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Fitch: USPF Housing Defines Coronavirus Scenarios for Loan Program Models

Fitch Ratings-New York-30 April 2020: Fitch Ratings' U.S. Public Finance Tax-Exempt Housing team is monitoring the global pandemic and all the implications that go along with it; these are outside the calibration of Fitch's regular through-the-cycle analysis, which is meant to capture sensitivity to more normal cyclical patterns. To reflect this unprecedented stress, Fitch has revised various assumptions relating to loan loss severity and frequency, liquidity and operating income stress to align with Fitch's Global Economic Outlook and its company-wide baseline case scenarios. For more information about Fitch's baseline and downside coronavirus scenarios, see 'Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases – Update'.

This report describes changes in the assumptions used in the analysis of Housing Finance Agency (HFA) loan programs. For the single-family whole loan programs the changes are directly correlated to the change in the "U.S. RMBS Loan Loss Model Criteria" outlined in the "Exposure Draft: U.S. RMBS Coronavirus-Related Analytical Assumptions". This criteria is used in conjunction with Fitch's "U.S. Housing Finance Agency Loan Program Criteria". In addition, this report describes how Fitch will analyze HFA multifamily pool programs that will experience increased delinquency rates in their portfolios due to moratoriums on evictions along with a rise in operating expenses. This report is specific to HFAs with multi-family programs that are not 100% guaranteed by Federal Housing Administration (FHA) or Government Sponsored Entities (GSE). Future rating reports will detail how USPF housing will define and apply the new scenarios to those ratings.

Fitch does not anticipate rating changes as a result of these changes; however, the Rating Outlook or Rating Watch status may change depending on the impact upon review of third party cash flows with the new assumptions.

Fitch's longer lasting downside scenario envisions a longer, more severe downturn than the baseline scenario and as such would have a greater impact on home prices and sustainable home prices and would negatively impact both investment-grade and speculative-grade housing sector ratings. Longer-term impact to sustainable home prices will naturally flow through the macroeconomic variables inherent to that model that are updated each quarter. Fitch does not anticipate changing the analytical assumptions associated with the Sustainable Home Price (SHP) model, rather values may be lower over time as new macroeconomic data and forecasts are updated. Fitch will qualitatively describe the potential impact under this sensitivity and quantify the impact over time as updated forecasts are input into the SHP model.

Single-Family Loan Loss Analysis
One of the key stresses incorporated into the third-party cash flows is the loan loss rate. The loan loss assumption reflects the riskiness of the program's asset quality. For the guaranteed mortgage backed securities (MBS) portion of the portfolio, the residential mortgage back security model is not run, and a zero loss is assumed in the cash flows. For the FHA-insured portion of the portfolio, a 3% loan loss assumption is incorporated into the cash flows, unless historical performance data provided for the program deviate from that assumption, in which case the loan loss assumption will be based

on the data provided by the HFA. For all other insured or uninsured loans in the portfolio, an expected loan loss assumption for a specific loan pool is calculated by multiplying a loan loss severity factor by an expected loan default frequency factor. Arriving at these individual factors, pre-COVID-19, was a two-step process as described below.

Expected Loan Loss Severity
For single family whole loan portfolios that Fitch reviews on a loan-by-loan basis, the tax-exempt housing group employs Fitch's U.S. RMBS loan loss model to derive a portfolio loan loss severity assumption. Once the data for the portfolio on an individual loan basis are input into the RMBS model, a loss severity output is produced at each rating level. The severity output factors in the mortgage insurance provisions for the portfolio. For more information regarding the model inputs, see the Loss Severity section of the "U.S. RMBS Loan Loss Model Criteria" For tax-exempt housing transactions, the model is not used to set enhancement levels for the bond program or to create thresholds for rating levels. This analysis remains in place and will continue to be employed.

Expected Loan Loss Frequency
To arrive at an expected loan loss frequency factor, Fitch reviews the program's historical 60+ day loan delinquency data and compares that to both the program's current 60+ day loan delinquency data and the current 60+ day delinquency data for FHA fixed-rate loans in the state as reported by the Mortgage Bankers Association (MBA). Generally, Fitch then applies a multiplier of 2.0x to either the current HFA reported 60+ day delinquency rate or to the most severe historical rate that the program experienced during the HFA industry's peak delinquency period between 2009 and 2013 to arrive at a frequency stress. In cases where the trend of delinquencies is rising, declining slowly, showing quarter-by-quarter high volatility and/or the portfolio is underperforming state trends, Fitch generally applies a 2.0x multiple to the higher historical 60+ day delinquency rate to keep the stress assumption at the higher stressed frequency. When the housing trends within the state appear to be strengthening and the loan program performance signifies an ongoing trend and a more permanent shift, Fitch will likely apply the 2.0x multiplier to the current 60+ day delinquency rate to arrive at a frequency assumption.

Given the nature of the current environment, in some instances employing the 2.0x multiplier will be reserved for post crisis analysis as described below.

