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*Equal Opportunity Housing and Equal Opportunity Employment*

## MINNESOTA HOUSING FINANCE AGENCY BOARD

# NOTICE OF SPECIAL MEETING

**DATE:** **Thursday, June 5, 2014**

**TIME:** **3:00 p.m.**

**LOCATION:**

**In person:** Minnesota Housing
Jelatis Conference Room
400 Sibley Street, Suite 300
St. Paul, MN 55101

**By phone*:** 1-888-742-5095; Code: 2680427896
**some members will participate by phone*

The topics for discussion at this meeting are:

A. Resolution Authorizing Issuance and Sale of Minnesota Housing Finance Agency Homeownership Finance Bonds, 2014 Series A

B. Approval, Section 8 Opt Out Notice Review Policy

*The Agency may conduct a meeting by telephone or other electronic means, provided the conditions of Minn. Stat. §462A.041 are met. In accordance with Minn. Stat. §462A.041, the Agency shall, to the extent practical, allow a person to monitor the meeting electronically and may require the person making a connection to pay for documented marginal costs that the Agency incurs as a result of the additional connection.*

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**AGENDA ITEM:** A
**MINNESOTA HOUSING SPECIAL BOARD MEETING**
**June 5, 2014**

**ITEM:** Resolution Authorizing Issuance and Sale of Minnesota Housing Finance Agency Homeownership Finance Bonds 2014 Series A

**CONTACT:** Rob Tietz, 651-297-4009
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Bill Kapphahn, 651-215-5972
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**REQUEST:**

☑ Approval ☐ Discussion ☐ Information

**TYPE(S):**

☐ Administrative ☐ Commitment(s) ☐ Modification/Change ☐ Policy ☐ Selection(s) ☐ Waiver(s)

☑ Other: Finance

**ACTION:**

☑ Motion ☑ Resolution ☐ No Action Required

**SUMMARY REQUEST:**
Agency staff is preparing to issue bonds to provide funds for the acquisition of newly originated mortgage backed securities. Kutak Rock LLP, the Agency's bond counsel, will send the resolution and Preliminary Official Statement describing the transaction under separate cover. The Board will be asked to adopt a resolution approving the terms of one or more bond issues on a not-to-exceed basis.

**FISCAL IMPACT:**
The transaction will result in the Agency earning the maximum allowable spread on the bonds.

**MEETING AGENCY PRIORITIES:**

☑ Promote and support successful homeownership ☐ Preserve federally-subsidized rental housing

☐ Address specific and critical needs in rental housing markets ☐ Prevent and end homelessness

☐ Prevent foreclosures and support community recovery ☐ Strengthening Organizational Capacity

**ATTACHMENT(S):**

- Preliminary Official Statement (sent under separate cover by Kutak Rock)
- Background memo from CSG Advisors

CSG | advisors

**Minnesota Housing Finance Agency**
**Single-Family Approach for 2014: Updated**
**June 2, 2014**

***OVERVIEW***

In December, CSG Advisors working with staff and the underwriters outlined an overall proposed approach for financing single-family this year. The approach was based on the following key features and assumptions:

1. **Strong Pipeline.** Minnesota Housing's new single-family pipeline continues to be robust, with the volume of loans purchased or expected to be purchased from January through June 2014 similar to January through June 2013.

2. **Balanced Production.** By establishing rates on different types of loans (GNMA, Fannie Mae, Fannie Mae preferred risk share) to provide the same net yield to the Agency, Minnesota Housing has been effectively offering a wide range of attractive loans, including significant numbers of all three types.

3. **Effective Hedging.** The system for hedging and selling new mortgage-backed securities is working well, both for the taxable loans it was originally intended for and, since July 2013, for tax-exempt loans as well.

4. **Balancing Current and Future Income.** The Agency has sought and seeks to be able to retain and bond finance at least a significant share of new production. Such on-balance sheet production provides a stable ongoing revenue stream for Agency operations and funding of Pool 3, as opposed to relying on fluctuations in up-front revenue from new production.

A key focus has therefore been finding creative and effective ways to use single-family bond financing to add to the balance sheet, while continuing the strong pipeline, balanced production and effective hedging. The recent and proposed approaches to this challenge have been a major part of the work of the Finance Team. This memo briefly explains and updates the approaches for 2014.

***CRITERIA***

In evaluating the range of options, we outlined the following important criteria which would apply to potential bond issues to help assure benefit to the Agency.

1. **Avoid Major Interest Rate Risk.** The current hedging system is designed to protect the Agency against changes in interest rates from the time loans are reserved until they are either sold or permanently financed. Funding options that include bond financing should not significantly increase risk since reservations have been hedged. The Agency does have a limited amount of zero participations (about $8 million at the beginning of the year and now about $12 million) that it can utilize if interest rates were to rise.

2. **Continue High Ratings on all Minnesota Housing Single-Family Bonds.** New bond financing should be structured in such a way as to maintain the current high (AA or AAA ratings) on Minnesota Housing's existing single-family indentures, and avoid long-term stresses on indentures that could create future problems.

