S&P Global
Ratings

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Massachusetts Housing Finance Agency; Joint Criteria; Multifamily Whole Loan

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Credit Profile		
US$53.12 mil Hsg Bnds ser 2016H due 06/01/2045		
Long Term Rating	AA/Stable	New
US$25.0 mil Hsg Bnds ser 2016I due 12/01/2056		
Long Term Rating	AA/Stable	New
Massachusetts Hsg Fin Agy (MBIA) (National) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Massachusetts Hsg Fin Agy hsg bnds		
Long Term Rating	AA/Stable	Upgraded
Massachusetts Hsg Fin Agy hsg bnds ser 2016F due 12/01/2058		
Long Term Rating	AA/Stable	Upgraded
Massachusetts Hsg Fin Agy hsg bnds ser 2016G due 12/01/2023		
Long Term Rating	AA/Stable	Upgraded
Massachusetts Hsg Fin Agy hsg bnds ser 2016H due 12/01/2058		
Long Term Rating	AA/Stable	Upgraded
Massachusetts Hsg Fin Agy hsg bnds (fixed rate)		
Long Term Rating	AA/Stable	Upgraded
Massachusetts Hsg Fin Agy hsg bnds (Federally Taxable) ser 2016C due 12/01/2055		
Long Term Rating	AA/Stable	Upgraded
Massachusetts Hsg Fin Agy JOINTCRIT		
Long Term Rating	AAA/A-1+	Current
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Massachusetts Hsg Fin Agy JOINTCRIT		
Long Term Rating	AAA/A-1+	Current
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Massachusetts Hsg Fin Agy JOINTCRIT		
Long Term Rating	AAA/A-1+	Current
Unenhanced Rating	AA(SPUR)/Stable	Upgraded
Massachusetts Hsg Fin Agy MFWHLLNS		
Long Term Rating	AA/A-1+/Stable	Upgraded
Unenhanced Rating	NR(SPUR)	Current

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings raised its long-term rating and underlying rating (SPUR) to 'AA' from 'AA-' rating on all bonds outstanding under the Massachusetts Housing Finance Agency's (MassHousing) main multifamily housing revenue bond resolution (the housing bond resolution). At the same time, S&P Global Ratings assigned its 'AA' long-term rating to MassHousing's housing revenue bonds, 2016 series H and I. The outlook is stable.

The rating action reflects our view of improvement in financial strength and loss coverage of the resolution to extremely strong from very strong.

The 'AA' ratings reflect our view of:

- The extremely strong government support, reflecting ongoing support in the form of low-income housing tax credits, Federal Housing Administration (FHA) risk-share mortgage insurance, federal and state rental subsidies, property tax exemptions, and tax-exempt bond financing;
- Very strong strategy and management and financial policies and practices by MassHousing;
- Very strong loss coverage, based on the resolution's high overcollateralization;
- The resolution's solid financial strength, reflecting the pool's weighted average debt service coverage (DSC) of approximately 2.19x, a debt service reserve fund (DSRF) sized at six months, and permitted investments with providers that carry ratings commensurate with the rating on the bonds; and
- Extremely strong operating performance of the loans held under the resolution, with only one loan delinquent and an average vacancy rate below 3% for 400 properties.

Partly offsetting the above strengths, in our view, are:

- Project subsidies from both federal and commonwealth sources that are subject to funding or appropriation risk,
- Limited liquidity under the resolution, and
- High flexibility in the bond documents allowing the issuer to release funds from the resolution.

The bonds are special revenue obligations of MassHousing, secured solely by a lien on money and investments held in all funds and accounts established by the resolution. The bonds are also secured by a lien on all income from mortgage loans. The bonds are subject to optional and mandatory redemptions, as outlined in the preliminary official statement. The 2016 series I bonds are subject to mandatory redemption on Dec. 1, 2026.

The proceeds of the bonds will be used to finance the acquisition, construction, and/or rehabilitation of affordable multifamily properties, fund the DSRF, and pay costs of issuance. The majority of the loans in the portfolio benefit from some form of federal or state subsidy. The loans are well seasoned, many having been financed in the 1970s and 1980s. Approximately 23.0% of the portfolio's loan balance represents properties that receive Section 8 subsidies through coterminous housing assistance payments contracts or Section 236 interest reduction payment subsidies, 60.2% benefits from FHA risk-share mortgage insurance, 5.6% benefits from other state or federal subsidies, and 11.2% is uninsured. We consider the quality of the loans in the portfolio very strong.

