US Public Finance

Weekly Credit Outlook

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FEATURE ARTICLES

RESEARCH HIGHLIGHTS

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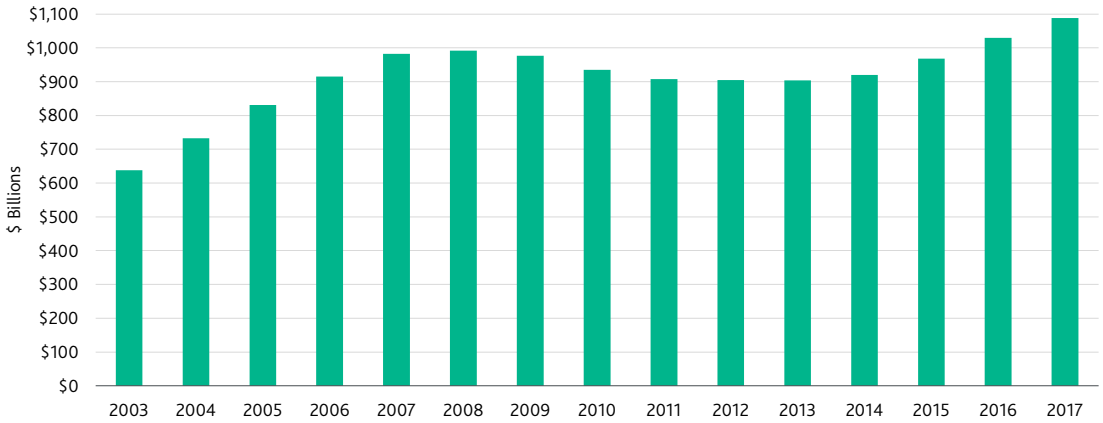
Massachusetts Local Governments' Higher Assessed Values Are Credit Positive

On January 5, the Massachusetts Division of Local Services reported that total assessed values for cities and towns grew for the third consecutive year in fiscal 2017 (which ends June 30, 2017). Assessed value is determined at the beginning of the fiscal year so that municipalities can set their tax rate and levy. The healthy growth is credit positive for the state's municipalities because it reflects economic strength and is a driver of local government tax revenues.

The recession and home price depreciation reduced total assessed value by an average of 3% per year from 2009 through 2011, stabilizing in 2012 and 2013. Since 2014, total assessed value has grown moderately, including a healthy 6% in both 2016 and 2017, exceeding $1 trillion for the first time in history (see Exhibit 1).

EXHIBIT 1
Massachusetts Local Governments' Aggregate Assessed Value
Assessed value is now above $1 trillion and pre-recession levels



Sources: Massachusetts Department of Revenue's Division of Local Services and Municipal Databank

Additionally, 2017 growth has been widespread, with 92% of the state's 351 municipalities reporting either an increase or stable valuations compared with 2016. The median valuation change is 3.5%. Tax base growth ranged from 14.3% for the City of Cambridge (Aaa stable) to a contraction of 3.9% for the City of Tolland (unrated) (see Exhibit 2).

EXHIBIT 2
Top Increases and Decreases in Massachusetts Local Governments' Assessed Value, 2016-17

Top 10 Increases in Assessed Value			Top 10 Decreases in Assessed Value		
Municipality	Change	General Obligation Rating	Municipality	Change	General Obligation Rating
Cambridge	14%	Aaa	Tolland	-4%	unrated
Chelsea	14%	unrated	Sheffield	-3%	unrated
Somerville	13%	Aa2	Windsor	-3%	unrated
Malden	13%	Aa3	Lanesborough	-2%	A1
Hubbardston	13%	unrated	Northfield	-2%	unrated
Boston	12%	Aaa	Holland	-2%	unrated
Medford	11%	Aa3	Whately	-2%	unrated
East Brookfield	11%	unrated	Cummington	-2%	unrated

EXHIBIT 2

Top Increases and Decreases in Massachusetts Local Governments' Assessed Value, 2016-17

Top 10 Increases in Assessed Value			Top 10 Decreases in Assessed Value		
Municipality	Change	General Obligation Rating	Municipality	Change	General Obligation Rating
Randolph	11%	unrated	Buckland	-1%	unrated
Kingston	10%	Aa2	Wenham	-1%	unrated

Sources: Massachusetts Department of Revenue's Division of Local Services and Municipal Databank

Tax base growth reflects a local government's overall economic health and it is no surprise that in 2017, four out of the top five assessed value increases, all in double digits, were in cities neighboring the City of Boston (Aaa stable), including Cambridge, Chelsea, Somerville (Aa2 positive) and Malden (Aa3). The economic strength of the greater Boston metro area continues to drive both residential and commercial valuation. Historically, the total municipal valuation consists primarily of residential and open space value constituting 82% of total valuation, while commercial, industrial and personal property account for 18%.