3. **Provide At Least a Comparable Expected Level of Return to Selling MBS.** In deciding whether to sell MBS or include them in a bond financing, Minnesota Housing should look at the overall expected return at a range of prepayment speeds to determine that (a) bond financing can reasonably result in the same or better returns than (b) selling the same MBS and reinvesting cash in current available investments. Such comparison needs to take into account any gains or losses the Agency would have as a result of 'paring out' of hedges and putting the loans in a bond issue instead.

4. **Enhance Long-Term Financial Sustainability.** The mix of bond financing and sales of MBS should provide more balanced and financially sustainable results for Minnesota Housing over the long term, taking into account likely prepayment speeds and various interest rate markets.

***SINGLE-FAMILY BOND FINANCING: TO DATE***

**1. Creating the Single-Family Pass-through Bond Market**

The single-family monthly pass-through bond market, which the Agency pioneered nationally in July 2012 and continued to use through June 2013, provided an effective way to earn at or near full spread. The Agency relied on and used it very successfully over that period for all its tax-exempt production, equaling $237 million. These bonds are AAA rated, MBS-backed under the Homeownership Finance Bond indenture (HFB).

In June 2013, investor interest for the pass-through product declined as they demanded relatively higher yields compared to TBA sales. From the Agency's point of view, this meant that selling into the TBA market would return a higher net present value. The Agency thus began selling new production (after using Pool 2 to warehouse pools in amount of approximately $100 million).

At the end of last year the Finance Team brought an alternative approach to the Board that would allow the Agency to significantly reduce the cost of bond financing on a given amount of bond issues in 2014.

**2. Overcollaterized Bond Issues**

This approach, first presented in December, took advantage of the fact that the Agency had previously refunded several old bond issues into the Residential Housing Finance Bond indenture (RHFB) leaving approximately $60 million of unencumbered loans. These loans need to remain in the indenture to meet rating agency tests, but the fact that they have higher interest rates and shorter maturities than new loans created an important potential opportunity.

The principal payment on these loans can be used, together with the principal payments on new loans, allowing for more bond principal to occur in the early years. This allows Minnesota Housing to sell bonds at a lower interest rate, thus allowing Minnesota Housing to achieve at or near full spread without using any of its remaining zero participations.

Because the overcollateral needs to remain in RHFB, the bonds are issued under the AA-rated RHFB indenture.

*How This Has Worked* In December the Board authorized issuing up to $150 million of new bonds in RHFB that would leverage this overcollateral, and allow staff to move quickly and

flexibly to take advantage of market opportunities. This has worked exceptionally well.
In January, Minnesota Housing sold $50 million of new RHFB Bonds, 2014 A, with these shorter maturities by pledging $16 million of the overcollateral. The average interest rate was approximately **2.5%**.

In March, the Agency sold RHFB 2014 B, also $50 million, again by linking to about $16 million of the overcollateral. The average interest rate on the new bonds was **2.3%**.

These low rates enabled Minnesota Housing to finance a combination of the low-rate loans it had purchased in Pool 2 when the pass-through bond market had weakened and new production. The low-rate loans, mostly in the 3 to 3.5% range, were able to be permanently financed at full spread, and in fact generating additional zero participations from the 2014 B transaction.

*Remaining Potential.* There is still approximately $24.5 million of remaining additional collateral in RHFB which can be used in conjunction with one more $50 million issue. This will enable Minnesota Housing to finance new production when desired later this year.

***SINGLE-FAMILY BOND FINANCING: GOING FORWARD***

**1. New Single-Family Pass-Through Issues**

RBC has recently indicated they believe they can again find investors for relatively modest-sized pass-through tax-exempt bond issues (in the $25 million plus range) who would find them attractive compared to buying MBS in the secondary market. This would provide an excellent opportunity for the Agency to expand the range of bond tools it has available in the current market. The aim is to structure such issues so as to:

a. finance new production at or close to full spread with only modest use of the existing zero participations,
b. initially use such a financing for approximately $25 million of loans which Minnesota Housing has already purchasing for its own account in Pool 2,
c. utilize the tax yield benefits permitted by bond counsel for taking into account associated net hedging gains or losses.

*Flexibility* If the first issue proves successful, the Agency would continue to seek opportunities as available to take advantage of this market for a portion of new production. In order to have the flexibility to come to market when it is most desirable, staff is asking the Board to approve issuance of up to $100 million in multiple issues.

*Criteria* In each case, we, together with staff, would look at each issue to help assure that it meets the criteria described above. This is especially important since the Agency can of course continue to sell its new MBS' directly into the secondary market. The aim is to balance how production is financed where the net present value from issuing bonds is at least comparable to selling. As with all bond issues, the return to the Agency depends on prepayment speeds so these would be taken into account as well.

