MINUTES
of the
THIRD MEETING
of the
MORTGAGE FINANCE AUTHORITY ACT
OVERSIGHT COMMITTEE
August 10, 2012

New Mexico Mortgage Finance Authority Office
344 Fourth St. SW
Albuquerque, New Mexico

The third meeting of the Mortgage Finance Authority (MFA) Act Oversight Committee for the 2012 interim was called to order by Senator Nancy Rodriguez, chair, at 10:08 a.m. on August 10, 2012 at the office of the MFA in Albuquerque, New Mexico.

Present	**Absent**
Sen. Nancy Rodriguez, Chair	Rep. Joni Marie Gutierrez, Vice Chair
Rep. Alonzo Baldonado	Sen. Mark Boitano
Rep. Ernest H. Chavez	Rep. Nate Gentry
Sen. Cisco McSorley	
Sen. Gerald Ortiz y Pino	
Advisory Members	
Sen. Rod Adair	Sen. Lynda M. Lovejoy
Rep. Thomas A. Anderson	Sen. Richard C. Martinez
Rep. Roberto "Bobby" J. Gonzales	
Rep. Sandra D. Jeff	
Rep. Rick Little	
Rep. James Roger Madalena	
Rep. Dennis J. Roch	
Sen. Sander Rue	
Sen. David Ulibarri	

Staff
Sharon Ball, Senior Researcher, Legislative Council Service (LCS)
Cassandra Jones, Research Assistant, LCS

Guests
The guest list is in the meeting file.

Handouts
Copies of all handouts and written testimony are in the meeting file.

August 10

Call to Order

Senator Rodriguez welcomed members of the committee, staff and guests to the meeting. Explaining that Claudia Armijo, LCS staff attorney, is out of town for a legislative staff meeting, she introduced Cassandra Jones, research assistant, LCS, to assist with the meeting. She also introduced Greg Geisler, senior analyst, who is the Legislative Finance Committee (LFC) analyst assigned to the MFA.

The chair advised members that the meeting is being video webcast and reminded them to keep sidebar conversations to a minimum to avoid noise interference with the webcast.

Approval of the July 11, 2012 Minutes

On a motion by Senator McSorley, seconded by Representative Chavez, the July 11, 2012 meeting minutes were approved without objection.

New Mexico Finance Authority (MFA) Update

Senator Rodriguez recognized Jay Czar, executive director, MFA, who welcomed committee members, staff and guests and introduced Frank Padilla, director, Office of Community Planning and Development, New Mexico State Office, Housing and Urban Development, who, he said would be providing committee members with information on federal budget trends and housing policy later on the agenda. Mr. Czar told the committee that MFA staff are always grateful to work in cooperation with other agencies, as well as with federal housing agencies.

Mr. Czar directed members' attention to an invitation in members' folders for the upcoming 2012 New Mexico Housing Summit, "Dwelling in the Future", presented by the MFA and the Southwest Affordable Housing Group (SWAHG), on August 22-24 at the Albuquerque Hyatt Regency. He said that all committee members are invited to attend the conference as guests of the MFA and explained the type of program they could expect.

Committee members expressed a number of concerns about current media coverage of alleged fraud at the New Mexico Finance Authority (NMFA). Members were particularly concerned about the similarity in names (MFA and NMFA) that may well confuse the organization they oversee with the NMFA. Concluding his introductory remarks, Mr. Czar noted that the MFA staff had put together a very robust agenda for this meeting that he hoped would address some of members' concerns.

MFA Audit Process

Mr. Czar explained that the MFA undergoes an external audit conducted annually by an independent firm. He then introduced John T. Kennedy, partner, KPMG Albuquerque, MFA's external auditor, to discuss the MFA audit with committee members. Mr. Czar explained that MFA's finance committee serves as the MFA board's audit committee and that Dennis Burt, CPA, is chairman of both the MFA board and its finance committee.

Directing committee members to the information behind Tab 1 in the meeting notebooks, Mr. Kennedy explained that KPMG has the largest financial institution audit practice in the U.S. and that KPMG audits numerous other state housing finance agencies. He also reported that KPMG and the New Mexico Office of the State Auditor (NMOSA) are conducting the MFA 2012 external audit as a joint venture. He noted that the NMOSA brings a high level of knowledge regarding state agency audits to the process. He explained that the audit team is physically on site in excess of two months in the summer and fall conducting the detailed external audit.

