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West Virginia Housing Development Fund; General Obligation

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Credit Profile		
West Virginia Hsg Dev Fd ICR		
Long Term Rating	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AAA' issuer credit rating (ICR) on West Virginia Housing Development Fund (WVHDF). The outlook is stable. The rating reflects WVHDF's general obligation (GO) and credit quality.

The ICR also reflects our opinion of the fund's:

- Extremely strong credit quality of very good asset-to-liability coverage and low-risk asset base;
- Extremely high reserve level and capital adequacy ratio;
- Highest equity to total assets over all other rated housing finance agencies (HFAs), which measures an agency's ability to absorb operating deficiencies;
- Ability to successfully meet its legislative mandate; and
- Management, with its extensive experience and conservative philosophy.

WVHDF is the only state HFA to receive a 'AAA' ICR from Standard & Poor's. We believe the fund has extremely high credit quality and a low-risk asset base due to its loans' insurance coverage and low loan-to-value ratios, and its extremely high reserve levels. Over the past five years, WVHDF has experienced positive trends in total equity over total assets. Although the fund's $1.08 billion asset base is one of the smallest, its 39.26% equity-to-assets ratio is the highest of all rated HFAs.

The five-year average of the fund's profitability ratios is higher than those of its 'AA+' rated peers (see table 2), demonstrating, in our opinion, its strong financial performance. We also believe WVHDF has a very strong and experienced management team that has been successful in meeting its mission of financing affordable housing for West Virginia residents, as demonstrated by the funding of single and multifamily programs from the fund's general reserves and earnings. Also, the fund has a strong and mutually beneficial working relationship with the state legislature that allows it to function with autonomy.

Outlook

The stable outlook reflects our view of the fund's consistent financial performance, large equity balance, strong and stable balance sheet composed of low-risk assets, and excellent oversight. We believe improved asset quality and leverage ratios have helped WVHDF work through the recent mortgage turmoil. The recent upheaval in the housing and mortgage markets has strained WVHDF's ability to raise capital at rates that can sustain demand for its loan products.

We believe WVHDF's strong equity and capital adequacy ratios indicate it is well positioned to maintain its strong credit quality. In addition, management's efforts on proactive outreach to the lending community and willingness to adopt creative strategic initiatives may help the company adjust to increased regulations and tighter lending requirements.

However, the company's diminishing assets are a concern, since the fund has had difficulty generating new single-family loans. If this trend significantly impacts on the fund's equity base, we expect it to degrade the fund's leverage ratio, profitability and net operating income. Based on our projections, we believe this scenario is unlikely during the two-year outlook period. Still, we will monitor how WVHDF's management counters this trend, which is common to all rated HFAs. We also expect the fund's management to continue policies and programs designed to maintain WVHDF's financial strength.

Asset Quality: Strong Asset Base

As of June 30, 2012, WVHDF's asset base stood at $1.08 billion, following a 9.11% decrease from the previous fiscal year. This drop was primarily due to a declining loan and investment portfolio. As of June 30, 2012, the fund's loan portfolio decreased to $819 million, reflecting a 6.67% decline, as the market's inability to fund mortgage loans with competitive rates slowed new loan production.

WVHDF's asset portfolio consists primarily of mortgage loans (76%) and investments (22%) (see chart 2).

WVHDF's bond-funded, single-family, and multifamily mortgage loans are originated under its housing finance bond program, with single-family and multifamily activity accounting for 98% and 2%, respectively, of total loans under the program. The housing finance bond program, in total, represents 65% of the fund's total asset base (see chart 2).

As of June 30, 2012, the fund's mortgage loan portfolio, in our opinion, is of extremely high credit quality and low risk. While 31.1% of loans carry private mortgage insurance, this risk is offset by the portfolio's excellent performance with respect to delinquencies and foreclosures, as well as overcollaterization. Of the single-family mortgages, all loans exceeding an 80% loan-to-value ratio are insured by the:

- Federal Housing Administration (33.85% of the total housing finance bond resolution portfolio),
- Veterans Administration (3.42%),
- Rural Housing Service (11.21%), or
- Conventional insurers (26.53%).

