MINUTES
of the
FOURTH MEETING
of the
MORTGAGE FINANCE AUTHORITY ACT OVERSIGHT COMMITTEE

October 31, 2016
New Mexico Mortgage Finance Authority Office
344 Fourth St. SW
Albuquerque

The fourth meeting of the 2016 interim of the Mortgage Finance Authority Act Oversight Committee was called to order by Senator Nancy Rodriguez, chair, at 10:11 a.m. on October 31, 2016 in the New Mexico Mortgage Finance Authority (MFA) office in Albuquerque.

Present	**Absent**
Sen. Nancy Rodriguez, Chair	Sen. Stuart Ingle
Rep. Alonzo Baldonado, Vice Chair	
Sen. Lee S. Cotter	
Rep. Kelly K. Fajardo	
Rep. Roberto "Bobby" J. Gonzales	
Rep. James Roger Madalena	
Sen. Cisco McSorley	

Advisory Members

Rep. Bealquin Bill Gomez	Rep. George Dodge, Jr.
Rep. Jimmie C. Hall	Sen. Bill B. O'Neill
Sen. Richard C. Martinez	Sen. Sander Rue
Sen. Gerald Ortiz y Pino	
Sen. Michael Padilla	

Staff
Mark Edwards, Drafter, Legislative Council Service (LCS)
Sharon Ball, Senior Researcher, LCS

Guests
The guest list is in the meeting file.

Handouts
Handouts and other written testimony are in the meeting file.

Monday, October 31

Introductory Remarks.

Jay Czar, executive director, MFA, provided a brief update on housing activities during the past two months. He said that the biannual Housing Summit was attended by approximately 420 participants representing affordable housing providers and lenders and housing advocates around the state. He reported that the Imperial building project in Albuquerque is now fully operational and has a grocery store, restaurant and tap room along with its rental units. The Imperial building project complements the Cuatro project for senior housing that also opened this year in Albuquerque. He also reported that the State Board of Finance has recently approved $11 million for rehabilitation of the Pasatiempo Senior Center in Santa Fe. This will be the first major reconstruction work at Pasatiempo since it was built in 1973.

A committee member asked about which agencies promulgate and implement the rules for housing eligibility and evictions, particularly with regard to people with criminal records. Isidoro "Izzy" Hernandez, deputy director of programs, MFA, answered that those rules are an amalgamation of the Section 8 housing assistance rules promulgated by the United States Department of Housing and Urban Development (HUD) and the requirements for housing assistance tax credits. The member commented about a need for transitional housing to prevent recidivism and asked if convicted felons are ineligible for housing assistance. After some committee discussion, the MFA was requested to provide some further information about housing policies for people with criminal records at the next meeting.

Mr. Czar also announced that Mr. Hernandez had just retired from the New Mexico National Guard as a colonel after 32 years, and the committee gave him a standing ovation for his service.

Approval of Minutes

Upon a motion by a committee member, and without objection, the minutes of the August 24, 2016 committee meeting were approved.

MFA Budget

Gina Hickman, deputy director of finance and administration, MFA, provided an overview of the MFA budget. As an initial matter, she reminded the committee that the MFA budgets for the federal fiscal year from October 1 through September 30, in contrast to the state fiscal year that runs from July 1 through June 30. Because the MFA fiscal year recently ended, the figures for 2016 are still estimates. She said that the private activity bond cap (PABC) accounts for approximately 72.2% of the estimated $508 million total budget. Other portions of the MFA budget derive from: federal housing programs (21.1%); MFA Revolving Loan Fund (3.4%); private funding (2.2%); and state funding (1.2%). She said that most of the private funding is provided by Public Service Company of New Mexico, the New Mexico Gas Company and other utilities for the MFA's weatherization program. She said that so far, propane distributors are not part of the weatherization program, but some local electric cooperatives are.

Ms. Hickman said that the MFA annually updates a 10-year snapshot of the affordable housing environment in the state (see the "Production and Financial Highlights" of handout 1a in the committee file). She said that the MFA theme for 2016 had been "program expansion". She indicated that this theme was adopted to take advantage of the unused PABC and historically low interest rates.

Outlining major revenue sources and expenditures for the MFA's operating budget, Ms. Hickman said that 44% of operations are paid for by administrative fees, 28% by interest on loans, 9% from investments, 8% from servicing income and 7% from housing programs. The total operating MFA fund for 2016 was approximately $16.5 million. Administration costs accounted for just under 90% of the MFA's operating expenditures, with approximately two-thirds of the operating budget being used for salaries and contract services. She noted that the MFA also dedicates 5% of its operating fund to manage the risk of "loan-loss".