**2. Other**

a. *Remaining Overcollateralized Issue in RHFB.* As indicated, Minnesota Housing has one more opportunity to use the remaining additional collateral in RHFB to help shorten the average life on one final $50 million issue. Since there is only one more opportunity, of course, it is important to develop alternative bond executions such as the pass-through approach when that can be done attractively.

b. *Refunding in RHFB.* In addition there is the upcoming opportunity to refund certain outstanding RHFB bonds at lower interest rates; the savings created by a tax-exempt refunding can be used to help finance new loans at lower interest rates while giving Minnesota Housing full spread. This was the approach used in the 2013 ABC bond issue and is potentially very desirable depending on interest rates at the time of the refunding.

c. *Possible Use of Variable Rate Bonds Fully Hedged by Cash in RHFB Indenture.* Any use of variable rate bonds would be very carefully scrutinized to assure it does not add to indenture risks, as set forth in the RHFB criteria guidelines adopted by the Board in 2007 and revised by the Board in May 2014.

The RHFB indenture does provide a built-in risk protection that is similar to many other HFA single-family indentures: a significant amount of cash (because of termination of downgraded guaranteed investment contracts, loan prepayments, etc.). This cash is invested in money market funds and thus in low interest rate environments like today is earning virtually nothing. As a result, Minnesota Housing like almost all state HFAs, performs much better in high interest rate environments than in low ones.

To reduce this gap, and to do better in low rate environments, Minnesota Housing can consider issuing a limited amount of variable rate bonds without interest rate swaps. Since the rate on these bonds tracks the rate earned on cash already under the indenture, the cash provides a natural 'hedge': the higher rates move on the bonds, the higher Minnesota Housing's investment earnings. Equally important, when interest rates are low, Minnesota Housing pays very low rates on these bonds.

As part of the 2014 Risk-Based Capital Study for the Agency as a whole, we will evaluate the risks and benefits of having such additional variable rate exposure and bring that back to the Board before considering any individual transactions.

Furthermore, to make this approach safe and avoid liquidity risks, it would ideally be designed in conjunction with floating rate notes placed with the Federal Home Loan Bank or other bank, so there is no risk of higher liquidity fees or termination or downgrading of liquidity facilities. Under these circumstances, and possibly with the purchase of interest rate caps to provide additional protection if rates do rise, we think such an approach is likely to be quite useful for the Agency.

In any case, any such approaches would be presented to the Board before such bond issues would be structured and sold.

***VALUE OF POOL 2***

Minnesota Housing has much more flexibility in financing single-family loans than some housing finance agencies. Pool 2 with relatively large cash balances can be used to purchase new MBS, either to:

- boost its long-term investment return or
- provide a way to fund new production at least for a period of time.

For example Pool 2 was used effectively to purchase the MBS in June 2013 when the 2013 C bond issue was reduced in size. These MBS could have remained as a long-term investment without needing to re-sell them on the market. However when the overcollateralized bond structure became available, it was possible to buy these out of Pool 2 at par (well above their market value) and now finance them long-term at full spread.

This in turn replenished Pool 2's cash and can thus continue to play an exceptionally valuable role for the Agency in how it finances new loans.

**AGENDA ITEM:** B
**MINNESOTA HOUSING SPECIAL BOARD MEETING**
**June 5, 2014**

**ITEM:** Section 8 Opt Out Notice Review Policy

**CONTACT:** Tonja Orr, 651.296.9820
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**REQUEST:**

☑ Approval ☑ Discussion ☐ Information

**TYPE(S):**

☐ Administrative ☐ Commitment(s) ☐ Modification/Change ☑ Policy ☐ Selection(s) ☐ Waiver(s)

☐ Other: ______________________________

**ACTION:**

☑ Motion ☐ Resolution ☐ No Action Required

**SUMMARY REQUEST:**
Staff requests approval of the attached policy regarding the Agency's response to notice of an owner's intent to opt out of the Section 8 program when agency consent is required. In most situations, the Agency will seek to preserve the property as federally assisted.

As the rental housing market tightens owners of Section 8 properties may consider terminating their participation in the Section 8 program at the next opportunity. A small portion of the Section 8 portfolio requires the Agency's consent to an opt out of the program. The attached policy is a statement of the agency's general approach when an owner has submitted an opt out notice and the Agency's consent is required.

**FISCAL IMPACT:**
None.

**MEETING AGENCY PRIORITIES:**

☐ Promote and support successful homeownership ☑ Preserve federally-subsidized rental housing

☐ Address specific and critical needs in rental housing markets ☐ Prevent and end homelessness

☐ Prevent foreclosures and support community recovery ☐ Strengthening Organizational Capacity

**ATTACHMENT(S):**
- Draft policy

## Policy 13 – Section 8 Opt Out Notice Review

Under federal requirements, owners of properties subject to Section 8 Housing Assistance Payment (HAP) contracts are required to provide notification one year in advance of their intent to opt out of renewing their HAP contracts.  Some properties subject to a Section 8 HAP contract do not allow for unilateral termination of the contract by the owner.  It is the Agency’s general policy when an owner of such a property submits a notice of intent to opt out, the Agency will take actions to preserve the property as a federally assisted property and will not consent to the opt out, provided the property meets certain physical condition standards and addresses local market needs. In limited circumstances, the Agency may consent to an opt out if there are compelling reasons to do so.