The majority of conventionally insured loans are insured by:

- Genworth Financial Mortgage Insurance (15.88%),
- Mortgage Guaranty Insurance Co. (7.42%) and
- PMI Insurance Co. (1.19%).

Furthermore, around 25.% of single-family mortgages do not require mortgage insurance as the loan-to-value ratios are below 80%. As a significant portion of WVHDF's loan portfolio is insured by private mortgage insurers, the loan portfolio has exposure to the mortgage insurers' credit quality. We factor the ratings of mortgage insurance providers when assessing the loan portfolio's financial strength. In our analyses, we reduce the credit for mortgage insurers from 100% if the provider is rated lower than the bonds.

We base the discount on the ratings on the bonds and the provider, along with the provider's capital adequacy ratio (CAR). A higher CAR and a smaller gap between the ratings on the bonds and the provider results in more credit. Should a rating fall below investment grade, we assume no payment from that insurance provider, and we incorporate the discount into its loss coverage assumptions. When more than one mortgage insurance company provides coverage for an indenture, we use a weighted average. All multifamily mortgages are either federally insured or are subject to Section 8 rental assistance subsidies. The multifamily portfolio contains 33 loans, of which 27 receive full or partial Section 8 assistance, while 11 are FHA-insured. The FHA-insured mortgage loans account for a majority of the outstanding principal balance of multifamily loans (66%).

WVHDF began servicing its single-family mortgage loan portfolio in 1989, and it currently services all of its single-family and multifamily loans. In terms of delinquencies and foreclosures, the fund has consistently outperformed the Mortgage Bankers Association (MBA) average for the state over the past few years. Delinquencies (in excess of two months, including foreclosures) for outstanding single-family mortgage bonds under the housing finance resolution were 4.17% as of Sept. 30, 2012, up slightly from 3.91% as of Sept. 30, 2011. This compares favorably with the MBA average for delinquencies (in excess of two months, including foreclosures) of 4.82% for West Virginia as of third quarter 2012.

Furthermore, nonperforming assets (NPAs) marginally increased in fiscal 2012. Loan-loss reserves stood at 355.64% to total NPAs and at 11.91% to total loans in fiscal 2012. Historically, WVHDF has reserved highly against its loans based on management's review of potential problem loans.

The fund's investments are made in accordance with its investment policies, and are of high credit quality and liquidity, in our opinion (see chart 3). WVHDF's investments totaled $242 million as of June 30, 2012, and provided around 9% of its revenue. Substantially, all of the investments are in 'AAA' rated U.S. government agency obligations, and tri-party collateralized repurchase agreements, collateralized by Fannie Mae (AAA) securities. A small percentage is invested in West Virginia Board of Treasury Investments (AAAm) and other investments. The fund does not have any exposure to derivative instruments. Approximately 42% of the fund's investments are short-term, maturing in one year or less, which, in our opinion, provides ample liquidity.

