Current Mortgage Finance Executions

RAYMOND JAMES®

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FLORIDA ALHFA

MORTGAGE REVENUE BOND OVERVIEW: BOND PARTICIPANTS

ISSUER/Housing Finance Agency (HFA): the entity authorized by law to issue tax-exempt bonds.

- State HFA: each state has 1 HFA (e.g., Florida Housing Finance Corporation)
- Local HFA: several states (including Florida) also have local HFAs, but most states do not.

ISSUER's COUNSEL: a law firm that represents the HFA and reviews documents on HFA's behalf.

BOND COUNSEL: a law firm engaged to produce the main bond documents and write a tax opinion.

FINANCIAL ADVISOR: a firm engaged by HFA to provide advice with respect to financing structure and timing of sale, along with other related matters.

TRUSTEE: a bank that administers the bond trust indenture and makes P&I payments on the bonds.

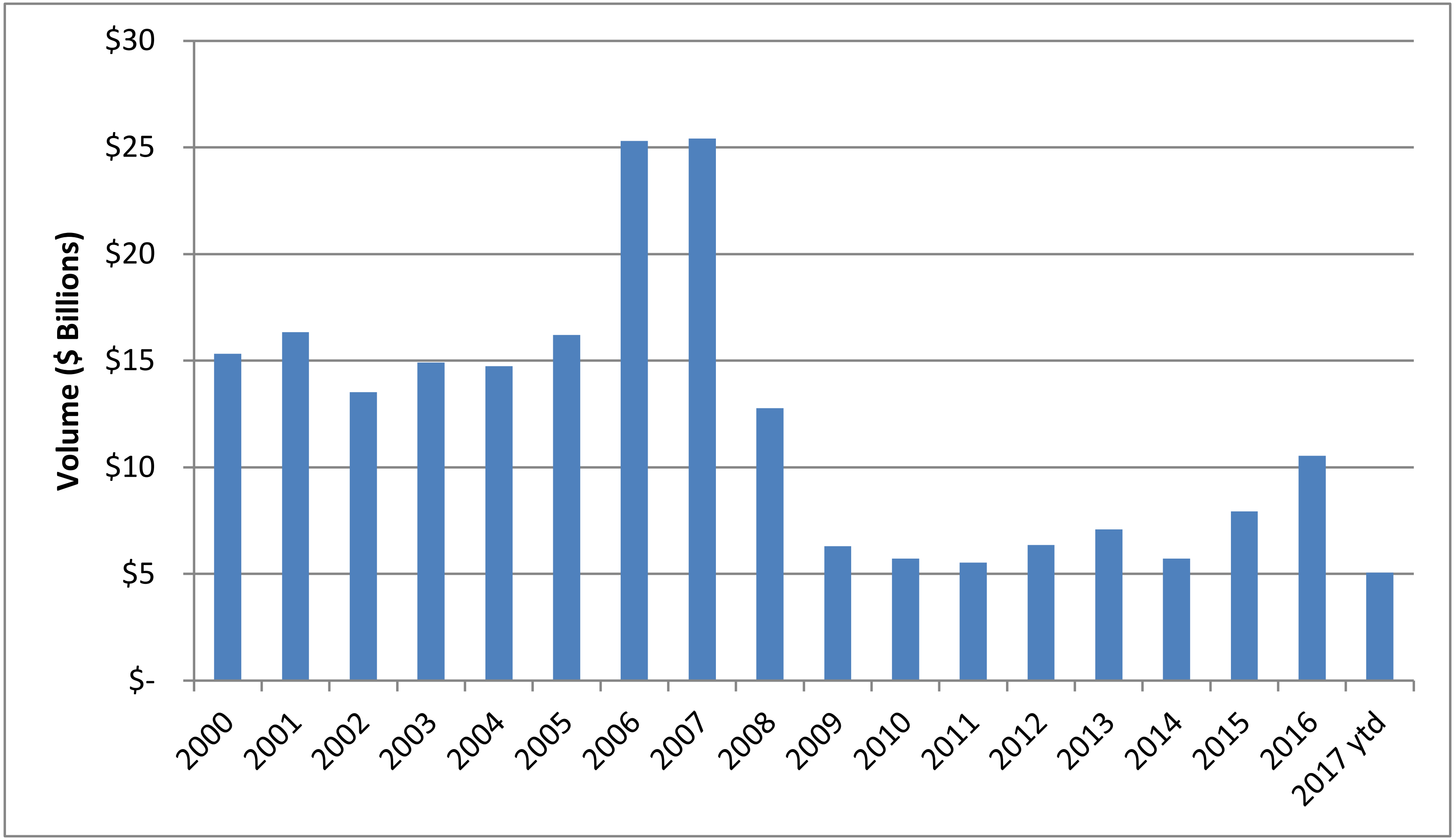
UNDERWRITER: a broker/dealer who helps structure and ultimately sells the bonds to investors.