In terms of MFA's history of audit results, he said that MFA has received "unqualified" (i.e., clean) audit opinions for the past 20 years. He said that for the past several years the audit has been submitted to the NMOSA, as required by law, by December 15 — three months earlier than the statutory deadline. He explained that audit results are presented to the MFA board each January in Santa Fe on the same day that the legislative session begins (the third Tuesday in January).

Mr. Kennedy explained that all findings are presented to the MFA finance committee and board. He said that MFA staff are responsive to audit recommendations and have addressed all findings in a timely manner and that auditors have reported no repeat findings.

He said that KPMG and NMOSA also conduct fraud interviews with individuals at all levels of the organization, including members of the MFA board, as part of the external audit process, and that no instances of fraud have been identified at this time. He explained that MFA has an anonymous third-party hotline for reporting suspected fraud and other matters of concern.

Finally, Mr. Kennedy noted that MFA has an experienced and well-trained accounting team with CPAs holding both the MFA deputy director and controller positions. He noted the active involvement in the audit process by executive staff and key members of management, as well as regular oversight by the MFA finance committee. He said that no significant issues have been identified in audits conducted by federal and state agencies that have oversight over the MFA and that no significant issues have been identified by the contracted internal auditors. He concluded that the MFA culture is one of a very well run organization, specifically from an audit perspective.

In response to questions about the make-up of the MFA finance committee, Mr. Czar explained that this committee is elected from the MFA board by board members. He explained that the board includes, by statute, the lieutenant governor, the state treasurer and the state attorney general, plus four members appointed by the governor with the advice and consent of the senate.

Noting that the MFA has had "clean" audits for the past 20 years, committee members praised the MFA staff's hard work and expressed concern that the MFA's reputation might suffer because of confusion with the New Mexico Finance Authority (NMFA) and the NMFA's current situation. Mr. Czar responded that this confusion is the primary reason that he and his staff wanted to bring in the outside auditor to address the MFA's audits with the oversight committee. He emphasized that no one scrutinizes the MFA more closely than the staff itself.

He then distributed a handout to committee members entitled "MFA Speaking Points in Reference to Finance Authority Audit Issues/Alleged Fraud". Going over the handout, he reiterated points about the MFA audit committee and MFA's history of clean audits. He added that the MFA also contracts with another firm, Moss Adams, LLP, to oversee an internal audit function to assist management and the board of directors with an independent appraisal of accounting, financial and operating controls; efficient use of resources; reliability of information provided to management; compliance with laws, policies and procedures and programmatic requirements; and the presence of potential risks, mismanagement, fraud and theft or other irregularities.

Mr. Czar also explained that the internal auditors also perform a follow-up on management's actions related to previously reported deficiencies. All internal audit reports and responses are approved by management, the board's finance committee and the board of directors. He explained that the internal audit firm presents the related internal audit reports directly to the finance committee and the board of directors. He noted that internal audit services are bid through a competitive process at least every three years and that the MFA will be issuing a request for proposals for these services in October 2012.

Also, Mr. Czar explained that because of the nature of the MFA's mission, the organization is subject to auditing and monitoring by nine federal agencies and three state agencies. He said that, in the past three years, the MFA has averaged 24 audits or reviews per year by all of these various entities, including: external audits, internal audits, federal agencies and state agencies.

Committee members thanked Mr. Czar and his staff for the report and for their fine work and noted that having a clear distinction between the MFA and the NMFA is important for both organizations.

Neighborhood Stabilization Program Update

Mr. Montoya directed committee members to information behind Tab 2 in the meeting notebook. He explained that, in 2008, New Mexico received $19.6 million in Neighborhood Stabilization Program (NSP) funds as part of the federal Housing and Economic Recovery Act of 2008. He said that the MFA has been instrumental in creating a program to buy foreclosed homes at one percent below appraised value, rehabilitate the properties to MFA's standards (among which is a Home Energy Rating System (HERS) of 85 or better) and then resell the homes to households with incomes at or below 120 percent of the area median income, which, for example, is up to $73,200 (2012) for a family of four in Albuquerque. He said that the MFA has contracted with three different entities with representatives that will report to the committee today: YES Housing, the Kaspia Group (formerly Omni) and the Bernalillo County Housing Department.

