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Risk-Based Capital Rule May Diminish GSE Interest in HFA Bonds

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Contained within the complex, 568-page Office of Federal Housing Enterprise Oversight's risk-based capital rule is a provision that has caused a commotion in the housing bond industry. The final rule was published September 13 and has met with objection from affordable housing finance professionals.

The risk-based capital rule establishes how much capital that government sponsored entities (GSEs) must hold to survive a 10-year "stress test." The controversial provision concerns counterparty, or default, risk and delegated underwriting and servicing programs (DUS), the primary multifamily affordable housing finance tool used by GSEs.

Essentially, the rule seems to create incentives for Fannie Mae to favor more highly rated lenders. The rule enforces "haircuts," a method used to discount the full value of a security to account for certain risks or problems, for DUS lenders. OFHEO assigns these haircuts for counterparty risk, based on a lender's rating. These ratings vary significantly — from 5 percent for AAA-rated companies to as much as 40 percent for lower rated companies. The impact of these ratings has yet to be fully defined.

In September, the National Council of State Housing Agencies (NCSHA) established a subgroup of its working group on housing finance agencies (HFAs) and GSEs to study the rule and its implications.

NCSHA's director of development, Garth Rieman, says the primary concern is learning what impact the rule will have on GSEs' business with HFAs, particularly the counterparty discounts' effect on GSEs investment and the purchase of HFA bonds. "Right now, we are trusting Fannie Mae's and Freddie Mac's comments that the rule significantly reduces incentives to purchase HFA bonds, and we are concerned about the effect that would have on HFAs' efforts to provide affordable housing," Rieman says.

Likewise, The Mortgage Bankers Association of America (MBA), in a letter to the OFHEO, says the rule could "decrease competition and stifle product innovation while increasing costs to the consumer."

In its letter, the MBA asked OFHEO to assign the same haircut to all DUS lenders at a level of 5 percent, asserting that the risk-based capital rule fails to

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Moody's Investors Service (Moody's) reports that despite an economic slowdown, tax-exempt housing bond issuers, particularly state housing finance agencies (HFAs), are stronger than ever. Moody's reports that the $15 billion combined fund balance for state HFAs and their 13 percent median profitability ratio should allow them to "easily withstand" some of the negative effects of the sagging economy, and consequently predicts a stable outlook for the state HFA industry. For more information about state tax-exempt bond allocating agencies, visit www.taxcredithousing.com.

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capture the economics underlying the DUS marketplace. The MBA emphasizes Fannie Mae safeguards that "assure coverage for their ability to meet risk-sharing obligations," including net worth minimums tied to portfolio growth, liquidity standards, specific liquidity reserves maintained with a trustee, loan loss reserves, rigorous oversight and risk monitoring, and access to servicing portfolio value.

The National Multi Housing Council has also expressed its interest in seeing the rule modified "to avoid increasing the cost of and decreasing the availability of mortgage capital to the multifamily industry."

Though the rule has been finalized, it is not enforceable until 12 months after it has been published. In this case, the rule will not be enforceable until September 13, 2002. Furthermore, Rieman says, OHFEO has responded to concerns among affordable housing professionals and plans to release a proposal of changes to the rule. OFHEO did not provide details, however, on which provisions will be open for revision.

During testimony before the House Financial Services Committee in August, OFHEO Director Armando Falcon said the agency was willing to rework problematic issues, if necessary. "While the finalization of the rule is a landmark, it certainly does not close the door on work on [the rule]," Falcon said.

And while there may be other recourse available to HFAs and affordable housing professionals if the counterparty discount provision is not revised, Rieman says a change to the final rule is certainly the outcome NCSHA would prefer. ❖

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The Internal Revenue Service (IRS) announced in October that it would provide issuers of tax exempt bonds affected by the September 11 attacks with additional time to file certain information returns and arbitrage rebate returns. Affected issuers who had an original filing deadline between Sept. 11, 2001 and Nov. 30, 2001 were given an additional six months plus 120 days to file the return and make payment due with the return. Details of the extension were given in the IRS Announcement 2001-101, which appeared in Internal Revenue Bulletin 2001-43, dated October 22.

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Moody's Investors Service has assigned a rating of Aa3 to the $298 million Chicago Housing Authority Capital Program Revenue Bonds, Series 2001. The $5.18 million Housing Authority of the City of Providence Rhode Island Capital Fund Housing Revenue Bonds, Series 2001 have also garnered an Aa3 rating from Moody's. According to Moody's, these ratings are based on the strong funding history of the programs, strong debt service coverage, very strong legal provisions and HUD's Approval Letter, which addresses public housing authority performance risk.