Chart 1

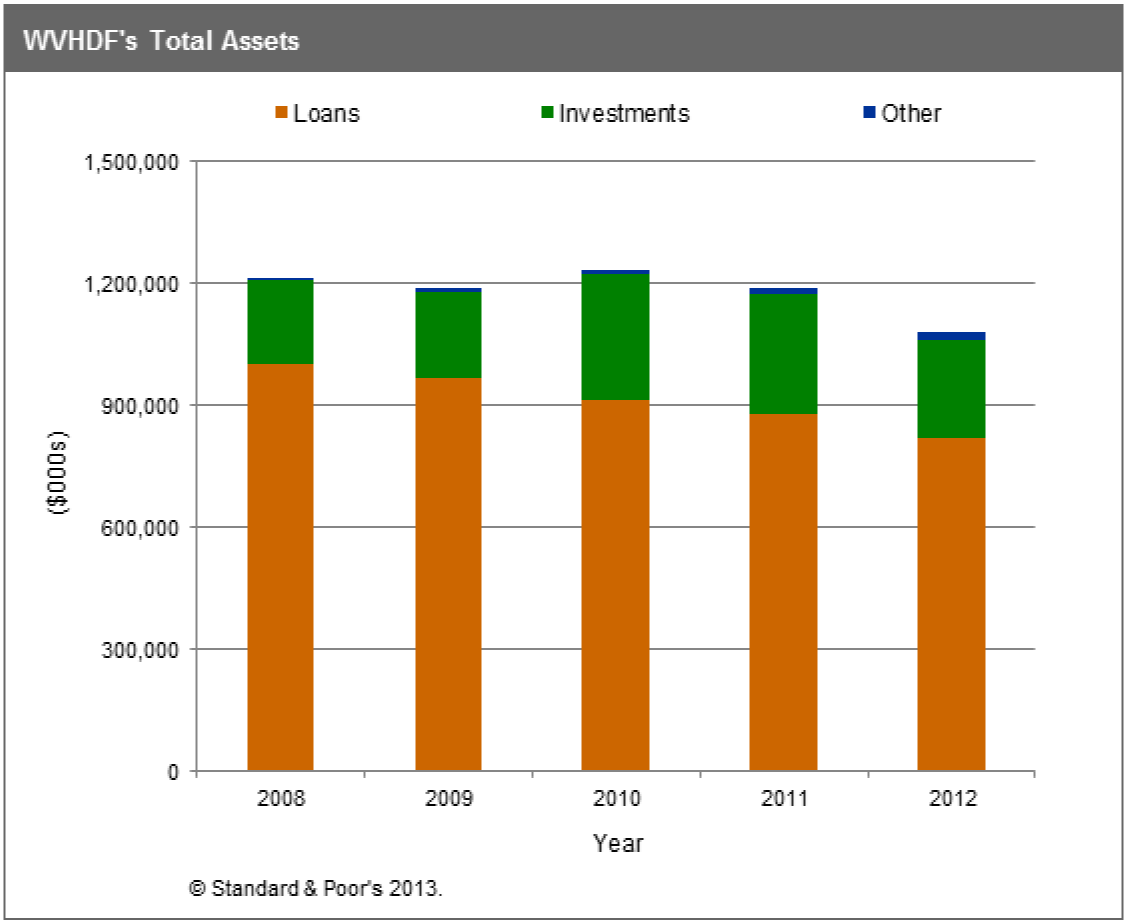

WVHDF's Total Assets
Loans
Investments
Other
1,500,000
1,200,000
900,000
600,000
300,000
0
($000s)
2008
2009
2010
2011
2012
Year
© Standard & Poor's 2013.