Outlook

The stable outlook reflects our view of the anticipated stability of the seasoned portfolio of mortgage loans, and MassHousing's careful oversight and management of the bond program to preserve credit quality. The stable outlook also reflects our view of the continued very low delinquencies in the portfolio and the projected increase in asset-to-liability parity despite projected annual withdrawals from the resolution.

Upside scenario

If overcollateralization for the resolution continues to grow, despite anticipated withdrawals, and loan performance continues to improve, this could lead to a positive rating action.

Downside scenario

A deterioration in loan performance and increased delinquencies, or a decline in the portfolio's DSC to less than 1.1x, could lead to a negative rating action. In addition, if MassHousing withdraws funds from the resolution to a level that would lead to a decline in overcollateralization to less than loss coverage at the 'AA' level, this could lead to a negative rating action.

Enterprise Risk Profile

Industry risk

We view industry risk as low for the affordable housing industry. Residential rental markets typically pose less risk than other property classes, and the increased need for affordable housing during times of economic stress lends further stability. Competitive risk is fairly low, owing to effective barriers to entry in many jurisdictions, the relatively low risk of substitution, and overall stable trends in growth and margins. In addition, ongoing governmental subsidies, other support, and oversight generally limit volatility, with the overall importance of the service delivered limiting the potential for negative government intervention.

Economic fundamentals and market dependencies

According to IHS Global Insight, the Massachusetts economy is driven by the high-technology, finance, higher education, and health care sectors. Massachusetts' private sector labor market grew 3.7% during the past three months, which translated to 27,000 new jobs. The health care and business services sectors were the key contributors to this growth, and are expected to remain so over the next several years. As seen in the past, the manufacturing sector eroded as a result of high operating costs, rising competition from abroad, and the adoption of automated manufacturing processes.

Massachusetts' unemployment rate was 4.7% as of August 2015 and is expected to remain under 4.6% through 2018. The state's economy expanded by 2.3% in 2014, and gross state product growth looks promising over the next several years.

IHS reports that home construction activities in Massachusetts have expanded over the past year, with total housing starts increasing 20% year over year as of the first quarter of 2014. However, performance was mixed across the two segments. Whereas single-family units declined, multifamily units increased by 18%. The improved economic environment and lean inventory of homes available for sale have increased the demand for new construction and have also played a significant role in quickly driving up prices. The average home price was $435,847 in 2014 and is projected to grow at an average annual rate of 2.3% for the next three years. Housing affordability in the state has historically has been lower than the national average. Home price appreciation should decelerate hereafter, but home prices are expected to rise in the long run.

According to the Mortgage Bankers Assn., 11.8% of subprime mortgages (compared with 8.5% nationally) and 1.2% of prime mortgages (compared with 1.2% nationally) entered foreclosure in the fourth quarter of 2014. With these rates, Massachusetts ranked 11th and 18th in the U.S. in subprime and prime loans foreclosure, respectively.

Government support

The resolution benefits from extremely strong government support, reflecting ongoing support from multiple levels of government in the form of low-income housing tax credit equity, Section 8 and state rental subsidies, FHA mortgage insurance, property tax exemptions, and tax-exempt bond financing.

Strategy and management

In our view, efficient and effective ownership and management are necessary to ensure an affordable housing program's feasibility and sustainability. Our assessment of strategy and management for MassHousing's housing bond resolution is very strong, reflecting sound management and oversight of the resolution by MassHousing, a very strong strategic planning process, and good operational effectiveness.

We consider MassHousing's management very strong based on its extensive experience and large portfolio of approximately 50,000 affordable multifamily housing units. We view agency staff as highly competent, well trained, and proactive in addressing key issues. The agency has approximately 340 employees, with the staff generally organized under an executive director, general counsel, chief financial officer, and chief administrative officer.

The staff includes employees with professional qualifications in the fields of finance, law, architecture, cost estimating, housing management, construction inspection, mortgage underwriting, business administration, accounting, information technology, and economic and community development. Recently, MassHousing has focused its efforts on maintaining consistent, strong management through internal succession planning. The former chief financial officer replaced the former executive director, and the finance director replaced the chief financial officer.