Changes to the Loan Loss Assumptions
Fitch is introducing a new forbearance delinquency cash flow scenario by loan type to reflect expected utilization of the payment holidays. Mortgage forbearance can either refer to a temporary or payment forbearance or it may refer to principal forbearance that result from a loan modification. Fitch believes the payment holidays being announced will function as a temporary or payment forbearance. The magnitude of the assumptions is based on observed delinquencies for HFA borrower in each loan type as observed from post crisis or recent natural disasters.

Fitch will begin applying the Payment Holiday Liquidity Stress effective immediately to coincide with the expected start of the payment holidays. These payment holidays are envisioned to be finite in nature; and therefore, Fitch will begin stepping down the stress in October 2020 and remove the stress completely by January 2021 under Fitch's baseline case. If macroeconomic conditions deteriorate beyond what is envisioned in the baseline case, these timelines may be extended.

Liquidity Stress
For HFA single family whole loan programs, Fitch is assuming 30% of borrowers will receive payment holiday for six months. Therefore, Fitch will assume the higher of 30% or 2.0x the historic delinquency rates as the expected loss frequency for a six month period in order to stress the loan loss assumption during the global pandemic. For the cash flow loan loss assumption beyond the six-

month period, Fitch will assume a loss frequency based on employing the 2.0x multiplier as described above. Fitch will continue to use the RMBS loan loss model to derive the portfolio loss severity assumption. The underwriting quality and large liquid reserves are likely to cushion the immediate impact; however, this will depend on the number of borrowers needing payment holiday.

Fitch does not anticipate rating changes as a result of this new stress; however, the Rating Outlook or Rating Watch status may change depending on the impact upon review of third party cash flows with the new assumptions.

Fitch may decide to extend the payment holiday assumptions for longer than six months and/or may change the utilization rate if evidence shows utilization of payment holidays for longer periods or a greater number of borrowers utilizing payment holidays as a result of the health and subsequent economic crisis caused by the coronavirus.

Multi-Family Loan Stress Analysis

The main method of calculating a multifamily bond program's financial strength is gauging the level of overcollateralization present, or the amount that assets exceed debt. The primary ratio used to capture this is the financial asset parity ratio. This ratio is calculated by dividing the dollar amount of total program pledged assets (including the multifamily mortgages and amounts on deposit in program funds and reserves) by the total amount of bonds outstanding. While Fitch is not changing the underlying approach to analyzing these programs, we are considering the current environment's impact on a HFAs portfolio.

Since Fitch deems the debt service coverage ratio (DSCR) to be most important in the analysis, it begins the review by benchmarking each individual subsidized and uninsured/unsubsidized loan's DSCR. Fitch's approach considers subsidized properties to provide a higher degree of predictability to a project's revenue stream than unsubsidized properties given the more stabilized cash flow from federal and state subsidies. As such, the DSCR parameters for subsidized loans are lower than those for uninsured/unsubsidized loans. Fitch has observed that excess assets are typically provided for loans that are underperforming the benchmarks referenced in the "U.S. Housing Finance Agency Loan Program Criteria". To stress the existing HFAs multifamily portfolio under Fitch's baseline scenario, Fitch will continue to use outlined DSCR benchmarks by rating category; however, we will stress the underlying assets in each portfolio.

Multi-family Operating Income Stress

Fitch looked at data from the National Multifamily Housing Council (NHMC) Rent Payment Tracker on over 11,000 units nationwide as of April 2020. Affordable housing rental properties often fall into the Class C category. Based on the NHMC tracker these properties by mid-April experienced an 85% payment rate or 15% either non-payment or delayed payment. Fitch used this data as a proxy for rental payment performance and stressed the assumption by doubling the 15% in non-rental payment to 30% to account for potentially greater financial challenges for renters over the next six months. Fitch also added a 10%-20% increase in operating expenses due to virus mitigation efforts.

For affordable housing multifamily pools Fitch will assume that 30% of each unsubsidized property will experience non-payment or a lag in payment in addition to a 10%-20% increase in operating expenses during a six-month period. This will be a total discount to the reported DSCR of 50%. For subsidized properties, Fitch will assume that the rental payments will continue to be in effect however, the property will experience an increase in operating expenses of 10%-20%, thereby discounting the DSCR by 10%-20%. By applying these stresses to each property in any given portfolio, Fitch has assessed the likelihood of rating pressure due to a decline in the net operating income via a discount to both revenue and expenses.

Generally, the sources of excess funds are primarily the programs themselves. The program's asset parity ratio is calculated by using the issuer's audited financial statements and the balance sheet for that bond program. Fitch's approach arrives at its excess assets assessment consistent with the portfolio's risk profile and compares that with overcollateralization available in the bond program to support the rating or the agency's general fund, if backed by the general obligation of the HFA. A typical housing bond program rated in the 'AA' rating category maintains an asset parity ratio of no less than 102% net of any excess assets or loan loss reserves. HFAs that fall to 102% will experience rating pressure.

Fitch may decide to increase the DSCR discount rates if evidence shows a higher percentage of non-rental payments for a prolonged period, as outlined in our downside scenario.

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