Chart 2

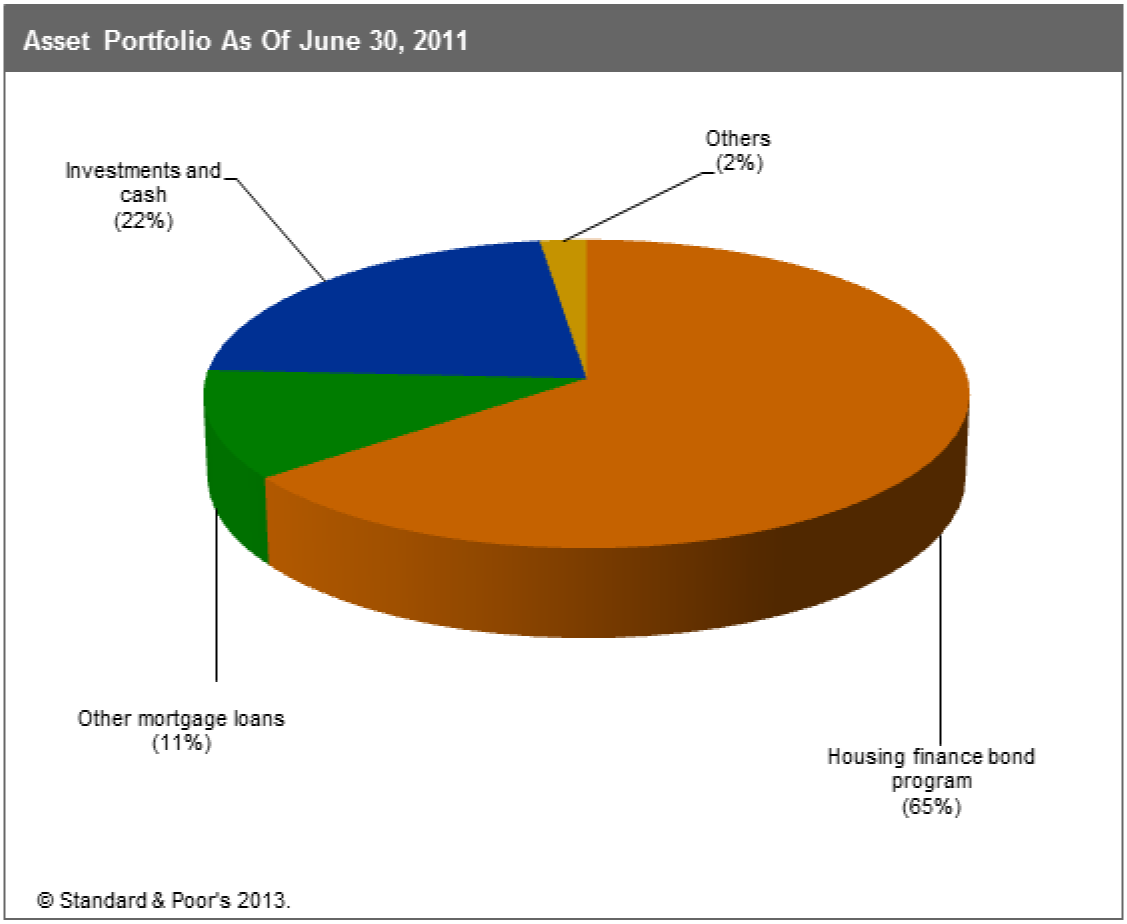