- Senior Manager: firm selected by the HFA to "lead manage" the financing (primary firm).
- Co-Manager: one or more firms selected by HFA to assist is the sale of the bonds.

UNDERWRITER's COUNSEL: law firm that represents the Underwriter in the bond financing.

RATING AGENCY: a nationally recognized rating agency (e.g., S&P/Moody's/Fitch) engaged by an issuer to provide a rating of the bonds. Most HFA bonds are rated in the "Aa" or "Aaa" category.

HFA SINGLE FAMILY MORTGAGE REVENUE BOND (MRB) ISSUANCE SINCE 2000



HFA single family bond volume in 2014-2016 is approximately 30% of volume in 2007 peak.

Source: Thomson Reuters

HISTORY OF HFA SINGLE FAMILY FINANCINGS (THROUGH 2012)

Traditionally, state and local HFAs have issued **tax-exempt mortgage revenue bonds (MRBs)** to provide funds to allow HFAs and their lending partners to originate mortgage loans over a limited origination period (less than 42 months). HFA would fund up-front costs of issuance (COI), reserves and "negative arbitrage" (i.e., the negative interest carry of MRBs during the origination period).

- **Limited risk to HFA** (recoupment of COI and negative arbitrage).
- **Mortgage rate "locked-in"** – lenders had generous time allotment to deliver loans.
- **HFA benefits from issuer fee and residual** (determined by future loan prepayment speeds).

In difficult MRB markets, HFAs have to be more creative to overcome market challenges (e.g., steep yield curve = high negative arbitrage). <u>Below are examples of non-traditional HFA executions</u>:

2000-2004 – **Private Placements & Forward Delivery Bonds**

- Variety of local HFA bond structures "privately placed" (rather than publicly sold) to Fannie Mae, such as the "forward-delivery bond" that eliminated negative arbitrage.

2005-2007 – **Step-Coupon Bonds & Interest-rate Swaps**

- Step coupon & "synthetic-stepped" coupons to reduce or eliminate "negative arbitrage".
- Swaps used by large state HFAs, particularly in markets where affordability was challenged.

2008 – **Onset of Financial Crisis . . .** at this time most MRB financing methods no longer worked.

2009-2012 – **US Treasury's "New Issue Bond Program" (NIBP)**

STATE OF THE SINGLE FAMILY MARKET FOR HFAs

Post NIBP it has been difficult for HFAs to create competitive single family programs funded through traditional mortgage revenue bonds ("MRBs").

- <u>Tax-exemption</u> at these historically low interest rates is less meaningful.
- <u>Steep yield curve</u> means significant negative arbitrage contributions required with MRBs.
- <u>DPA now is the primary distinguishing factor</u> for HFA single family programs.

<u>Mortgage Revenue Bonds</u>: HFAs currently can create a competitive single family mortgage product using **MRBs** generally by **subsidizing the new money mortgages** through:

- <u>a refunding component</u>
    - refunding opportunities, however, will be limited post-2017 once the bonds issued pre-2008 crisis have been refunded;
- <u>0% participations</u> from prior MRBs, or
- <u>resolution/balance sheet strength</u>.

<u>TBA</u>: In this low interest rate environment, **most HFAs have chosen "TBA"** (<u>a non-bond execution</u>) in addition to or in lieu of MRBs to fund their single family programs.