YES Housing: Holly Barela, NSP manager for YES Housing, explained that YES Housing had purchased and rehabilitated 19 foreclosed homes in Sandoval and Valencia counties, 18 of which have been sold with one sale pending. She said the average purchase price was approximately $138,000 with an additional $44,000 for repairs and energy efficiency upgrades.

Ms. Barela discussed the positive impact that this program has had for the various communities in which the houses are located. She said that existing residents of neighborhoods benefit from the program through the stabilizing and improvement of property values and neighborhood quality. She said participation in the program allows individuals and families to realize the dream of home ownership by purchasing a home with affordable financing, which is crucial for family financial stability. She said that the average family income of the home buyers is $50,256. She also pointed out the advantages of jobs creation and saved jobs, particularly in the construction and real estate areas. She said that YES had utilized the services of six construction companies, along with their subcontractors, and had also used the services of appraisers, surveyors, real estate agents, mortgage lenders and title companies.

Michelle DenBleyker, vice president of the Real Estate Division, YES Housing, discussed a multi-family rental project in Belen, La Hacienda Apartments. She explained that YES identified a 22-unit apartment in Belen near downtown that was basically abandoned (only two units occupied) and that was known for drug activity. She explained that YES has served as the developer and owns the community with 100 percent of the funding provided through the NSP and MFA. She said that YES did extensive renovations focusing on energy efficiency and also provided some quality-of-life amenities beyond the interior of the apartments, such as installation of a playground and facilities for families to barbecue outside. She said that the project has been a real success story for the city of Belen and that all apartments have been rented for the past year.

Chair Rodriguez indicated at this point that she had to leave the meeting to tour the Santa Fe County courthouse project in Santa Fe and, in the absence of the vice chair, she appointed Senator Ortiz y Pino as temporary chair of the meeting.

Committee members had an extensive discussion about the success of the program and complimented both the YES and MFA staffs on their work. Some committee members expressed concern, however, that some projects appear to cost more for the rehabilitation than the amount realized through the sale. Mr. Czar said that MFA staff would provide the committee with cost and sale information for projects discussed. Mr. Czar explained that in other states, entire neighborhoods have failed, but New Mexico has very few, if any, such entirely failed neighborhoods. He said that the purchase and rehabilitation of a foreclosed home increases the values of all of the surrounding homes in the neighborhood. That is the real intent of the program, he said.

Several committee members wanted to know why the program had been limited to Sandoval, Valencia and Bernalillo counties. Mr. Montoya explained that the federal Department of Housing and Urban Development (HUD) regulates where the MFA can spend federal dollars. He noted that Sandoval County, especially Rio Rancho, was the area hardest hit in the state by foreclosures. Debbie Davis, programs and initiatives manager, MFA, explained that most of these projects were in Rio Rancho, with a few in Valencia County and outside the Albuquerque city limits in Bernalillo County. In response to questions, Mr. Montoya said that the City of Albuquerque and the City of Las Cruces have their own HUD projects.

Mr. Montoya and some committee members agreed that needs exist in other parts of the state, including Taos County, which has a particularly unique situation in that, reportedly, only four percent of Taoseños can afford homes in that community.

In response to committee questions, Ms. Davis explained that NSP homes are energy efficient making utility costs lower to home buyers over the long term. She said that during the rehabilitation process, all homes were updated with new furnaces, water heaters, stoves, refrigerators and dishwashers, and some homes were provided with washers and dryers.

In response to committee questions and discussion, Mr. Montoya said that nine homes were sold to families whose income is at or below 50 percent of median income; 20 to families whose income is between 50 and 80 percent of median income; and 35 to families whose income is between 80 and 120 percent of median income. He said that homes have been sold to a variety of working families, including teachers, casino workers, mechanics, bank tellers, delivery service drivers, a U.S. Forest Department employee, an emergency room nurse and a retired couple caring for their handicapped adult son. He said that most are first-time buyers and that the majority are young families with small children. In response to a question, he explained that home buyers pay the market rate on the first mortgage and, currently, no interest on the second. Mr. Montoya indicated that the program has been significantly extended through the use of recouped funds, but that all the money has now been expended on the project.

Chairman Ortiz y Pino requested that the minutes reflect the committee's interest in providing state funds to keep the NSP functioning.