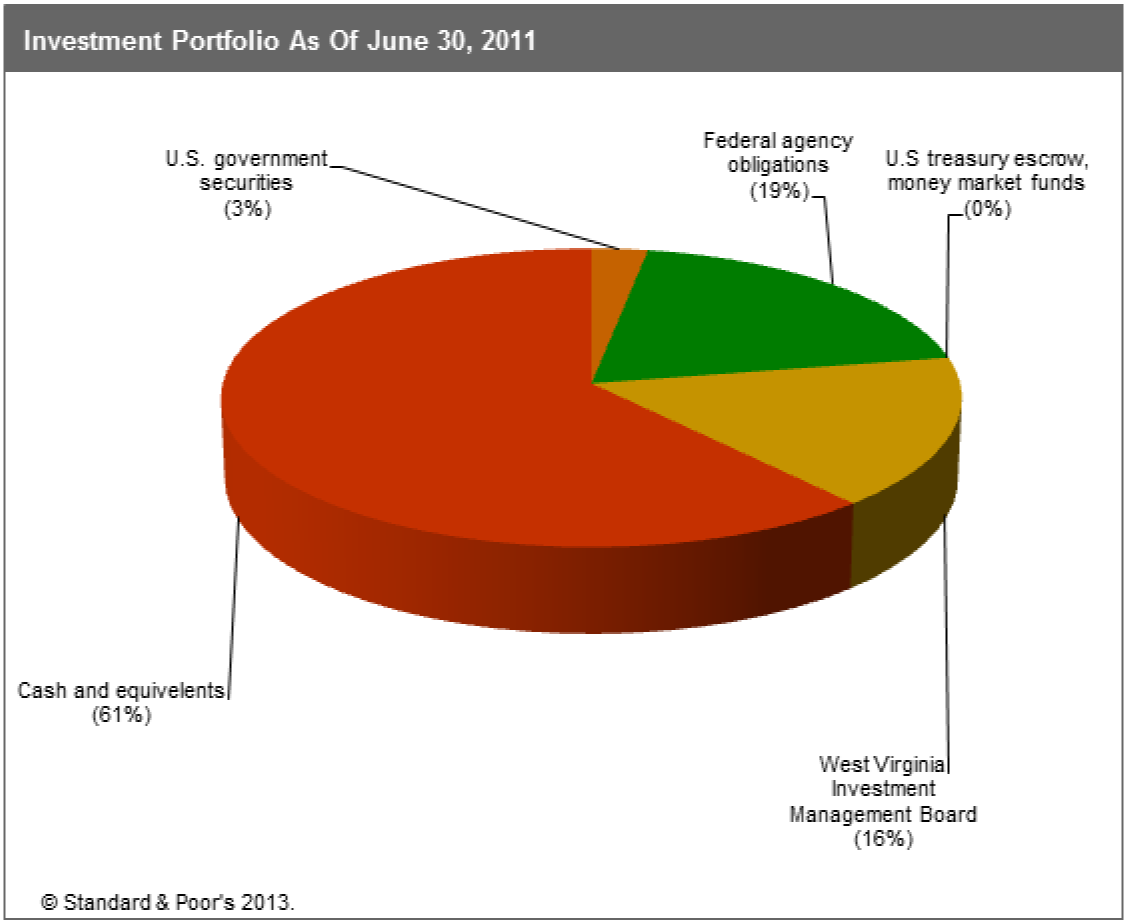

