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SECTOR COMMENT
30 March 2020

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Housing finance agencies – US

Coronavirus leads to potential mortgage payment deferrals, but HFAs can weather the negative cash flow impact

On March 28, New Jersey became the latest of several states to announce that borrowers in financial distress due to the coronavirus outbreak should be permitted to defer mortgage payments without penalty during the crisis. State and local housing finance agencies (HFAs) are accordingly considering or developing programs that will allow mortgage forbearance. Forbearance will pause mortgage payments and halt foreclosure, temporarily disrupting cash flow for single-family programs, a short-term credit negative for HFAs. Proposed eviction moratoriums as well as recommended payment and foreclosure forbearance on rental projects will also lead to cash flow disruptions for HFA multifamily programs. Nevertheless, HFAs' financial strength can comfortably sustain the negative impacts, and our stable outlook for the sector remains appropriate.

In addition to the pause in mortgage payments, two other factors will result in cash flow stress in HFA single-family programs: a substantial drop in investment income because of near-zero interest rates following the Federal Reserve's recent rate cut, and elevated interest-rate resets on HFAs' variable-rate debt (VRDOs).

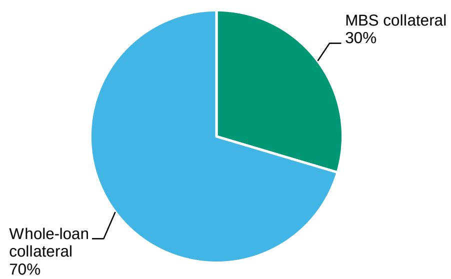
Mortgage payment deferrals only affect whole-loan programs, and eligibility is limited

Mortgage payment deferrals will affect only whole-loan programs, which represent about 70% of HFA single-family portfolios (see Exhibit 1), limiting the negative impact on the agencies. Programs with mortgage-backed securities (MBS), by contrast, are guaranteed by Ginnie Mae (GNMA), Fannie Mae or Freddie Mac (GSEs). MBS master servicers are required to advance on behalf of borrowers in the event of delinquency, and GSEs and GNMA will likely cover any deficiency if master servicers fail to do so.

Furthermore, eligibility requirements will limit the number of mortgage deferrals, since HFAs must follow insurers' guidelines on providing relief to borrowers affected by the coronavirus pandemic. About 84% of the HFA single-family whole-loan portfolio is insured, by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the US Department of Agriculture Rural Development (RD) or private mortgage companies (see Exhibit 2).

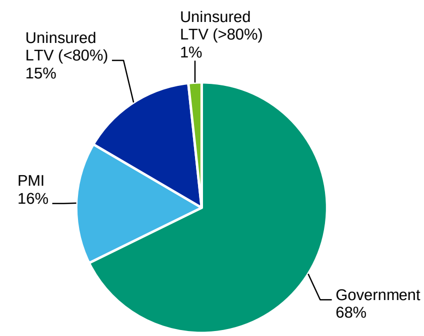
To qualify for GSEs' payment deferral programs, borrowers must have faced a short-term financial hardship which caused them to miss up to two months of mortgage payments, and must have demonstrated the ability to catch up in full after two months. GSEs will allow certain borrowers to make the deferred mortgage payments at the end of their mortgage or when they sell their house. Relief programs being considered by HFAs may allow for payment deferrals of more than two months.

Exhibit 1
Whole-loan programs represent about 70% of HFA single-family portfolios



Source: Moody's HFA Q4 2019 surveys

Exhibit 2
Government and private entities insure 84% of HFA whole-loan portfolios



LTV stands for loan-to-value ratio
Source: Moody's HFA Q4 2019 surveys

Multifamily programs will also face cash flow disruptions from eviction moratoriums

We focus on cash flow disruptions for HFA single-family programs, since that is where most HFA lending activity occurs, except for a few with large multifamily portfolios. However, HFA multifamily programs are also likely to face temporary cash flow disruption as public officials ordered eviction moratorium and recommend mortgage payment and foreclosure forbearance for project owners who agree not to evict tenants who have missed rent payments. Most mortgage loans in HFA multifamily programs are insured or guaranteed, which eliminates the risk of nonperformance. For uninsured loans, HFA net assets, program over-collateralization (1.17x in 2018) and federal Section-8 rent subsidies (for eligible projects) are likely to mitigate nonperformance risk. Sixteen HFAs have uninsured multifamily loans.

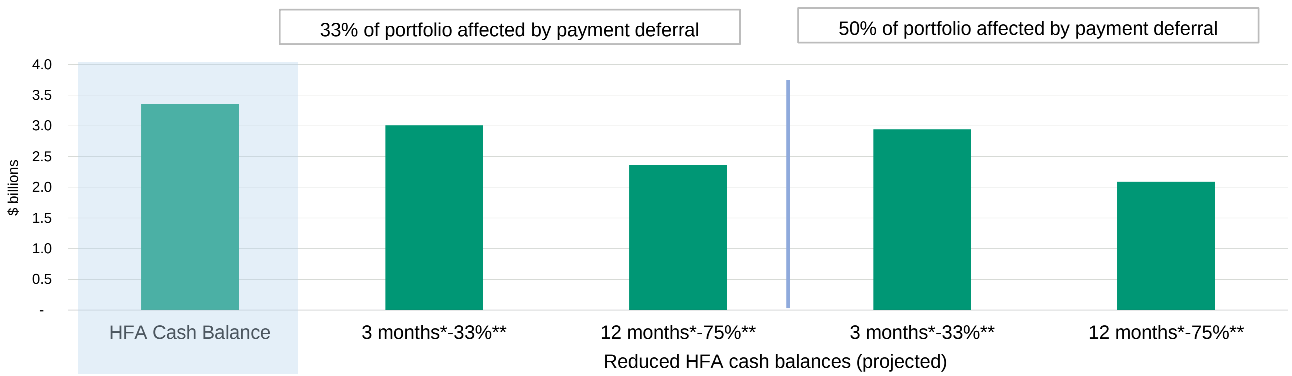
HFAs' strong financial and cash positions will mitigate the short-term cash flow disruption