Boston's positive effect on total assessed value increasing to $1.1 trillion also extends to its immediate suburbs, including a handful with very strong growth above their pre-recession levels. For example, the towns of Belmont (Aaa stable), Lexington (Aaa stable) and Wellesley (Aaa stable) have each grown by $1.5 billion since 2008. The primary reason is the demand for residential housing because of these communities' top-ranked schools, proximity to Boston and above-average median family income. These towns also did not see material declines in assessed value during the recession.

Not all cities' and towns' assessed values returned to pre-recession levels, however. Some 58% are still below their 2008 assessed value. Municipalities with more than $1 billion in value left to recover from pre-recession peaks include the cities of Brockton (A1 negative), Fall River (A3 negative), New Bedford (A1 stable) and Taunton (Aa3 no outlook), all in the southeast region of the state. The southeast region experienced deeper and more prolonged declines than the state average because of a depressed commercial and industrial economy causing ongoing weakness in the regional housing market. However, all these cities experienced assessed value growth in the past two or three years and expect to return to pre-recession valuation given improving economic conditions and increasing home prices throughout the region.

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Housing Finance Agencies Will Benefit from Cut in FHA Mortgage Insurance Premiums

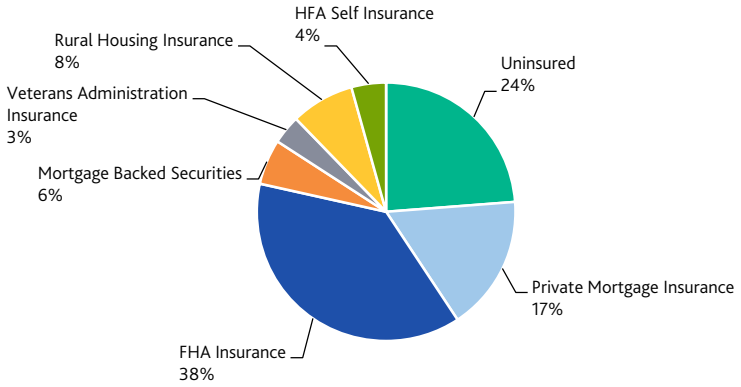
On Monday, the Department of Housing and Urban Development (HUD) announced that the Federal Housing Administration (FHA) will reduce by 25 basis points insurance premiums that borrowers pay on single-family mortgages. The premium cut is credit positive for housing finance agencies (HFAs) because it will make FHA-insured mortgage loans more affordable to borrowers and increase HFA loan originations. The premium reduction will apply to new loans closing on or after January 27.

HFAs are charged with providing and increasing the supply of affordable housing in their respective states for first-time homebuyers. The FHA, unlike other mortgage insurance providers, insure loans with loan-to-value ratios of up to 97%, which is key to the HFA lending base, given that first-time homebuyers often have limited funds for down payments.

The 25-basis-point decrease in the FHA's insurance premium, which we expect will save new homeowners as much as $500 a year, also increases the competitiveness of HFA mortgage products. A lower FHA cost will attract more borrowers and stimulate stronger FHA loan originations at a time when mortgage interest rates are rising. As of June 30, 2016, FHA mortgage insurance provided the biggest share of the insurance on HFA pools, constituting approximately 38% of Moody's-rated HFA whole-loan mortgages (see Exhibit 1), compared with 17% of mortgages utilizing private mortgage insurance.

EXHIBIT 1

State Housing Finance Agencies' Loan Portfolio by Type of Mortgage Insurance



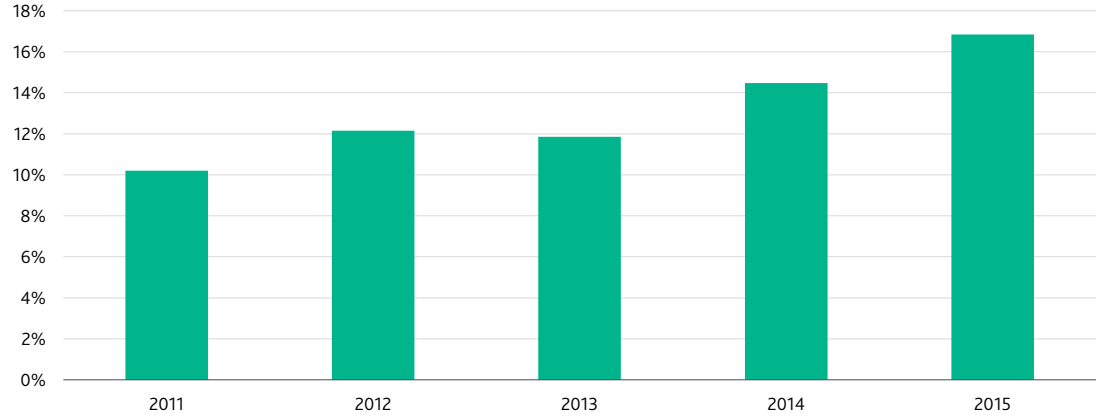
Source: Moody's Investors Service Housing Finance Agency Survey

HFA portfolio performance will strengthen because more loans will benefit from FHA insurance coverage. FHA insurance offers the deepest level of protection against foreclosure losses relative to other mortgage insurers because it covers nearly 100% of the loan principal balance plus interest and foreclosure costs. Additionally, the FHA provides the strongest claims-paying ability relative to private mortgage insurers. Although private mortgage insurers maintain ratings of Baa1 to Ba1, FHA insurance is backed by the US government.