Asset Portfolio As Of June 30, 2011
Others
(2%)
Investments and
cash
(22%)
Other mortgage loans
(11%)
Housing finance bond
program
(65%)
© Standard & Poor's 2013.

Chart 3



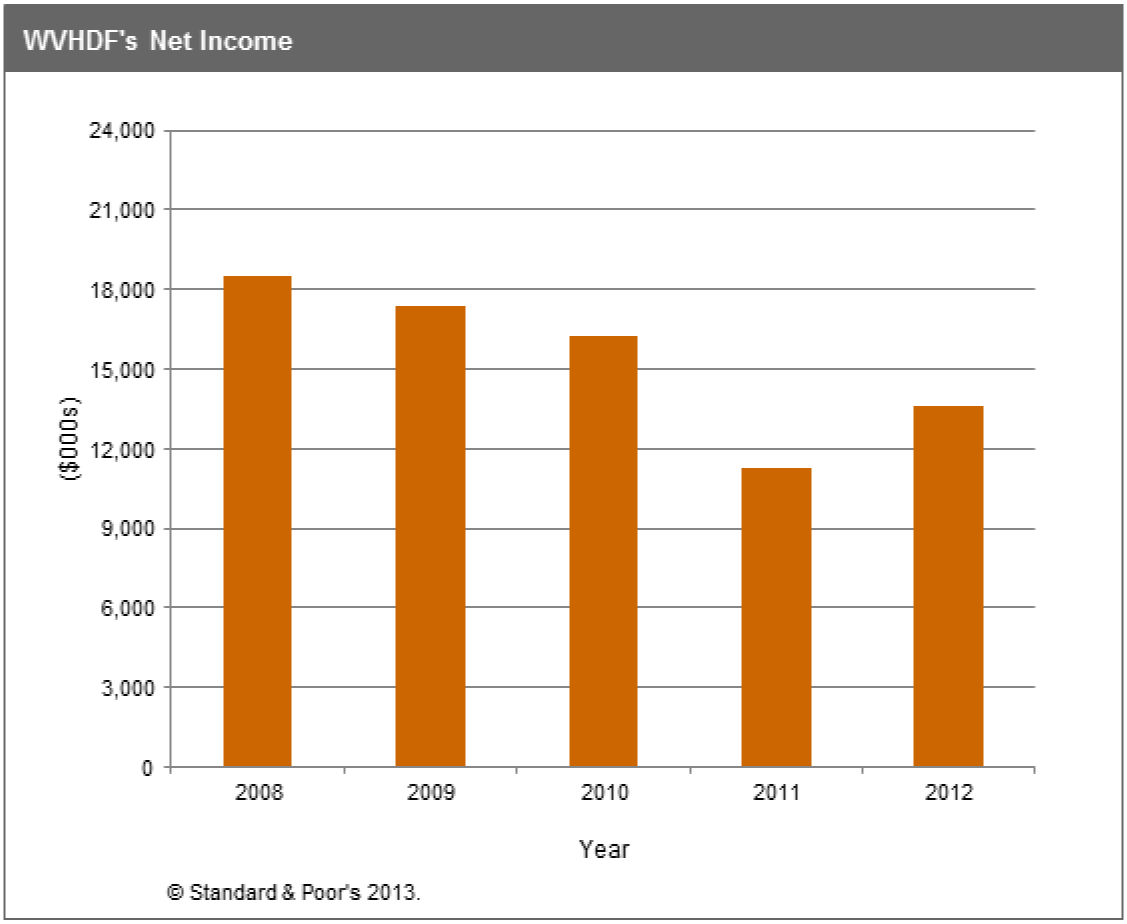
Earnings Quality And Financial Strength

WVHDF's loan portfolio provided approximately 77% of its revenue stream in fiscal 2012, a marginal decrease from the previous fiscal year. In 1992, the fund began servicing loans on behalf of Fannie Mae and Freddie Mac, in addition to servicing its entire outstanding mortgage loans. From this, the fund generates fee-based revenue that currently represents 12% of its operating revenues. According to management, they will exert more direct loan originations and correspondent lending as a strategic plan.

In 2012, WVHDF's profitability increased due to a drop in expenses. During 2012, the fund's net income increased to $13.5 million, a 20% increase from the previous fiscal year. As a result, the fund's profitability -- as measured by return on assets (ROA) and net interest margin (NIM) -- increased in fiscal 2012. ROA and NIM increased to 1.20% and 2.20%, respectively, in fiscal 2012, from 0.93% and 1.99%, respectively, in fiscal 2011. As detailed in table 2, the fund's profitability ratios over five years averaged higher than those of its 'AA+' rated peers; this indicates strong financial performance, in our view. Meanwhile, mortgage loans have dropped marginally by 4%, while the loans' net interest margin has trended upward since 2007; this indicates loan portfolio is well–managed, in our view.

WVHDF's strong earnings profile is complemented by its healthy equity base of almost $424 million. We believe an HFA's equity position is one of the most important indicators of its financial strength. WVHDF's 39.26% equity-to-assets ratio is among the highest of all rated HFAs. This indicates the fund's ability to withstand real estate downturns, in our view. The fund's use of refunding during low interest rate periods and cross-calling of bonds continues to strengthen its equity position. After adjusting for potential losses, the fund's sound-adjusted assets as a percentage of debt is 74.91%, and its liquid assets are above 12% of mortgage loans outstanding.

Chart 4



Debt: Backed By Fund's GO Pledge

WVHDF's debt as of June 30, 2012, stood at $581 million, a 17.08% decrease from the previous year. The debt decrease was primarily due to the early bond redemption and no bond issuance under the Housing Finance Bond Resolution in 2011 (except $33 million of 2011 New Issue Bond Program bonds). The fund redeemed $267 million in bonds during fiscal 2012.

