

SECTOR IN-DEPTH

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State Housing Finance Agencies – US

Bond issuance continues to fuel originations, growing balance sheets

Summary

Housing finance agencies (HFAs) will continue to benefit from strong mortgage origination volumes in 2024-25 as tax-exempt mortgage revenue bonds (MRBs) allow them to finance loans below conventional rates and grow balance sheets. Our projections call for \$31 billion in originations this year, with tax-exempt MRBs accounting for \$19 billion (up a tick from a strong 2023 and nearly double the \$10 billion in 2019). Taxable MRB bonds will also remain a key funding source, helping boost originations. With greater bond issuance, revenue from secondary-market loan sales, which provide a one-time cash infusion, will decline again this year. Still, higher investment income and revenue from full-spread mortgage loans will partly offset the reduction in income from loan sales.

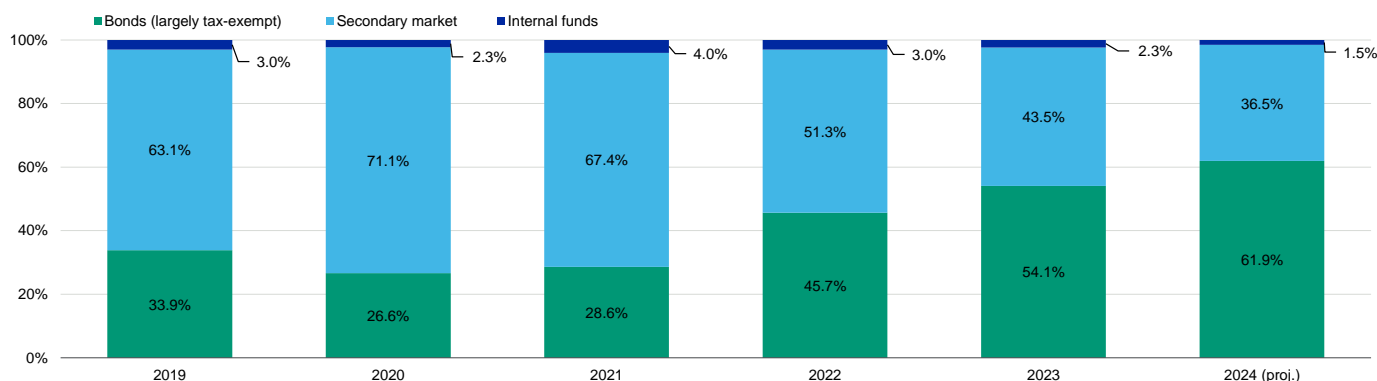
- » **HFAs will continue to grow balance sheets as MRB issuance surges.** At 62%, MRBs will fund the largest share of HFA loan originations for the second year in a row (\$19 billion out of a \$31 billion total). MRB-funded single-family loans enhance HFAs' financial stability by providing recurring revenue over the 30-year loan repayment period, a [contrast](#) with the one-time revenue injection from loans sold on the secondary (or to-be-announced) market. Increased MRB-funded loans will reduce overcollateralization, but program asset-to-debt ratios will remain relatively strong.
- » **Taxable MRB bond issuance will continue to increase, further boosting HFA loan originations.** Taxable bonds offer HFAs an opportunity for continued issuance when constrained by a tax-exempt volume cap and an option to originate loans for homebuyers not eligible for a loan financed by an MRB. Taxable bonds accounted for 37% of all bonds issued by HFAs in the first half of 2024, up from 26% for the same time period in 2023. Meanwhile, secondary-market sales will continue to decline as our projections call for originations financed by the sales to fall 21% to \$11 billion this year versus 2023.
- » **The decline in revenue from secondary-market sales will be partly offset by increased investment earnings, helping HFAs maintain solid margins.** Stronger investment earnings driven by increased short-term rates will provide a buffer against the loss of upfront premiums gained from the secondary market. The loss in secondary-market revenue has prompted HFAs to seek other funding sources for down payment assistance.

HFAs will continue to grow balance sheets as MRB issuance surges

In 2024, MRBs will fund the largest share of HFA loan originations for the second consecutive year after secondary-market sales served as the leading financing source for years. We project the share of originations funded by MRBs this year to increase to 62% (\$19 billion out of a \$31 billion total), up from 54% in 2023 (see Exhibits 1 and 2). The addition of new full-spread mortgage loans to balance sheets will bolster HFA margins and provide a stable, recurring revenue source.