We consider MassHousing's portfolio quality high as a result of the strong curb appeal, very high occupancy, and limited deferred maintenance on its properties. MassHousing has a good track record of managing the resolution, based on positive net operating income for approx. 92% of its loans. We believe MassHousing's strategic planning process is very strong. MassHousing has a five-year strategic plan with multiyear financial and capital projections, maintains detailed organizational charts, and has an informal succession plan. In addition, we believe the issuer has good operational effectiveness based on the emergence of unexpected operational risks that only occasionally affect cash flow.

The issuer's governance structure has a neutral impact on our assessment of strategy and management. This is based on the extensive experience of board members; minimal board member turnover, which enhances effective governance; strong oversight by board members, and their regular involvement in making and reviewing important decisions. MassHousing is governed by a nine-member board: the secretary for administration and finance as well as the director of the department of housing and community development of the commonwealth, ex officio, and seven other members appointed by the governor. Three of the seven appointees are required to have expertise in mortgage banking, architecture, or city or regional planning and real estate transactions, and two are required to have experience in single-family housing finance. Another appointee is required to be a representative of organized labor. Each appointive member serves for a term of seven years and until his or her successor is appointed and duly qualified. Board members meet once a month or more frequently, if necessary.

Financial Risk Profile

Loss coverage

We consider the resolution's coverage of projected loan losses very strong based on our evaluation of the underlying properties. We derived net cash flow (NCF), DSC, and value for each property based on capitalization rates ranging from 6.25% to 7.0%. The loan-to-value (LTV) ratio and DSC were the primary factors used to determine the transaction's credit enhancement levels. Based on our analysis, the transaction has sufficient overcollateralization available to cover projected loan losses in the amount of approximately $164 million, or 8.625% of loans outstanding, which corresponds to a loss coverage assessment of very strong. The resolution's asset-liability parity is 116.5%, with approximately $265 million in excess assets available to cover projected loan losses. The loan portfolio consists of loans on 400 properties, with a principal balance of $1.6 billion as of Sept. 30, 2016. The average DSC and LTV ratios for the loans in the pool are 2.19x and 69.3%, respectively.

Financial strength

We view the transaction's financial strength as solid based on the loan portfolio's average DSC ratio of 1.74x. The primary source of revenue to pay debt service on the bonds is payments on the underlying loans. Including the new series 2016HI, MassHousing's housing bond indenture contains nearly $1.68 billion in bonds outstanding. Of the total debt, approximately $140 million (8%) is variable rate.

Liquidity for variable-rate demand bonds is provided in the form of standby bond purchase agreements from Bank of New York Mellon (AA-/A-1+) and TD Bank NA (AA-/A-1+), and in the form of self-liquidity from MassHousing on one bond issue (series 2003F).

Use of variable-rate debt exposes the agency to fluctuating interest rates; as a result, the agency has entered into a series of interest rate swaps to hedge roughly 64% of its floating-rate exposure on variable-rate bonds. MassHousing's swaps are divided between two rated counterparties: Bank of America Corp. (BBB+) and JPMorgan Chase & Co. (A-).

Consolidated cash flows evidence the ability of pledged revenue to pay debt service under a variety of stress scenarios. The cash flows reflect program activity through July 1, 2016 and bond issuance activity through the issuance of series 2016 HI. The cash flows incorporate the following assumptions:

- Modeling of fixed-payer and floating-receiver payments under the agency's swaps,
- Swap basis risk expense of 50 basis points,
- A 30-day payment lag on all mortgage loans,
- Liquidity fees that increase to at least 1.0% upon expiration of existing liquidity facilities, and
- An open flow of funds.

The resolution's asset-liability parity position as of July 1, 2015 was 116.8%, representing approximately $278 million in program equity. Consolidated cash flow projections demonstrate an initial drop in asset-liability parity to a low of 114.5% as of June 1, 2016, followed by rising equity through bond maturity. The level of program equity is sufficient to withstand our assessment of potential loan losses at a level commensurate with the current rating.