To participate in the U.S. Treasury plan, the fund adopted a new bond resolution, titled the General New Issue Bond Program Resolution. Bonds under this program are issued in two parts. In December 2009, convertible option bonds were sold to the U.S. Treasury for $100 million. Proceeds from these bonds were deposited into a Treasury-approved trust account. During fiscal 2012, the fund converted roughly $61.1 million of these bonds to long-term single family housing bonds, and it redeemed approximately $38.9 million of the bonds with the remaining proceeds on deposit with the trustee. As of June 30, 2012, roughly $34.7 million in mortgages have been made under this program.

All of the fund's other bonds are outstanding under the Housing Finance Bond Resolution, its active indenture. The 'AAA' rating on the resolution is based on our opinion of:

- The assets' extremely high credit quality,
- The extremely strong reserves,
- The ability of the resolution's cash flows to withstand loan losses, and
- The fund's GO pledge.

With the exception of series 2008B, which has a liquidity facility provided by Branch Banking and Trust Co., all of the fund's debt is fixed rate. The fund has a $15 million credit line with the Federal Home Loan Bank that serves as a warehouse line for the purchase of single-family, multifamily, secondary market, and economic development loans. This credit line is secured by pledged collateral within the bond insurance fund. As of June 30, 2012, no advances had been drawn on this credit line, and accordingly, no balance was outstanding.

Management: Characterized By Stability, Tenure

The act governing the fund, as amended in January 2005, designates the governor or his designee as chairman of the board of directors, and provides that the governor shall appoint the executive director, with the state senate's advice and consent, and that the executive director serves at the governor's will and pleasure. We believe the new governor is cognizant of the importance of WVHDF, and, in our opinion, the fund has a good relationship with the state government. Management is unchanged.

WVHDF is governed by an 11-member board of directors, of which seven members are appointed by the governor, with the state senate's advice and consent, for four-year terms each. The remaining board members consist of four ex-officio members: the governor, attorney general, agriculture commissioner, and state treasurer. The board is backed by a core group of nine principal officers, with a long track record of effectively overseeing the fund's activities. Their experience provides a great source of stability and depth of knowledge to the fund, in our opinion. WVHDF operates in three offices and has 108 employees on staff.

WVHDF has been very proactive in trying to ensure state residents have ample housing. In addition to the traditional mortgage revenue bond and low-income housing tax credit programs, it offers other programs that are tailored specifically to in-state housing needs. WVHDF also provides refinancing options to customers looking to reduce their borrowing costs; therefore, it continues to earn servicing income on those loans. Currently, WVHDF self-services 100% of its loan portfolio, and it has increased its loan servicing operation through its secondary market program as a Fannie Mae and Freddie Mac seller/servicer of mortgage loans. The fund is currently the largest loan servicer in West Virginia, servicing a loan portfolio exceeding $1.34 billion. Furthermore, management has taken measures to improve profitability by capturing the maximum allowable spread, and reducing negative arbitrage by accelerating the origination/purchasing process and warehousing loans simultaneously with bond issuance.

We expect WVHDF's relationship with the state government to remain strong in the future. The fund has an excellent history of working with the state to meet its legislative mandate. A series of 1989 charter amendments designed to promote economic growth, and to develop nonresidential projects and the fund's participation in state-related activities, underscore the state's continued confidence in WVHDF's ability to help promote rental and ownership activities for state residents.

Economy

According to IHS Global Insight, job growth declined by 4% (annualized) in third quarter 2012. This contrasts with the steady growth West Virginia has seen the past couple of years. The manufacturing, services, and mining sectors, in particular, have seen considerable job losses. Mining is most badly affected, in our view, due to a 25% drop caused by declining coal production. Coal output had to be slashed due to slowing European and Asian economies, which subsequently reduced coal demand. In contrast to 2012, mining experienced a boom in 2010 and 2011, creating 6,000 jobs. As the last three years demonstrate, the mining sector can be highly cyclical in nature.