- ~70% of single family HFA production now being done TBA.

WHAT IS "TBA"? HOW IS "TBA" DIFFERENT THAN "MRBs"?

TBA is a forward sell/buy trade of federally-insured MBS (e.g., GNMA). The actual MBS security to be bought/sold pursuant to a TBA trade is not known at the time of the initial trade; such MBS is **"to be announced" 48 hours prior to settlement**. Because one or more factors aren't known at the time of the initial trade, TBA contracts are deemed to be **"investment derivatives"** which are required to be disclosed in an HFA's financial statements as derivatives.

TBA contracts are used by mortgage originators to **hedge interest rate movements b/w the time of a loan reservation & the MBS settlement** (generally 60-100 days from initial loan reservation).

- **With MRBs, the financing cost of funding a loan generally is known** (e.g., the bond rate) and an HFA's primary MRB exposure is "origination risk" and recoupment of COI/Neg. Arb.
- **With TBA, funding costs of a loan aren't known until a TBA contract is executed**.
  - From time of loan reservation until a TBA hedge is put on, an HFA is incurring **market risk** of rates moving higher (and the loan being less valuable in the MBS market).
  - Upon executing a TBA contract, the HFA is exposed **to pipeline risk** (e.g., fallout risk).

HFAs that have risk tolerance, and do **direct TBA trades,** still often engage a "**hedging consultant**" to provide hedging advice when entering into TBA contracts due to the above-referenced risks.

HFAs that do not want financing risks, or the political risk of reporting "derivatives" on its financials, can choose a TBA program where a **3rd-party (e.g., Raymond James/"Turnkey") absorbs 100% of the market and pipeline risks**, in which case **no TBA contracts** are entered into by the HFA.

MANAGING MARKET RISK IN NEW ENVIRONMENT

Timing of "Locking-in" Pricing is Critical to Managing Market Risk

Loan Reservation

Lock-in Financing On or Before Loan Reservation

HFA locks in financing **ON or BEFORE** loan commitment is made.

- Traditional Bond Financing with 0%s or Refundings
- RJ's "Turnkey"/Immediate TBA Hedges

HFA risk is limited/transferred.

Best execution: Rising or volatile interest rate environment.

Lock-in Financing After Loan Reservation

HFA locks in financing **AFTER** loan commitment is made.

- MBS Pass-Through Financing
- "Delayed" TBA Hedges

HFA is exposed to market risk until financing is obtained.

Best execution: Falling or stable interest rate environment.

WHY ARE HFAS USING "TBA" TO FUND SINGLE FAMILY PROGRAMS?

TBA-related financings, either directly or via a 3rd-party program, have become the **primary single family funding mechanism** for HFAs nationwide, instead of through MRBs. TBA programs are popular with HFAs due in large part to:

- TBA generally provides a **higher NPV return ($$)** to the HFA than MRBs;
- TBA allows **broader homebuyer universe** (e.g., borrower income not required to include household income; no 1st-time homebuyer req't) and less paperwork for lenders (e.g., Form 1003 to establish 1st-time homebuyer status (3 years tax returns not a req't)); and
- **Lenders find it more user friendly** since TBA is how most mortgage originators fund and hedge their single family programs, so the terms are familiar (more so than a bond program).
- Under TBA, **most aspects of mortgage loan program operations are unchanged from MRBs**.
    - A **primary difference** between MRBs and TBA is how the MBS are delivered. Instead of being sold to a bond trustee and held as security for a bond, the MBS in a TBA program instead are sold to an institutional investor ("counterparty").

While tax-exempt markets provide challenges, non-MRB-based programs enable HFAs to:

- Support mission of helping low-income borrowers that have difficulty obtaining credit;
- Earn income;
- Maintain lender networks: Lenders are key to an HFA's success, and maintaining a network of lenders is vital to the future success of any HFA's single family program; and
- Expand MCC offerings, as MCCs cannot be paired with tax-exempt MRB program loans.