Exhibit 1

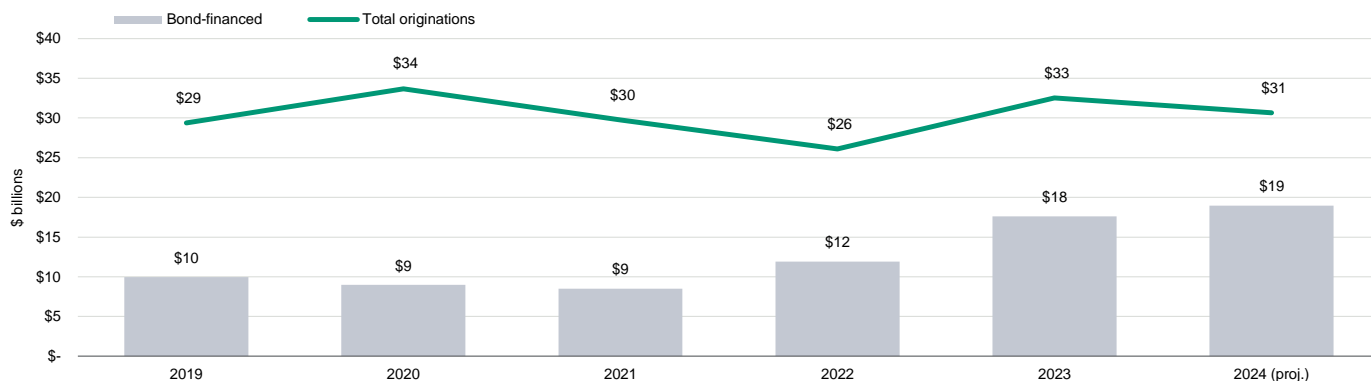
MRBs will remain the dominant funding source for HFA loan originations for a second straight year



Source: Moody's Ratings HFA surveys

Exhibit 2

Even with a slight decline, originations will remain strong in 2024



Source: Moody's Ratings HFA surveys

The surge in MRB-funded originations means overcollateralization levels will naturally decline. However, HFA program asset-to-debt ratios (PADR) rose significantly between 2018 and 2022, providing a buffer against the leveraging in 2023 and 2024. Further, HFA portfolios continue to shift toward mortgage-backed securities (MBS) versus whole loans, mitigating potential losses on loans held in their portfolios. Delinquencies in whole loan portfolios remain relatively low, with the overall delinquency rate at 4.50% at the end of 2023.

Thirty-eight HFAs we rate used bond proceeds to originate mortgage loans in 2023 compared with just five that only used secondary-market funds, underscoring the shift toward bond-funded originations. Additionally, MRB-funded loan originations accounted for more than 50% of the loan portfolios of 30 HFAs. Eight used MRBs exclusively to fund originations.

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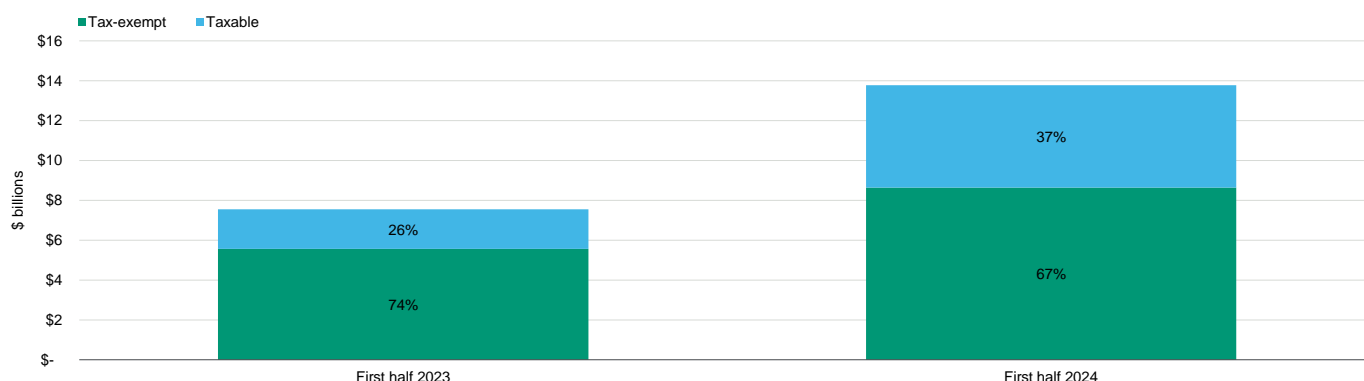
While bond-funded originations are currently more prevalent and provide a more stable revenue source, most HFAs use secondary-market sales as appropriate. The flexibility allows for a continuous pipeline of originations. As interest rates fluctuate, we expect most HFAs to strategically pivot from one funding source to the other.

Taxable MRB bond issuance will continue to increase, further boosting HFA loan originations

While MRB issuance will continue as the largest funding source for HFA loan originations in 2024, taxable MRBs will also grow significantly as HFAs need additional funding sources beyond their private-activity volume caps on tax-exempt MRBs. In addition, some HFAs are issuing taxable debt to fund loans to homebuyers who do not qualify for loans funded by tax-exempt MRBs. In the first half of this year, taxable MRBs accounted for 37% of bonds issued by HFAs, up from 26% during the same period in 2023 (see Exhibit 3).