According IHS Global Insight, West Virginia has been insulated from the housing crisis, in large part, because it did not experience surging growth during the boom years. The current difficulty in the state's real estate market is more closely related to a weakened local economy. According to Federal Housing Finance Authority's purchase-only index, home values are close to their pre-recession levels at a time when the national decrease is well into double digits. At the end of second quarter 2012, foreclosure activity stood at 2% of all loans. According to the MBA, West Virginia's subprime and prime mortgage foreclosure rates diverged slightly from one another during third quarter 2012. In West Virginia, 5.5% of subprime mortgages (compared to 12.4% nationally) entered foreclosure, while 1.2% of prime mortgages entered foreclosure (compared with 3.0% nationally). With these rates, West Virginia was ranked eighth lowest in subprime foreclosure rates nationwide.

Table 1

Financial Ratio Analysis

	2008	2009	2010	2011	2012	Five-year average (2008-2012)
Profitability (%)						
Return on average assets	1.54	1.45	1.34	0.93	1.20	1.29
Return on assets before loan loss provision and extraordinary item	1.53	1.46	1.32	0.95	1.26	1.30
Net interest margin	2.33	2.25	2.14	1.99	2.20	2.18
Asset quality (%)						
NPAs/total loans and real estate owned	2.82	3.50	3.43	3.05	3.32	3.22
Loan loss reserves/total loans	4.65	4.94	5.69	8.17	11.91	7.07
Loan loss reserves/NPAs	164.48	140.61	164.89	265.25	355.64	218.17
Leverage (%)						
Total equity/total assets	30.18	32.25	32.43	34.54	39.26	33.73

Table 1

Financial Ratio Analysis (cont.)						
Total equity and reserves/total loans	41.22	44.59	49.48	54.90	63.64	50.77
Liquidity (%)						
Total loans/total assets	82.54	81.36	74.06	73.90	75.89	77.55

Table 2

Five-Year Average Financial Ratios

	WVHDF	All 'AA+' HFAs	All HFAs
Profitablity (%)			
Return on average assets	1.29	0.57	0.53
Return on assets before loan loss provision and extraordinary item	1.30	0.75	0.72
Net interest margin	2.18	1.65	1.11
Asset quality (%)			
NPAs/total loans and real estate owned	3.22	2.80	3.37
Loan loss reserves/total loans	7.07	2.11	2.07
Loan loss reserves/NPAs	218.17	4,782.56	1,030.83
Leverage (%)			
Total equity/total assets	33.73	25.88	17.20
Total equity and reserves/total loans	50.77	38.56	26.01
Liquidity (%)			
Total loans/total assets	77.55	72.35	72.09

Table 3

Trend Analysis

	2008	2009	2010	2011	2012
Total assets	1,211,387	1,187,314	1,230,809	1,188,425	1,080,189
% change	1.86	(1.99)	3.66	(3.44)	(9.11)
Total debt	760,177	722,665	751,392	701,179	581,384
% change	1.24	(4.93)	3.98	(6.68)	(17.08)
Total equity	365,598	382,955	399,184	410,472	424,049
% change	5.33	4.75	4.24	2.83	3.31
Revenues	74,355	73,162	67,647	61,878	57,648
% change	0.65	(1.60)	(7.54)	(8.53)	(6.84)
Net income	18,507	17,357	16,229	11,288	13,578
% change	(4.27)	(6.21)	(6.50)	(30.45)	20.29
Total loans	999,854	965,973	911,568	878,301	819,761
% change	4.36	(3.39)	(5.63)	(3.65)	(6.67)
Nonperforming assets	28,271	33,948	31,462	27,036	27,456
% change	11.36	20.08	(7.32)	(14.07)	1.55
Loan loss reserves	46,499	47,734	51,877	71,714	97,644
% change	3.43	2.66	8.68	38.24	36.16

Related Criteria And Research

USPF Criteria: Housing Finance Agencies, June 14, 2007