The reduced FHA premiums will also benefit HFA to-be-announced (TBA) loan sales, which are secondary market sales using the Ginnie Mae TBA market. All loans utilizing Ginnie Mae must have US government insurance, and the FHA provides a substantial share of this insurance. Higher TBA sales will increase HFA margins given that TBA sales have been a major driver of loan production and volume, contributing to an all-time high 17% margin in fiscal 2015, which ended 30 June 2015 (see Exhibit 2).

EXHIBIT 2

Housing Finance Agencies' Average Profit Margin



Sources: Housing finance agencies' financials and Moody's Investors Service calculations

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Wage Growth Is Credit Positive for Housing Finance Agencies

On January 6, the Bureau of Labor Statistics (BLS) announced that hourly pay jumped 2.9% in 2016, the largest year-over-year increase in more than seven years. The wage growth is credit positive for housing finance agencies (HFAs) because it improves borrowers' ability to make payments on single-family mortgage loans, the principal revenue source for HFA debt service. Higher wages will also positively affect loan originations, support revenue growth and revive HFA balance sheets. The wage growth adds to an improving operating environment for HFAs marked by a low unemployment rate and rising interest rates.

According to the latest BLS jobs report, the 2.9% annual increase in private, nonfarm employment pay came as 2016 finished with a 10-cent bump to $26 per hour in December, after a slight dip in November. The growth in households' ability to meet their mortgage obligations supports our view[1] that HFA delinquency levels will continue to decline over the next 12-18 months.

The growth in wages will further strengthen the performance of HFAs' current loan portfolios. As the Exhibit below illustrates, total delinquencies fell below 6% in the 2016 second quarter, the lowest mid-year level since 2009. The decrease extended the downward trend seen over the last three years. With delinquencies down, foreclosures dropped 16%, more than double the 2015 mid-year level. Stronger loan performance will help HFAs realize projected mortgage income and lower loan losses resulting from fewer foreclosures. Fewer foreclosures in turn should lead to faster foreclosure times and corresponding lower accrued interest, property maintenance costs and staff expenses.

Increase in Wages Will Continue to Reduce Delinquency Rates on HFAs' Single-family Loan Portfolios

	Q2 2016	Q2 2015	Q2 2014	Q2 2013	Q2 2012	Q2 2011	Q2 2010	Q2 2009
Percent of loans 60-89 days delinquent	1.62%	1.62%	1.62%	1.92%	1.80%	1.73%	1.77%	1.66%
Percent 90+ days delinquent	2.52%	2.58%	2.99%	2.89%	2.75%	2.31%	2.64%	2.21%
Foreclosures	1.83%	2.17%	2.35%	2.48%	2.21%	2.29%	2.06%	1.57%
Total Deliquency Rate	5.97%	6.37%	6.97%	7.29%	6.76%	6.33%	6.47%	5.44%

Delinquency data as of June 30

Source: Moody's Investors Service HFA surveys

Wage growth, along with a low unemployment rate of 4.7% and rising interest rates, could also lead to an increase in single-family mortgage loans financed with bonds. HFAs typically issue tax-exempt bonds to finance mortgages, resulting in more attractive mortgage rate to borrowers than conventional mortgages. Improved employment prospects and wage growth increase the ability of borrowers to qualify for the loans. Loans purchased by HFAs with bond proceeds remain on their balance sheets and create an ongoing revenue source and support their financial position.

[1] See HFA Single-Family Delinquencies Continue to Decline, Bolstering Loan Portfolios, October 21, 2016

RESEARCH HIGHLIGHTS

Galveston County, TX Upgraded to Aaa; Outlook Stable

Jan 4 - We upgraded Galveston County, TX's outstanding general obligation limited and unlimited tax obligations to Aaa, affecting $260 million in debt. The outlook is stable. The upgrade to Aaa reflects the county's large and diverse tax base that benefits from ongoing commercial and residential development, healthy financial position supported by conservative budgetary management, and average debt and pension burdens. The rating also incorporates the county's average wealth and income profile and demonstrated ability to sustain balanced operations during natural disasters.

Buncombe County, NC Upgraded to Aaa; Outlook Stable

Jan 6 - We upgraded Buncombe County, NC's General Obligation Bond rating to Aaa from Aa1. Concurrently, we upgraded the county's more essential Limited Obligation Lease Revenue Bonds to Aa1 from Aa2 and the county's less essential Taxable Series 2014B Limited Obligation Lease Revenue Bonds to Aa2 from Aa3, affecting a combined $401 million of outstanding limited obligation debt. The outlook was revised from positive to stable. The Aaa rating reflects the county's strong financial position as a result of conservative budgeting practices and a growing, regionally important local economy. The rating further reflects an elevated but manageable debt burden with comprehensive debt management policies.

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