, however, was that Treasury could in fact choose to exchange Fannie/Freddie securities acquired before Dec. 31, 2009 for other Fannie/Freddie securities, e.g. simply as a way of managing and maintaining its portfolio. Under this approach, Treasury could take some of the Fannie/Freddie MBS securities it already owns and exchange them for other Fannie/Freddie securities, namely NIBP 2 securities. In other words, while Treasury does not

have the legal authority to go out and purchase more from the GSE's, it could simply replace some securities with others (with no greater principal amount or value).

EXAMPLE

Treasury owns Fannie and Freddie securities in an outstanding par amount of $50 million Fannie's and $50 million Freddie's (having bought these in equal amounts from each agency just as it did under NIBP 1). These were purchased prior to Dec. 31, 2009, are MBS' and say have a 4% pass-through rate.

As part of managing its portfolio of Freddie's and Fannie's, Treasury does the following:

a) exchange these Fannie and Freddie MBS securities with Fannie and Freddie respectively for an equal amount of Fannie/Freddie securities wrapping NIBP bonds from the Pennsylvania HFA. Such bonds are initially in their floating rate mode and will be converted or redeemed by Dec. 31, 2013.

b) for simplicity, we're assuming the securities that Treasury gives Fannie and Freddie have a par value (as do the securities they're receiving). If their market value is slightly above or below par, Treasury simply exchanges the amount of currently owned securities that equal the par value of the securities they're receiving.

c) mechanically what would happen is as follows. On a specified date:

    1 Fannie and Freddie, in this example, purchase $50 million each of NIBP 2 Program Bonds from the specific HFA.

    2 Treasury exchanges, $100 million of existing Fannie/Freddie MBS' with Fannie and Freddie for an equal amount of Fannie/Freddie NIBP 2 securities.

3 Fannie and Freddie can then sell in the open market the MBS they have just received in exchange for NIBP 2 securities.

On an overall basis, for simplicity, there could be a single exchange later this year of perhaps $15 - $20 billion of currently owned securities for an equal amount of replacement securities (with initial NIBP bonds from whatever issuers (NIBP 1 and others) issue such debt in its floating rate mode on/by that date).

ADVANTAGES

If this approach is deemed possible, it provides a way — by using the very Fannie and Freddie MBS Treasury is now seeking to dispose of anyway — to continue to invest in NIBP. It would not require any new procedures (but a very few modifications outlined below), would not require legislative action to extend HERA and maintains Treasury as the owner of NIBP securities, e.g. the one party who benefits from taxpayers not utilizing the tax deduction for tax-exempt interest on such bonds. Most important it gives the Administration a direct way to continue this critical effort.

POTENTIAL BASIS FOR APPROACH

Treasury has very reasonably indicated it does not have authority to purchase new securities under HERA, nor to have issuers pay off NIBP bonds and have Treasury use the proceeds to go out and buy other NIBP bonds from other issuers. What this approach takes advantage of is the large portfolio of Fannie and Freddie MBSs that Treasury is already holding and simply provides a way to exchange some of those with new Fannie and Freddie securities.

We have asked NALHFA Affiliate member Hawkins Delafield & Wood as to potential basis for this approach:

Question presented: Can the Treasury Department exchange GSE MBS that it currently owns under authority of HERA Section 1117 for an equal amount of NIBP Bonds?

Short Answer. A plausible good faith argument can be made that the Treasury Department has sufficient authority to make such an exchange, and that such an exchange furthers Treasury's stated goals and priorities. See attached.

MODIFICATIONS/CLARIFICATIONS IN NIBP 2 TO PROVIDE KEY FLEXIBILITY

Minimum Change. We believe that in general the entire system established by Treasury and the GSE's works very well – the round of allocation requests and awards, the requirements, the terms for Program Bonds, the rate lock and re-lock mechanisms, the floating rate period and the conversions, the legal documentation, the administration of the program. This has all worked very well and one of the great advantages of an NIBP 2 is that it can take full advantage of this and of an in-place system among Treasury, GSE's, HFA's, counsels and underwriters.

In fact an important benefit of NIBP 2 is that it allows participants who have used or will have used all their allocations to continue their programs and – especially important among localities – enlist many local HFA's who were not able to participate initially but can now see the mechanisms and on the ground success of programs of other agencies. Your participation in the NALHFA conference and your efforts to help manage the program all contribute to this potential.