COMPARISON OF BOND & TBA/"TURNKEY"

	PAC Bond Structure Serials, PAC, Terms	Turnkey/TBA	Turnkey/TBA
Origination Period	6 months - level	Continuous	Continuous
Program/Bond Par	25,000,000	25,000,000	25,000,000
Premium	-	1,037,500	607,750
Total	25,000,000	26,037,500	25,607,750
Mortgage Rate	**4.310%** *Full-Spread*	**4.250%**	**4.000%**
Mortgage Yield	4.310%	NA	NA
Bond Yield	3.192%	NA	NA
Spread	1.118%	NA	NA
PV Issuer Fee/Residual (100% PSA)	1,174,240	NA	NA
PV Issuer Fee/Residual (200% PSA)	*1,099,644*	NA	NA
PV Issuer Fee/Residual (300% PSA)	*1,031,976*	*NA*	*NA*
PV Premium Raised	-	1,037,500	607,750
DPA Grant	-	-	-
Reserve Fund	(325,000)	NA	NA
COI (est. $12.5/bond)	(312,500)	NA	NA
NPV (100% PSA)	**536,740**	**1,037,500**	**607,750**
NPV (200% PSA)	***462,144***	***1,037,500***	***607,750***
NPV (300% PSA)	***394,476***	***1,037,500***	***607,750***

Footnotes: 1) 1% Origination fee
2) NPV analysis using 3% disc

Since 2012, TBA generally has produced a lower mortgage rate than most MRBs

TBA income not subject to PSA experience

Rates as of 7/10/2016.

MRB ANNUITY VS. TBA INCOME

- MRB income generally is received over the life of the bond ("**annuity income**") based on the amount of bonds/mortgages outstanding from the allowable up to 1.125% spread.
- TBA income generally is a **one time, up-front amount** paid to the HFA based on the difference between the cost to fund the underlying loan and the TBA price it sold the MBS for.
- HFAs that wish to can **"annuitize" the up-front TBA profits**. For example, in comparing from the prior slide the **$536,740,** NPV of an MRB transaction (at a favorable 100% PSA prepayment speed assumption) to a TBA execution, if one were to invest the **$1,037,500** of up-front TBA income in a **30-year U.S. Treasury** with a 2.93% yield, here is the annuity and NPV comparison:

Comparison of MRB Annuity & TBA Annuity

INCOME/(EXPENSE)	BONDS (100% PSA)		TBA	
1st 10 Years	$ (182,766)*		$ 303,988	
Years 11-20	105,821		303,988	
Years 21-30	1,583,020		1,341,488**	
Gross Cashflow	**$1,506,075**		**$ 1,949,464**	
				TBA difference:
NPV @ 3% Discount Rate	**$ 536,740**	**vs**	**$1,008,079 =**	**+ $568,333**

* Reflects $637,500 contribution at MRB closing to cover COI, reserves, and negative arbitrage for 6 months (level) origination.

*** Includes $303,988 of interest income and repayment of $1,037,500 of principal upon T-Bill maturity in 2047.*

ANOTHER NON-MRB EXECUTION: MORTGAGE CREDIT CERTIFICATE (MCC)

- An MCC is an annual tax credit that reduces a homeowner's federal tax liability each year the borrower occupies the home as a principal residence.
- MCCs cannot be paired with MRBs because they each use PAB volume cap.
- Like tax-exempt MRBs, borrowers must qualify for an MCC (e.g., purchase price, income, 1st-time homebuyer (unless a veteran or in a targeted area)).
- One must have federal income tax liability to take advantage of MCCs, and the annual MCC tax benefit is capped at lesser of $2k or 50%* of mortgage interest.

Example of MCC calculation:

1.	Home Loan Amount	$150k
2.	Annual Interest Rate (30-yr fixed)	4.00%
3.	Approx. Total Mortgage Interest Paid (Year One)	$6,000
4.	**Mortgage Credit Certificate Rate**	**25%***
5.	**Annual MCC Amount (Line 3 x Line 4)**	**$1,500**
6.	Monthly MCC Amount (Line 5 / 12)	$125**

* % credit determined by HFA, up to 50%; a higher % reduces # of households benefitted.

** Estimated MCC monthly savings can be deemed income when qualifying the borrower.

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