

Rating Update: Moody's Downgrades Colorado Housing and Finance Authority's Issuer Rating to A2 from A1; Outlook is Stable

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COLORADO HOUSING & FINANCE AUTHORITY
State Housing Finance Agencies
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Opinion

NEW YORK, November 17, 2011 --Moody's Investors Service has downgraded the rating of Colorado Housing and Finance Authority (CHFA) to A2 from A1. This action affects an approximate \$65 million of Class III bonds outstanding as of December 31, 2010 contained in CHFAs Single Family Mortgage Program Bonds and Multi-Family/Project Bonds Indentures. CHFA also maintains several stand-alone, Senior/Subordinate bond programs. While these subordinate tranches carry the general obligation of the Authority, they are not affected by the downgrade as they are self-supporting.

SUMMARY RATING RATIONALE

The downgrade reflects CHFAs very high composition of variable rate debt (currently at 74% of total debt outstanding), potential losses arising from their variable rate debt profile as well as the material impact of payments due to Lehman Brothers Special Financing, Inc (LBSF) and Lehman Brothers Financial Product, Inc (LBFP) resulting from CHFA's final settlement of the Lehman Derivatives ADR notice.

The outlook is stable based on CHFA's satisfactory financial position, decline in delinquency and the extension of the Temporary Credit Liquidity Program (TCLP) liquidity facilities from 2012 to 2015 (accounting for 33% of total variable rate demand obligations).

STRENGTHS

Increased profitability (10.46% net revenue as a percent of total revenue) and stabilized collateralization levels as evidenced by agency asset to debt ratios of 1.11

Strong loan portfolio consists of primarily of government insured, fixed-rate, 30 year amortizing single family mortgage loans and highly over-collateralized multifamily loan programs

Improved delinquency trends (seriously delinquent loans of 4.44% as of 6/30/11)

Reduced general obligation issuance

Strong and proactive management

CHALLENGES

Highly sensitive to a variety of risks including rollover and counterparty risk as a result of variable rate debt profile

Payments resulting from the final settlement of the Derivatives ADR notice will negatively impact Authority's financials

DETAILED CREDIT DISCUSSION

CHFA has 74% exposure to variable rate debt. This leaves the Authority vulnerable to a variety of risk including liquidity rollover and swap counterparty performance.

- CHFA has been successful in renewing and obtaining replacement liquidity facilities. In addition, the Department of Treasury in conjunction with Fannie Mae (FNMA) and Freddie Mac (FHLMC) have extended the Temporary Credit and Liquidity Program (TCLP) by three years to December 15, 2015. While this reduces the amount of liquidity due in 2012 from \$1.2 Billion to \$437 Million (63% reduction), terms of TCLP renewal are still unknown. CHFA has also restructured several variable rate demand obligations to index floaters thereby reducing liquidity needs.

- The Federal Home Loan Bank (FHLB) and TCLP account for 76% of liquidity agreements (approximately \$1.7 billion in debt). Should CHFA be unable to obtain replacement facilities, debt service costs may increase dramatically as applicable debt would become bank bonds.

- CHFAs debt profile remains vulnerable to third party risk. Counterparty downgrades have resulted in a large percentage of variable rate debt to be treated as "unhedged" in high rate cash flow scenarios. CHFA has 19% exposure to AIG (rated Baa1) and 19% exposure to BofA (rated A2/P1). In the event of a counterparty default, in a high rate interest rate environment, the cost of debt increases significantly on applicable debt. Should this trend continue, greater stress will be placed on the General Fund as counterparties continue to suffer from credit deterioration and resulting downgrades.

Final Resolution of ADR Payment may have material impact on Authority Financials

As a result of the final settlement of the Lehman ADR notice dated October 21, 2010, the Authority is responsible for a "material" payment to Lehman. Although this is mitigated by a contingency reserve and identified liquidity sources, the estimated payment will negatively impact financials.

CHFA Maintains Strong Portfolio Performance

Improved delinquency levels and strong loan portfolios offset the effects of shortfalls incurred through

variable rate debt and capital charges applied to the agency. CHFA's Single Family loan portfolio is 75% government insured (FHA, VA and RD) offering the greatest level of coverage in the event of loan loss. This is evidenced by their improved delinquencies. CHFA delinquency rates have improved year over year, most recently reporting seriously delinquent loans (90+ and foreclosures) of 4.44% as of June 30, 2011. Aggregate delinquency rates (60+, 90+ and foreclosures) have improved to 5.92% for the same period. CHFA's single family loan portfolio continues to outperform state and national levels.

CHFA's Multifamily loan portfolio exhibit strong performance, composed of a large amount of over-collateralized, uninsured loans (69%) and large amount of FHA insured and subsidized loans (31%). The Authority issues bonds under two indentures.

The Multi-Family Insured Mortgage Revenue Bonds Resolution is rated Aa2 with a negative outlook. The negative outlook reflects the negative outlook on the sovereign rating of the United States Government. The indenture is entirely composed of loans insured by the Federal Housing Administration, exhibiting a 1.18 program asset to debt ratio (PADR) in excess of 1.02 requirement.

The Multi-Family Projects Bonds Resolution is rated Aaa/Aa2/A2 with a stable outlook. The program exhibits high collateralization levels allowing for absorption of potential losses from uninsured/unenhanced project loans (1.60/1.09/1.08 PADR levels).

CHFA has Significantly Reduced General Obligation Issuance

General Obligation issuance has been reduced significantly and combined fund balance is sufficient to cover general obligation liabilities.

Class III and Subordinate Bonds (which carry pledge of Authority's General Obligation) issuance have been reduced substantially. The past three years show a decline of direct general obligation debt by 20%. As per 2010 audit, there is an approximate \$65M in direct general obligation debt.

CHFA's Audited Financial Statements Exhibit Strong Profitability and a Decline in Fund Balances

The Authority's combined and general fund balances have decreased (13% and 27% respectively) primarily as a result of the \$35 million contingency reserve as well as a lack of issuance, spurred by the global financial crisis. Asset to debt ratios have been stable at 1.11 for the past 10 years and net revenue has tripled from FYE 2009; (\$12M to \$36M). Interest expense as a result of the low interest rate environment and large component of floating rate debt has decreased and has positively impacted CHFA's profitability.

Cash Flow Projections Demonstrate Ability to Withstand Stresses:

Moody's has reviewed cash flow projections demonstrating the ability of all indentures to withstand stresses in line with the rating assigned. Resulting shortfalls to the general fund have been incorporated in the analysis. The cash flows, prepared in accordance with Moody's methodology, include high (3-year average life) and low (25%) prepayment speeds in both high and low interest rate environments as well as Bank Bond scenarios. Cash flow scenarios also demonstrate the ability of the program to withstand the lost interest rate hedges applicable to debt maintaining AG and BofA swap interest rate agreements.

OUTLOOK

The outlook is stable, given the leveling off of delinquencies levels and the improving trend in the Program's financial performance.

WHAT COULD MAKE THE RATING GO UP

Reduction in variable rate debt, thereby reducing a variety of risks including rollover, counterparty and interest rate risk

Continued improvement in financial performance, including increases in asset-to debt ratios

WHAT COULD MAKE THE RATING GO DOWN

Decline in program financial performance, including decreases in asset to debt ratios or profitability

Increases in potential losses from mortgage loans, as demonstrated by increasing levels of delinquency or foreclosure

Increasing counterparty downgrades, resulting in ineffective hedges to variable rate debt

Declining performance of cash flow projections

The principal methodology used in this rating was Moody's Methodology for Assigning Issuer Ratings to Housing Finance Agencies published in May 2001. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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