Federal Housing Policy and Budget Trends

Mr. Montoya told the committee about what he called a "conversation between consumer protection advocates and banks" at the federal level as well as other issues that will affect the way in which the MFA does business. He discussed a review of regulations regarding first mortgages that could allow people to be educated on mortgage issues, especially before they acquire their first mortgage. In response to a committee question, he noted a clear difference of opinion between banks and regulators regarding just how much regulation is needed for the nonstandard mortgage process.

Mr. Padilla told the committee that his agency also reviews the MFA's performance on an annual basis. He said that the performance, professionalism and ethics that the MFA board and staff have displayed over the past 15 years has been truly extraordinary.

Regarding the MFA's participation in the NSP, Mr. Padilla explained that the federal government's original allocation to New Mexico was $20 million in 2008 and that, since that time, New Mexico has received additional funding from two additional programs that has allowed the NSP to turn around more than 200 homes that have been foreclosed. He said that half of the inventory of foreclosures in the market, between 1,000 and 1,500 homes, will have participated in this program before it ends.

In response to committee discussion and questions, Mr. Padilla agreed that the only drawback to the program is that the family whose loan is being foreclosed cannot stay in the home while it is being returned to the market. Some committee members expressed concern that, with the end of federal stimulus funding, these types of programs cannot be expanded or modified in order to help families avoid foreclosure. Committee members also discussed the issue that having the foreclosed homes returned to the market and sold helps maintain the value of other houses in those neighborhoods.

In response to committee questions and discussion, Mr. Padilla said that the HELP program provides funding so that people can renovate or build a facility to serve as a home that will allow the homeowner to dedicate part of the property to establishment of a business such as a workshop or a shop. Mr. Montoya indicated that the issue with this type of building is the nature of regulatory controls, which seem to make this type of building more difficult to build.

Regarding funding levels for the coming year, Mr. Padilla directed members' attention to the handout he had provided, "Budget Authority by Program", which, he said, reflects the President's budget request to Congress. He said that the Senate has deliberated the HUD budget on its side and that the House of Representatives is currently in the process of deliberating. In response to a committee question, he said that he felt HUD would see a $3 to $5 billion dollar increase for the next fiscal year.

Housing Finance and GSE Reform
Bond Markets and Financing Alternatives

Gina Hickman, deputy director of finance and administration, MFA, directed committee members to the information behind Tab 3 in the meeting notebooks. Paul Cassidy, vice president and managing director, Royal Bank of Canada (RBC) Capital Markets, started by mentioning how much he appreciates working with the MFA staff as the agency's senior managing underwriter. Directing committee members' attention to information on page 2 behind Tab 3 in the meeting notebook, Mr. Cassidy explained that this chart illustrates interest rates in sovereign bonds since 2008 and shows the strength of U.S. treasury notes. Together with those of Germany and France, U.S. treasury notes are the "go-to" credit sources internationally, even though treasuries have fallen to the lowest level in more than 65 years. On page 3, he pointed out the effect of the "housing bubble", which continues, although not as strongly, into the present time.

In terms of the tax-exempt municipal market data index (on page 4), Mr. Cassidy pointed out that this market is different from the treasury market in that this market demonstrates an unsloping yield curve. He said that if one compares the yield curve from 2010 to 2012 one would see that we are at the lowest point in terms of interest rates. He noted that interest rates have been lower only 1.5 percent of the time. He said that the MFA has been taking advantage of these low rates by refinancing higher rate bonds at these new lower rates.

Pointing out the listing of the MFA's top 25 bondholders, which own nearly $4 million of MFA debt, Mr. Cassidy said that retail investors own MFA bonds because of the MFA's high ratings with agencies such as Moody's and Standard & Poor's. He also explained that MFA has been able to provide adequate liquidity so the agency can continue to make affordable loans to its clients. He explained that the MFA sets interest rates on first-time home buyers through a number of programs and noted that the MFA makes loans at about 3.5 percent. He said that conventional markets cannot handle a lot of first-time home buyers.

Looking at government-sponsored enterprise (GSE) reform, Mr. Cassidy said that the Obama administration continues to offer a three-options proposal directed at Fannie Mae and Freddie Mac as of February 2011:

- Option 1: A fully privatized system of housing finance; government insurance limited to the Federal Housing Authority (FHA), the United States Department of Agriculture (USDA) and the Department of Veterans Affairs assistance;
- Option 2: Allow the private market to play a dominant role with the government stepping in only during a crisis; and
- Option 3: Create new loan guarantees to replace Fannie Mae and Freddie Mac and provide guarantees for catastrophic losses after private entities take the first loss.