Ms. Hickman noted two other aspects of the MFA's 2016 budget: a 2.75% merit pay increase for employees and developing in-house capacity to service loans. Responding to questions from the committee, Ms. Hickman said that the pay increase was based on an analysis of the market but that it is hard to find comparable salary figures given the specialization of the MFA's work. Regarding the new servicing capacity, she said that it would initially save contracting costs and might provide future new revenue if the MFA can contract loan servicing to other agencies. She said that servicing fees are incorporated into loans provided by Fannie Mae or Ginnie Mae for single-family homes. Mr. Czar added that the variability of servicing fees limits the market for service providers. Noting the experience of the North Dakota state bank, Mr. Czar projected that building an in-house MFA loan servicing capability would reduce costs.

A committee member asked about the potential to reduce the servicing fee costs on mortgage payments. Mr. Hernandez said that there is always a cost to servicing a loan, and the question facing the MFA is whether to keep paying that cost to contractors or to develop its own capacity. He projected that the MFA could use future servicing fee costs to expand its services. He also said that the MFA would provide more information to the committee on the cost of loan servicing as part of mortgage payments.

A committee member asked about employee benefits. Ms. Hickman said that most of the MFA's employee benefits involve medical insurance, but that the MFA does match employment retirement account contributions up to 5%. The committee member requested that the MFA provide more detailed information on its employee benefit package.

Committee members asked about the MFA's bond rating and whether it is affected by changes in the state's rating. Ms. Hickman responded that the MFA's bond rating is based on the housing market and not on the state budget. Further, each lender transaction gets a separate rating. She said that because MFA bonds are backed by mortgages, the MFA always gets the highest rating.

A member asked for an explanation of the "negative growth" in asset management depicted in the 10-year snapshot page. Mr. Hernandez acknowledged the problem and said that federal housing assistance programs allow developers to opt out after 15 years. The federal programs receive low interest loans and tax credits on rental facilities if a certain portion of the units is for affordable housing. He said that many developers have chosen to opt out after 15 years and have removed those units from the affordable housing market. However, he said that the MFA and similar agencies in most of the other states started requiring developers to waive the opt-out provision several years ago. He said that since 2002, the MFA has required a 30-year commitment from developers to participate in the housing assistance programs. He said that there are still units that are covered by the old rule, so losses of some affordable housing units could be expected over the next few years.

The committee then turned to questions about the MFA's reserves and financial accountability. Ms. Hickman said that the MFA's audit from 2015 had one minor finding and that the audit for 2016 is in process. She said the audit would be provided to the MFA board in mid-January. She acknowledged that the Office of the State Auditor believes that the MFA keeps a high reserve, and she said that the MFA operates as a private entity, which may account for some of the difference between the MFA and a state agency in this regard. She directed the committee's attention to pages 10 and 11 of her handout regarding the benefits of a reserve and MFA fund balances. Ms. Hickman noted a $43.2 million Governmental Accounting Standards Board fair market value adjustment listed on page 11. She indicated that this figure is to meet accounting standards but that the adjustment does not represent a liquid asset. Ms. Hickman spoke about a HUD requirement to keep a "loan risk" reserve and the value of a reserve to maintain high bond ratings. A committee member then requested that the MFA provide a summary of its loan loss history.

Asked to compare the MFA's bond rates to its counterparts in other states, Ms. Hickman said that the MFA's rates are equal to other states when using a mortgage-backed method. She said that some states use a "whole loan" method that usually receives a lower rating.

Reports on Bonds Issued, Financing Strategy and Market Update

David Jones, CSG Advisors, provided an overview of national and state market trends for housing finance authorities (HFAs), mortgage rates and bonds (see handout for item 3, "Financing Trends Among HFAs; Implications for MFA" in the committee file).

Mr. Jones said that the MFA creates a weekly comparison of the national and state bond and mortgage rates as a basis to determine bond issuance and asset sales. He also said that the MFA compares 30-year fixed-rate mortgages, 15-year fixed-rate mortgages and 30-year adjustable-rate mortgages in its weekly updates and that the MFA's current "first home" 3.5% loan rate is very competitive. He showed a comparison between municipal rate bonds (MRBs) and treasury bonds and said that MRBs had been less expensive for HFAs, but that trend had reversed. Now, the cost of MRBs is always higher than for 10-year treasury bonds.