There are however two specific provisions with respect to flexibility that will enable the program to work much more effectively and that can and need to be addressed in an NIBP 2. Neither of these in any way affect the basic rules, design or operation of NIBP.

1. Premium on Single-Family Program Bonds. For many years, most local and a number of state HFAs have offered some form of closing cost and downpayment assistance (DPA) to their

low/mod first-time homebuyer families. For households with incomes below 80% of area median income (AMI), funding has been available under federal programs such as HOME and CDBG. For buyers above this income level, but within the MRB programs income limits (115% of AMI for households of three or more; 100% of AMI for households of two or fewer), there is usually no other source of DPA available. Therefore, in the past many local and some state HFAs have structured and sold a large portion or all of their MRBs at a premium price of 3% - 5% in order to fund DPA. The provision of DPA through this structure has also been accepted by the Federal Housing Administration (FHA), which insures a large number of MRB-financed loans.

The DPA funds that are provided to borrowers under the premium bond structure can either be provided as a grant or a loan, or a loan that is forgiven over a number of years if the borrower remains in the house. Almost all HFAs who provide DPA require that the borrower contribute at least some of his/her own funds ($1,000 is typical), and none of the DPA funds can be released to the borrower. If the DPA exceeds the required down payment and closing costs less the required borrower contribution, the excess is applied to reduce the principal amount of the mortgage loan. This would respond to what we understand was Treasury's concern about allowing premium bonds in NIBP 1.

Many local HFAs require that all borrowers under their MRB programs receive homeowner counseling, and they may also receive credit counseling if deemed appropriate. The HFAs or their non-profit partners may also offer classes in home maintenance after closing. The result of these additional activities and the focus on providing permanent, sustainable homeownership is that most HFAs have had delinquency and foreclosure rates that are significantly below the general market rates in their geographic area.

The rules of the Treasury's 2009 NIBP program effectively prohibited the use of premium bonds on the NIBP program bonds, and those agencies that did participate had to use their own scarce resources to provide DPA. Local HFAs typically committed $500,000 to $1,000,000 or even more to fund DPA in connection with the NIBP program. Clearly, this is not sustainable practice. HFAs going forward do not have sufficient resources to continue to fund DPA equal to 3% - 5% of their bond issues. An extension of the NIBP program therefore also should allow the use of this effective, proven mechanism to fund DPA.

This issue is critical not only for local HFA's but for the overall success of NIBP:

- Where NIBP has been successful, many of the loans have been accompanied by downpayment assistance. In agencies where this was limited or unavailable, new production has been slower.
- The major constraint facing both state and local HFAs, especially in an environment of diminishing HOME and other resources, is how to continue to fund downpayment assistance.
- Most important, the changes proposed for FHA (as well as those already made by the GSE's and the mortgage markets) mean that downpayment assistance will become far more crucial in the future for first time homebuyers.
- State and local downpayment assistance programs, with many years of successful history and operations are a critical tool for addressing this need.
- Thus being able to use 3% premiums on Program Bonds will make a great difference to the success and production of NIBP.

2. Transferring Single-Family Allocations to Multifamily – Under NIBP 1 issuers could transfer multifamily allocation to single-family but not single-family to multifamily. Treasury

officials informed NALHFA that the program could not be changed because it would disrupt OMB's scoring of the program. We have heard from members who wish to transfer unused single-family allocations to multifamily so as to be able to use all of their allocation. This would be an important programmatic change for NIBP 2 and could be taken into account up-front in the scoring. Treasury announced on November 23, 2011 a change to NIBP 1 that would permit such a shift.

EFFECT OF THE PROPOSAL

Thus the approach NALHFA wishes Treasury to explore would:

a. Not require any additional cash from Treasury nor require statutory authorization.
b. Not require any structural changes in NIBP.
c. Utilize powers and assets that Treasury already has.
d. Enable a second round of NIBP, both for participants who will have already used or are using their allocations and for new participants.
e. Enable the program to provide conversions through 2013.
f. Build on the success you have already achieved.