Exhibit 3

Issuance of taxable MRBs continues to grow

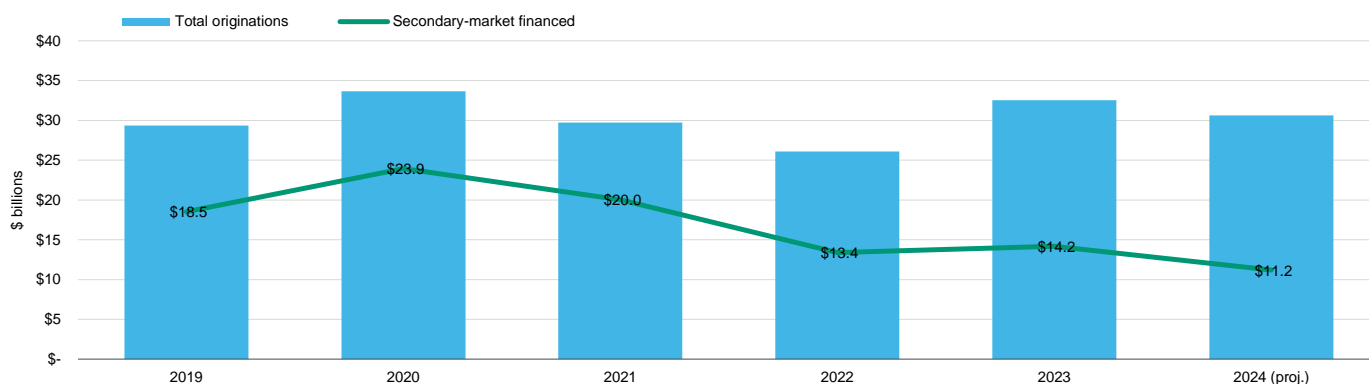


Source: Moody's Ratings (derived from rated HFA issuance)

Total secondary-market revenue will continue to slow as our projections call for a decrease to \$11 billion this year, a 21% drop from 2023 (see Exhibit 4). Meanwhile, bond funding will rise 8% to \$19 billion. During the financial crisis and years directly following when the bond market was less efficient, secondary-market loan sales allowed HFAs to earn immediate income in the form of upfront premiums to meet their mission and finance loans. HFAs, however, now have the ability leverage both bond financing and secondary-market loan sales, allowing them to switch tactics depending on market conditions.

Exhibit 4

Bond funding will continue to surpass secondary-market loan sales as a funding source for loan originations



Source: Moody's Ratings HFA surveys

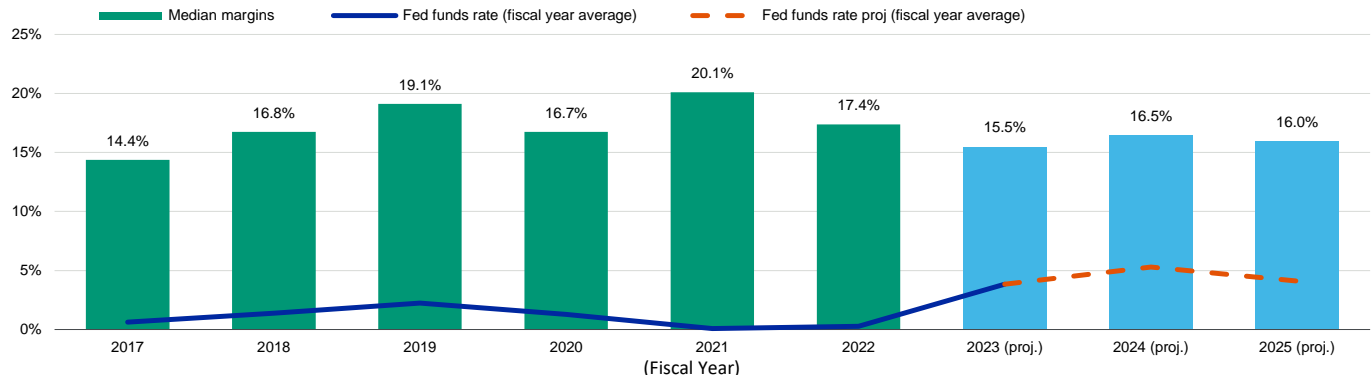
Decline in revenue from secondary-market sales will be partly offset by increased investment earnings, helping HFAs maintain solid margins

The decline in secondary-market revenue will not have an adverse effect on overall HFA margins, which have in recent years benefited from the upfront premiums generated from loan sales on the secondary market. Increased short-term investment earnings driven by

higher short-term interest rates along with full-spread mortgage loans will partly counter the revenue loss and allow for continued healthy margins (see Exhibit 5).

Exhibit 5

Increased investment earnings driven by improving interest rates will help HFAs maintain margins as secondary-market sales decline



Sources: Moody's Ratings-adjusted HFA audited financial statements, Federal Reserve and Moody's Macroeconomic Board

Less revenue from secondary-market sales has caused HFAs to look for additional sources of funding for down payment assistance (DPA). DPA is an integral component of HFA loan offerings as many first-time homebuyers cannot afford large down payment requirements. With the shift away from the secondary market, HFAs are increasing the use of other funding sources for DPA, including unrestricted funds, bonds, bond premium and/or state grants.

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