He also discussed a number of the Republican Party's reform bills (as of May 13, 2011) that would:

- prevent dividend payment decreases;
- apply the Freedom of Information Act to GSEs during conservatorship;
- require GSEs to dispose of all "non-mission-critical assets";
- establish a bailout cap for GSEs;
- ensure that an exact replica of GSE is not created;
- prohibit taxpayer funding of GSE employee legal fees;
- abolish affordable housing trust funds; and
- establish five new agencies to replace Fannie Mae and Freddie Mac with lower level guarantees.

In response to committee discussion, comments and questions, Mr. Cassidy and Mr. Czar indicated that, since nothing has been done to reform GSEs and nothing seems to be in the serious planning stage, the MFA will continue to do what it has always done: take loans, package them and sell them on the market at as profitable a rate as possible.

Mr. Cassidy said that, according to Moody's rating agencies reports, external stresses from the U.S. economy and housing market will continue to stress U.S. state housing finance agencies (HFAs). He said that the primary drivers for Moody's negative outlook include low conventional mortgage rates, low investment rates, deterioration of counterparty credit, high unemployment (which drives high rates of loan delinquencies and foreclosures), high liquidity fees for variable rate debt (which puts pressure on profitability) and new strategies for financing loan originations that may bring a new set of risks. In response to a committee question, Mr. Cassidy explained that the term "counterparty" can refer to brokers, investment banks and other securities deals that may be a "contracting party" for over-the-counter securities transactions.

Continuing, Mr. Cassidy pointed out that, according to the Standard & Poor's rating agency, despite deteriorating loan quality, the overall strength of HFAs is stabilizing because of more conservative bond indenture management, a redeeming and refunding of variable rate debt, a switch to mortgage-backed securities (versus whole loan) and a reduction of counterparty exposure.

Directing committee members' attention to page 14 of his handout, Mr. Cassidy explained that, in 2011 and to date in 2012, RBC Capital Markets has served as senior underwriting manager for the MFA for a total of five individual transactions of $40 million, $59.9 million, $70 million, $40 million and $45.5 million each. He said that the MFA has Standard & Poor's ratings of AA- for issuer credit and AA+ for the single family program, with stable outlooks for both.

Ms. Hickman explained that the MFA's single family program is one of four with a market of low- to moderate-income, first-time homebuyers. She noted that the MFA's program is a national model. Mr. Cassidy added that a number of HFAs throughout the country are switching to the program that the MFA adopted 20 or 25 years ago. Ms. Hickman added that the MFA has been very successful over the years at financing mortgages through issuance to tax-exempt bonds. She said that one problem at this point is that bond investors want a greater return on their investment but, with mortgage rates so low, those kinds of returns are not possible. Committee members spent some time discussing the concept of a "new normal" in these post-recession times.

Mr. Czar explained that the MFA, with support of its board, continues to take a conservative approach to doing business. He said that Standard & Poor's evaluation of the MFA included spending much time with management and discussion of issues. He said it had looked at a business model for years to use mortgage backed securities rather than the "whole loan" model. He said that many HFAs in the country using the "whole loan" model can gain more profit but with more risk.

Mr. Cassidy directed committee members' attention to the Standard & Poor's issuer credit rating (ICR), "New Mexico Mortgage Finance Authority; General Obligation" document in the committee notebooks. He noted that the report reflects MFA's:

- high quality and the low risk of the loan portfolio;
- very low risk debt profile based on the use of 97.2 percent fixed-rate debt and 2.8 percent variable-rate member debt guaranteed by "AA+" eligible, government-

sponsored entities (GSEs);
- very low general obligation debt, with less than 0.2 percent of total debt outstanding;
- strong legislative and gubernatorial support of the MFA;
- stable and effective management; and
- the improving economic base in New Mexico.

Mr. Czar introduced Bill Elliot, Rocky Mountain Mortgage, who, he said, is one of the MFA's premier lenders, helping people all around the state to own their own homes.

Committee members thanked MFA staff and presenters for the very informative presentations at the meeting. There being no further business to come before the committee, members adjourned at 12:55 p.m.