Reserves

Sufficient credit and liquidity reserves are present to cover any potential credit or liquidity shortfalls. Under the bond resolution, there are two reserves: the DSRF and the housing reserve fund. The DSRF for each new series bonds will be cash funded in an amount equal to one-half of the maximum annual debt service coming due in any calendar year on the bonds. This amount has been determined to be sufficient to cover any liquidity needs of the resolution during the period between a mortgage loan default and loan recovery. The strong performance of the mortgage pool, coupled with the reserves available at the projects, assist in providing ample coverage. As of July 1, 2015, approximately $95 million (5.8% of loans outstanding) was held in the resolution's DSRF.

The housing reserve fund is broken out into two accounts: the retained revenue account and the reserve account. The retained revenue account is where any excesses will remain in the flow of funds and will always remain pledged to bondholders. The reserve account will be pledged under the resolution only at the option of MassHousing and can be funded from the retained revenue account subject to asset-liability and cash flow certificates. The reserve account is not reflected in the cash flows, but the retained revenue account is reflected in the cash flows. To the extent the funds in the reserve account are held under the resolution, the trustee will use them before using the retained revenue account to fund amounts needed to support the bonds. The reserve is invested in U.S. Treasury strips maturing in 2016 to 2024.

MassHousing holds reserves outside the resolution for the benefit of each property. These reserves were established to fund any capital or other improvements necessary at the properties. Over time, these reserves have grown significant. The funds held at each property can be used to support debt service at that property, if necessary. The project reserves are significant credit strengths because they reduce the risk of temporary disruptions in cash flow resulting from difficulties at a project.

Asset quality

We consider the quality of loans held under MassHousing's housing bond resolution very strong. As of Sept. 30, 2016, the portfolio's loan balance stood at $1.6 billion, consisting of loans on 400 properties and nearly 37,000 units. The majority of the loans in the portfolio benefit from some form of federal or state subsidy. The loans are well seasoned, many having been financed in the 1970s and 1980s. Approximately 23.0% of the portfolio's loan balance represents properties that receive Section 8 subsidies through coterminous housing assistance payments (HAP) contracts or Section 236 interest reduction payment (IRP) subsidies, 60.2% benefits from FHA risk-share mortgage insurance, 5.6% benefits from other state or federal subsidies, and 11.2% is uninsured. Although the federal Section 8 program is undergoing a period of uncertain funding, the Section 8 contracts under the resolution are not subject to HUD pronouncements concerning subsidy termination because the underlying loans have not been refinanced. In addition, MassHousing successfully applies for and receives rent increases to ensure the viability of these properties.

The loans supported by the commonwealth's Section 13A subsidy are subject to appropriation risk of the commonwealth for the subsidy. From time to time, since the mid-1980s, the commonwealth's budget has not always provided for the full amount of its commitments under the Section 13A program. The presence of high levels of loan reserves at these properties and the strong performance of these loans mitigates the risk of funds not being appropriated. From now to 2020, all of the remaining mortgage loans assisted under the Section 13A program are scheduled to mature and the existing subsidy commitments under Section 13A and the related affordability requirements will terminate.

In addition, we consider the credit quality of investments under the resolution very strong and consistent with the rating. MassHousing's investment guidelines are conservative, in our opinion, stressing principal preservation and disallowing derivative securities or products. As of June 30, 2015, the indenture included $307 million in investments, most of which were held in 'AAA' rated money market funds or U.S. Treasury obligations. MassHousing has one guaranteed investment contract with Berkshire Hathaway (AA-/A-1+) with a balance of approximately $15.5 million.

Operating performance

Our assessment of operating performance is very good, based on the high average occupancy rate (97.5%) among the resolution's properties and minimal loan delinquencies, with just one loan ($1.7 million) that is 60 or more days delinquent, representing 0.1% of the total loan balance.

Financial policies and practices

We view MassHousing's financial policies and practices as excellent. This is based on formal, detailed guidelines for approving loans, including internal credit and underwriting reviews and a committee approval process prior to board approval. In addition, MassHousing requires annual audits and performs comprehensive annual reviews of all projects, and has policies and procedures in place to address payment delinquencies and projects that are not in compliance with regulatory requirements. MassHousing's loans are generally fixed-rate, first- or second-lien mortgage loans that fully amortize over 30 years.