Turning to single-family home financing, Mr. Jones noted a trend for HFAs to move from traditional mortgage-backed securities to "to be announced" (TBA) mortgage-backed security futures markets. He showed how the MFA's new loan production had grown from approximately $100 million in 2013 to approximately $200 million in 2016. In that time frame, the percentage of funding from TBAs and traditional bond funding has flipped. In 2013, TBA funding accounted for just under one-fourth of the MFA's loan funding, but in 2016, TBAs accounted for approximately three-fourths of new loan funding for single-family homes (see graph on page 7 of Mr. Jones' handout). He said that the MFA is now refinancing bonds to lock in lower rates and it is having success with monthly pass-through bond sales to generate revenue. Maintaining a mixture of these bond structures, Mr. Jones said that the MFA is receiving strong bond ratings with an AA- rating from Standard and Poor's and an Aaa rating from Moody's.

Concluding his remarks, Mr. Jones said that servicing loans is hard for HFAs. He noted that some state HFAs, like Tennessee's, service their own loans and that Idaho's HFA sells services to others.

Asked to expand on the use of TBAs versus traditional bonds, Mr. Jones said that TBAs are used to hedge interest rate risks. He said that there is a three-month lag between when a loan is made and the bond sales to support the loan. A TBA is used to lock in the interest rate on the bond.

Asked about how MFA programs leverage other funding, Mr. Czar said that the MFA would be seeking $5 million through the state's infrastructure capital improvement plan process for its housing trust fund. He said that this program leverages $20.00 in other funding for every $1.00 in state funding. He also said that the MFA does have a down-payment assistance program for purchasing a second home but that it has a higher interest rate.

MFA Strategic Plan: 2016 Accomplishments and 2017 Benchmarks

Ms. Hickman and Mr. Hernandez told the committee that the MFA develops a strategic plan every three years (see handout item 3a "2015-2017 Strategic Plan") with a yearly benchmark analysis (for 2016, see handout item 3b "MFA Strategic Plan Dashboard — Q4"). The MFA's mission to is assist New Mexico residents in acquiring quality affordable housing by expanding rental and homeownership opportunities.

Mr. Hernandez walked the committee through some of the benchmarks that the MFA uses to examine its performance, including measures to maintain its financial stability, employee satisfaction and improvement; the development of new resources; and the creation of effective partnerships. He highlighted the hiring of a compliance officer to keep track of the requirements for different funding sources; development of new relationships with El Paso Electric Company and rural electric cooperatives for the MFA's weatherization program; and outreach efforts with the regional housing authorities to hold five regional meetings around the state.

Mr. Hernandez said that 2016 was a banner year for housing loans. The MFA's target was to issue 1,250 loans, but it actually issued 2,000. Further, he said the state added 480 rental units in 2016.

The committee then entered into a discussion about pre-foreclosure counseling and assistance for communities that suddenly lose a large employer. Mr. Hernandez said that he does not know whether a counseling program run by the Office of the Attorney General had an outreach component or if it required individuals to seek it out. He said that he would find out and provide that information to the committee.

Cybersecurity

Joseph Navarette, information systems manager, MFA, presented on the trends in cybersecurity. He noted that major companies will regularly alert customers to known vulnerabilities in their software, and he highlighted the following four areas of growing security concern.

1) More and more information is stored in the cloud. Mr. Navarette said that is critical for organizations to ensure that they have oversight and control the information that they store in this fashion.

2) Ransomware is a growing threat. In a ransomware case, someone gets into a system and encrypts the information stored there. When the user accesses that system, a page pops up demanding payment or the information will be locked down. Mr. Navarette said that typically the ransom is for limited amounts, and the Federal Bureau of Investigation is recommending that victims pay the ransom. However, there is no way to determine if that information is secure afterward. He cited an example where a hospital did pay the ransom because the information was time-critical for its patients. He also said that the MFA was hit with ransomware in 2015. The MFA was able to avoid paying ransom because it had its information backed up every night.

3) Spear-phishing requests. Mr. Navarette said that these can come in the form of announcements such as "You Have Won $1 Million!" or messages with titles such as "Dear Client". He said that a typical spear-phishing attack tries to get the user to send back specific information or to get the user to click on an embedded link. While a link can be designed to look like a link to anywhere, he said that a telltale sign is to hover the user's mouse over the link and see if it shows a different address with "redirect" included in it.

4) The internet of things (IOT). The IOT references the growing use of cars and appliances that have accessible computers in them. Many companies have not realized the need for proper security for these devices, so many are vulnerable to being hacked.

To address these potential threats, Mr. Navarette said that the MFA had completed a vulnerability scan and a penetration test in August, is implementing disk and email encryption and is updating its virus scanning software.

Adjournment

Without objection, the meeting adjourned at 12:18 p.m.