Analysis of Legal Basis for NALHFA's Proposal

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Background. HERA Section 1117 authorized Treasury to purchase "any obligations and other securities issued by the [GSEs] under any section of this subchapter, on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine." (HERA Section 1117(a), codified at 12 USC 1719(g)(1)(A). (For convenience, citations are to the codified provisions of HERA governing Fannie Mae. Substantially identical provisions are found in HERA Section 1117 governing Freddie Mac and the FHLBs.) HERA expressly provided that the authority it granted to Treasury to purchase GSE MBS expired on December 31, 2009. 12 USC 1719(g)(4).

HERA Section 1117 also provides that the Secretary of the Treasury may "at any time, exercise any rights received in connection with such purchases [of GSE MBS]". 12 USC 1719(g)(2)(A). Further, HERA Section 1117 authorized the Secretary to, "subject to the terms of the security or otherwise upon terms and conditions and at prices determined by the Secretary, sell any obligation or security acquired by the Secretary under this subsection." 12 USC 1719(g)(2)(B). The authority of the Secretary to exercise these rights acquired with the securities, and to sell the securities, are expressly excluded from the December 31, 2009

termination of the Secretary's authority to purchase GSE MBS. 12 USC 1719(g)(4).

On September 7, 2008 the Secretary of the Treasury determined to undertake the GSE MBS purchases authorized by HERA Section 1117, and its aggregate holdings ultimately reached approximately $192 billion in GSE MBS. (See "MBS Wind Down Update" attached). Current holdings are approximately $140 billion.

Treasury announced on March 21, 2011 that it will begin to sell off its portfolio of GSE MBS. Sales will proceed according to market conditions at the rate of approximately $10 billion per month. See http://www.treasury.gov/press-center/press-releases/Pages/tg1111.aspx.

The purchase authorization provided by HERA Section 1117 was in addition to the already-existing authority of Treasury to purchase GSE MBS in an amount up to $2.25 billion. 12 USC 1719(c). This authority to purchase GSE MBS was not terminated by HERA and still is in place. However, because the Treasury currently owns far in excess of this $2.25 billion limit, the Section 1719(c) authorization is currently of no effect. At the announced sell-off rate of $10 billion per month, the Treasury will not be able to exercise it power to purchase GSE MBS under Section 1719(c) for another fourteen months or so.

According to Treasury, "Treasury has designated independent asset managers as financial agents to undertake the purchase and management of portfolio of GSE MBS on behalf of Treasury. The portfolios are managed with clear investment guidelines and investment objectives. The primary objectives of this portfolio are to promote market stability, ensure mortgage availability, and protect the taxpayer." (http://www.treasury.gov/about/budget-performance/Documents/CJ_FY2012_GSE_508.pdf). The objectives recited in this quote closely paraphrase the three findings that the Secretary was required by HERA to make in order to undertake the GSE MBS purchases authorized by HERA Section 1117 (See 12 USC

1719(g)(1)(b)(i)-(iii).

Analysis: Other than general public announcements, no statements by Treasury were found in which Treasury described or interpreted its authority under HERA Section 1117. Thus the sole legal basis for Treasury to conduct the HERA Section 1117 purchase program would seem to be HERA itself. A substantial amount of discretion was granted to the Secretary to conduct the GSE MBS purchase program under HERA Section 1117, which authorizes the Secretary at any time prior to December 31, 2009, to "purchase" GSE MBS "on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine." 12 USC 1719(g)(A)(A). The Secretary is also permitted (and is still permitted) to "exercise any rights received in connection with such purchases," and to "at any time . . . sell any obligation or security acquired by the Secretary under this subsection."

Thus, the Secretary's current rights under HERA consist of the ability to exercise rights acquired in connection with the purchase of the GSE MBS, and at any time to sell the GSE MBS. The question whether the Secretary is authorized to exchange any GSE MBS in its current portfolio for GSE NIBP Bonds, in turn, can be answered in the affirmative if either of these two powers can fairly be interpreted to authorize such an exchange.

Whether the "rights received in connection with such purchases" would include the right to exchange such securities can only be determined by examination of the circumstances of each purchase, and the particular security purchased. Most likely, what was intended by the statutory reference to "rights received in connection with such purchases" was rights inherent in the securities themselves, such as put rights, conversion rights, etc. However, broadly construed, it is reasonable to assume that the rights one acquires with the security include general property rights of ownership, which ordinarily would include the right to dispose of the property by means

of exchange.