HFA single-family programs are entering a challenging period in a strong financial position, with a high 1.25x asset-to-debt ratio (1.20x median), strong 32% margins (22% median) and low delinquencies. Stress analyses show a narrow range of declines in HFA net assets (as a percentage of bonds), from 1% in the best-case scenario to 3% in the most stressful. Our scenarios assumed various lengths of mortgage payment deferral and elevated VRDO interest rate resets, as well as different magnitudes of reduced investment income.

HFA cash balance will provide a sufficient buffer to bridge a temporary 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 that elevated interest rate resets on all HFA VRDOs persist for 6 months – the liquidity hit to the single-family program sector remains less than 40% of HFAs' cash balance at the end of 2018 (see Exhibit 3).

Exhibit 3

HFA cash balance provide a sufficient buffer to bridge temporary cash flow disruption



*Duration of payment deferral in whole-loan programs (months)
**Drop in sectorwide investment income
Source: Moody's Investors Service

While our stress analyses considered the potential impact of elevated VRDO resets for a period up to six months, this scenario is unlikely. Last week, interest rates on HFA VRDOs reset at between 5% and 8% compared with a pre-crisis average of less than 0.5%. These elevated resets were driven by market disruption due to the coronavirus and not by a deterioration in HFA credit quality. Tax-exempt money market funds, which are the primary investors in HFA VRDOs, had to sell to meet investor redemption requests. Since the Federal Reserve's announcement on March 20 that it will include high-quality short-term municipal securities in its asset purchase program, HFA VRDOs already reset at significantly lower levels this week.

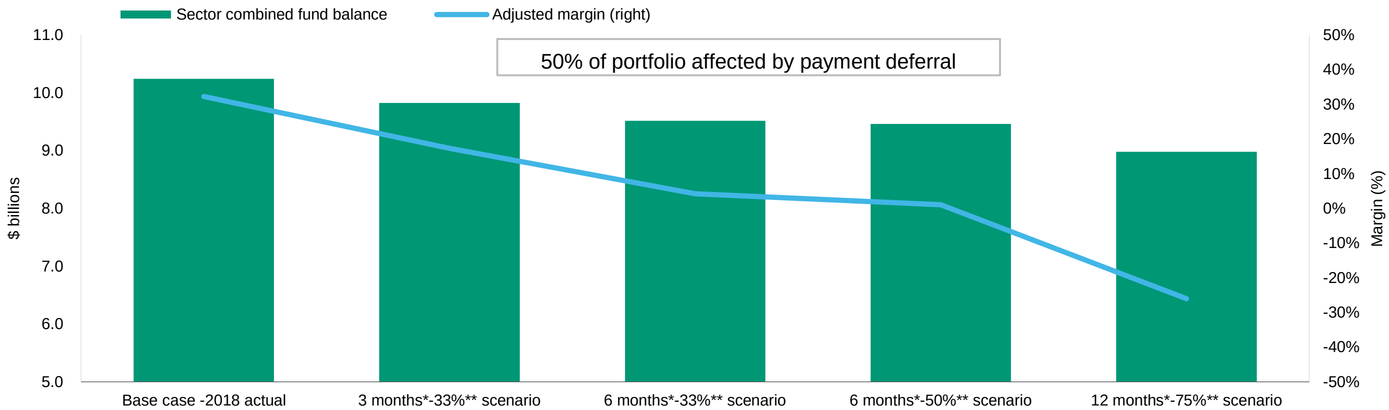
The negative impact on HFA margins will likely be steep but our stable sector outlook remains appropriate

HFAs are likely to have enough liquidity and financial resources to mitigate the short-term and temporary cash flow disruption caused by the coronavirus pandemic, so the stable outlook for the sector remains appropriate at this time.

Margins in HFAs' single-family sector have been strong since 2014, reaching a high of 32% in 2018 (median 22%), but that growth trend will likely end as a result of the cash flow disruption. The size of the decline in margins will depend on the length and amount of mortgage payment deferrals, how long elevated VRDO resets continue, and the degree of reduction in investment income. In the most stressful scenario, HFA margins will likely decline very steeply from the 2018 high. Despite the potential sharp drop, the negative impact on HFAs' combined fund balance is likely be more muted (see Exhibit 4).

Exhibit 4

Potential decline in HFA margins may be steep but negative impact on fund balances is more muted



*Duration of payment deferral in whole-loan programs (months)
**Drop in sectorwide investment income
Source: Moody's Investors Service

Moody's related publications

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Medians - HFAs' financial metrics remain solid and bond issuance ramps up, October 2019

Medians – Multifamily loan programs deliver solid performance, April 2019

REPORT NUMBER 1221167

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