The Agency TBA Market

California Housing Finance Agency
Board of Directors Meeting

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TBA (Mortgage-Backed) Securities Market

- Mortgage-backed securities (MBS) -- debt obligations

- The most common form of MBS are pass-through certificates

- MBS are highly liquid -- particularly those backed by agency guarantees

- Most mortgages in the US are securitized through the agency MBS market

- This trading convention significantly improves agency MBS liquidity – leading to lower mortgage rates for households

- The key distinguishing feature of agency MBS is they carry a form of government guarantee – explicit (Ginnie Mae) or implied (Fannie and Freddie)

- Other distinguishing feature is the existence of liquid forward market for trading

- “TBAs” or “To Be Announced” are a form of future contracts
TBA (Mortgage-Backed) Securities Market – continued

• Vast majority of MBS trading (over 90%) occurs in the forward market – TBA Market

• Seller and buyer agree to a sale price without identifying the specific pool numbers

• Six basic characteristics -- issuer, maturity, coupon rate, price, par amount and settlement date are agreed upon

• Pools guaranteed by Ginnie Mae (a federal government agency), Fannie Mae or Freddie Mac (GSEs) can be allocated to TBA transactions

• The goal of the TBA market was to create liquidity

• A hedging tool – with settlement dates up to nine months out -- allows lenders to “lock in” sale prices for loans
  ➢ The use of dollar rolls allows the seller to extend hedges

• Drivers of market activity are broker dealers

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TBA (Mortgage-Backed) Securities Market – continued

• TBA trading occurs electronically on an over-the-counter basis
  ➢ Two platforms, DealerWeb (interdealer trades) and TradeWeb (customer trades)
  ➢ Trades can take place via telephone, fax or e-mail – not common

• Securities Industry and Financial Markets Association (SIFMA) has specific rules regarding what constitutes TBA eligible deliveries also knows as “good delivery”

• Only mortgages meeting certain size and credit quality criteria “conforming mortgages” are eligible for inclusion

• Sheer aggregate size and the homogenous nature of agency MBS contribute significantly to liquidity – compared to corporate bonds or munis

• TBA Market is the largest debt market in the world outside of US Treasuries

• Virtually every primary broker/dealer on the street and in the world makes a market in TBA MBS
TBA (Mortgage-Backed) Securities Market – continued

• TBA Market is made possible largely because agency MBS are exempt from the registration requirement of the Securities Act of 1933

• Although not required, agencies do publicly disclose information about the composition of each pool

• Similar to Treasury futures, TBAs trade on a “cheapest-to-deliver” basis

• On a forty-eight-hour day, the seller selects which MBS in its inventory will be delivered to the buyer at settlement

• In practice, most TBA trades do not ultimately lead to a transfer of physical MBS
  ➢ In most cases the seller will either unwind or “roll” an outstanding trade
## Liquidity

### Daily Average Trading Volumes in Major U.S. Bond Markets

**Billions of dollars**

<table>
<thead>
<tr>
<th>Year</th>
<th>Municipal Bonds</th>
<th>Treasury Securities</th>
<th>Agency Mortgage-Backed Securities</th>
<th>Corporate Bonds</th>
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<tbody>
<tr>
<td>2005</td>
<td>16.9</td>
<td>554.5</td>
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<td>344.9</td>
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<tr>
<td>2010</td>
<td>13.3</td>
<td>523.2</td>
<td>320.6</td>
<td>16.3</td>
</tr>
</tbody>
</table>

*Source: Federal Reserve Bank of New York.*
TBA Program Benefits When Compared to MRB

- Provides a no risk forward commitment mortgage program with no costs of issuance, negative arbitrage and legal expenses
- Produces a significantly lower mortgage rate when compared with Pass-Thru and traditional MRB structures – including using zeros
- Fund down payment and closing cost assistance without using HFA funds
- Flexibility to adjust rates as the market moves -- no yield implications
- Affords HFAs the option to pay higher lender compensation
- Can be used to provide financing for non-first time homebuyers
- Program is more lender friendly -- less paperwork for the lender
- Can be combined with MCCs thus creating a lower effective mortgage rate
- Gives HFAs the option of offering refinesances
- Significantly more profitable for HFAs than tradition MRBs and Pass-Thru structures both on present value and ongoing basis
- It can be used as a tool to accumulate MBS for future bond transactions
  - Either “Pass-thru” or “Traditional MRB” structures
  - HFA has the option to repurchase its MBS at prevailing TBA levels
Disadvantages

• Because it does not require explicit authority to issue bonds or relies on volume cap, other entities can offer competing programs
  • Cal Rural Home Mortgage Finance Authority (CHF) operates a statewide program in California – in light of its power to only operate on 32 rural counties
  • National Homebuyers Fund – a nonprofit subsidiary of CHF – operates statewide programs in 25 other states

• No ongoing issuer fee income, the HFA’s income is made up of gain-on-sale and residual income when the DPA or the second mortgage is repaid
Production Trends

- Average weekly locks since inception $3.1 million
- Average weekly locks as of July 1, 2014 - $6.8 million
- Average weekly locks the last 60 days - $12.1 million
- Average loan amount of $240,000
Market Volatility
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