Additionally, the other express power granted to Treasury by HERA, namely, the right to "sell any obligation or security acquired by the Secretary" under HERA, can also fairly be interpreted to include the right to exchange of securities. It is likely that HERA expressly excluded the Secretary's right to sell securities from the December 31, 2009 expiration date in order to make clear that the Secretary did not have to liquidate the GSE MBS holdings by December 31, 2009. However, interpreted in that way, HERA's grant of a "right to sell" after December 31, 2009 can be interpreted as synonymous with a right to own the securities after December 31, 2009 and therefore does not serve to limit the rights of ownership that the Secretary can exercise merely to the right to sell the security. That is, "May sell after December 31, 2009" is synonymous with "May own after December 31, 2009," and is not a limitation on the rights of the Secretary. Interpreted in this way, the Secretary would presumably be authorized to dispose of GSE MBS from Treasury's portfolio through exchange and not only through outright cash sale.

Another avenue by which Treasury could authorize the exchange of its GSE MBS may lie in the portfolio management objectives that Treasury has provided. According to Treasury, the management of its GSE MBS portfolio has been delegated to private management companies (State Street Global Advisors currently manages all of the securities), "with clear investment guidelines and investment objectives. The primary objectives of this portfolio are to promote market stability, ensure mortgage availability, and protect the taxpayer." If these guidelines encompass the exchange of securities, or if the exchange of securities can be justifiably subsumed under the stated objectives of the portfolio, then perhaps the authorization for such exchange can be found within the portfolio management guidelines themselves. Clearly, to the

extent that a market for NIBP can be made through exchanges of Treasury's GSE MBS, the goal of ensuring mortgage availability is furthered.

While the actual portfolio guidelines could not be located, the Office of the Inspector General's Audit Report of the Treasury Department for Fiscal Years 2009 and 2010 states that HERA "authorized the Department to enter into the GSE MBS Purchase program. Under this program, the Department, using private sector asset managers, purchased on the open market a portfolio of mortgage-backed securities issued by the GSEs. . . . The asset managers were also authorized to enter into other trade/sell transactions such as pair offs, turns, assignments, and dollar rolls to further support the market under the HERA provisions/mandate." (Office of Inspector General, "Audit of the Department of Treasury's Fiscal Year 2010 and 2009 Financial Statements, November 15, 2010" page 218, accessed at http://www.treasury.gov/about/organizational-structure/ig/Documents/oig11031.pdf.) Thus, it would appear that Treasury's own interpretation of its authority under HERA, as evidenced by the portfolio guidelines, clearly encompasses activities other than straightforward purchases and sales, and includes "trade/sell" transactions. It must be noted, however, that Treasury does not currently seem to be pursuing its management of the GSE MBS portfolio under that broad mandate. In the FAQ published in connection with March 21, 2011 announcement of the GSE MBS sales, Treasury states that none of the transactions will be "coupon swaps and dollar rolls;" rather, "[a]ll transactions will be outright sales, *as authorized by HERA*" (emphasis added). Found at http://www.treasury.gov/press-center/press-releases/Documents/03.21%20Portfolio%20Disposition%20FAQs%20FINAL.pdf.

As a final observation, one of Treasury's four stated priorities with respect to the GSEs for FY 2012 is "To restore the capacity of state and local HFAs to provide affordable housing resources to working families at the state and local level." (Treasury Budget document, page GSE-1,

found at: http://www.treasury.gov/about/budget-performance/Documents/CJ_FY2012_GSE_508.pdf.) To the extent that the exchange of GSE MBS for NIBP Bonds furthers these stated goals, the position can be advanced that Treasury should interpret its existing authority under HERA to permit such an exchange. Again, it seems clear that making a market for NIBP Bonds will advance Treasury's stated priority of restoring the capacity of HFAs to provide affordable housing.

Conclusion. Narrowly interpreted, HERA Section 1117 may not appear to expressly authorize Treasury to exchange the GSE MBS currently in its portfolio for NIBP Bonds. However, a reasonable interpretation of HERA in light of the stated policies and objectives found in HERA itself, and expressed by Treasury, make it reasonable to conclude that such an exchange is authorized by HERA.

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