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# Iowa Finance Authority; General Obligation

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Credit Profile		
Iowa Fin Auth ICR <i>Long Term Rating</i>	AA/Stable	Upgraded
Iowa Fin Auth multifam hsg bnds ser 2006A <i>Long Term Rating</i>	AA/Stable	Upgraded
Iowa Fin Auth var rate multifam hsg <i>Long Term Rating</i>	AA/A-1/Stable	Upgraded
Iowa Fin Auth Multifamily hsg bnds 2008 Ser A (AMT-var rate) <i>Long Term Rating</i>	AA/A-1/Stable	Upgraded

## Rationale

Standard & Poor's Rating Services raised its issuer credit rating (ICR) on Iowa Finance Authority (IFA) to 'AA' from 'AA-'. In addition, Standard & Poor's raised its long-term rating to 'AA' from 'AA-' on the authority's outstanding debt. The outlook is stable.

The rating is based on our opinion of the following strengths:

- The very high quality and very low-risk profile of its asset base;
- The authority's success in meeting its major goals in its recently completed five year plan;
- Very consistent profitability ratios that are in line with other 'AA' rated housing finance agencies;
- Minimal GO debt exposure;
- Management's proactive steps to minimize uncertainty regarding variable rate debt since October 2008, although its variable rate debt remains a challenge, the authority is planning to reduce its exposure to variable rate demand obligations (VRDOs); and
- Stable and active management team with strong legislative support.

In 2003, IFA established a five-year plan, which included the goal of increasing its assets to 140% above the 2003 baseline. By fiscal year 2008, the authority surpassed that mark, growing 207% from fiscal year 2003 while reducing the risk profile of its assets. IFA reduced its risk profile by financing single family mortgage loans secured through 'AAA' eligible Ginnie Mae and Fannie Mae mortgage-backed securities (MBS). The strength of the asset portfolio is complemented by good profitability ratios, given the low-risk nature of the portfolio.

Offsetting the growth in assets was a dilution of equity. The decline in equity was expected by Standard & Poor's as IFA rapidly expanded its asset base. Since the authority has achieved its growth goals, Standard & Poor's expects the equity ratios to level off as IFA changes its course with an emphasis on expanding financial flexibility.

The authority has increased its risk profile on the debt side, which we believe has become more evident following the current credit crisis. IFA has been able to mitigate these effects, replacing lower-rated liquidity facility providers and general investment contract (GIC) providers. As of the date of publication, the authority had eliminated all bonds previously held by liquidity banks, a figure that was \$100 million in 2008.

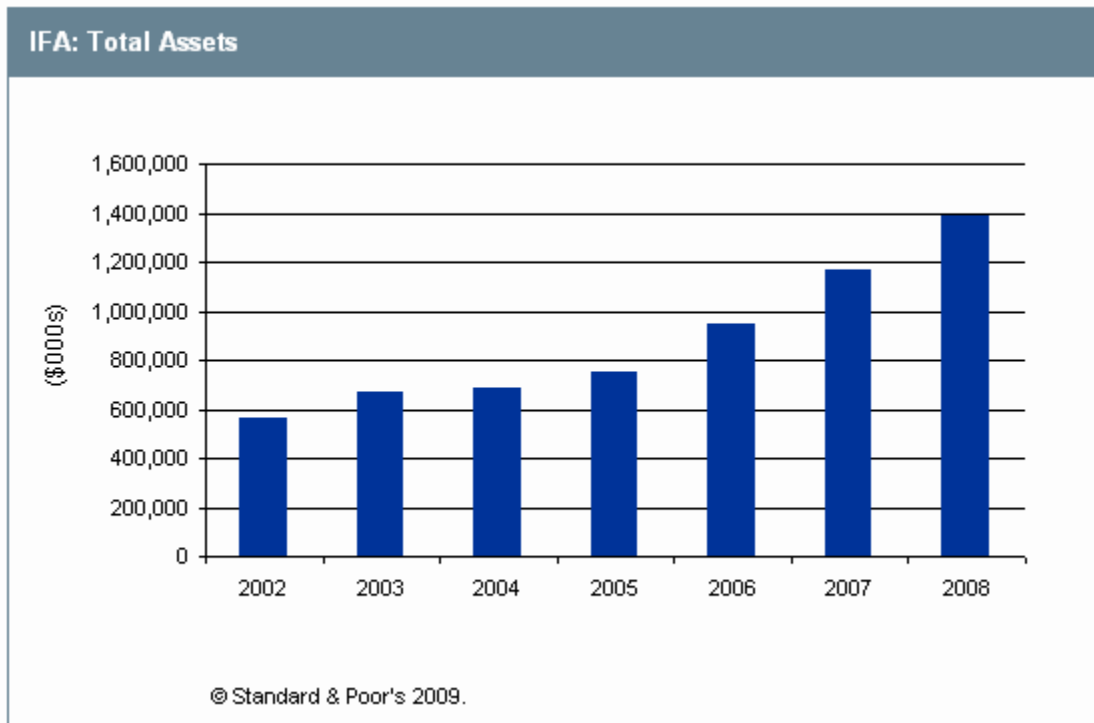
## Outlook

The stable outlook reflects our opinion of the strength of the authority's asset base, its financial performance, and management that is transitioning from an aggressive five-year strategic plan. IFA will operate in a capital market that is not amenable to housing finance authorities (HFAs), but should the authority's financial performance continue, with improving trends and a leveling off of leverage ratios, we expect the authority to be able to maintain its rating. However, if assets experience unforecasted growth, leading to weaker leverage ratios, or if the environment facing IFA and other HFAs proves too volatile, a negative rating action could result.

## Asset Quality: Increase In Asset Base; High Quality MBS

IFA's asset base has more than tripled in size since the beginning of fiscal 2000. As of June 30, 2008, the authority's asset base was at an all-time high of \$1.38 billion, following an 18% increase from the previous fiscal year. The assets and other financial information Standard & Poor's used for this analysis exclude the state revolving fund that IFA administers as well as any conduit bond issues, which have no recourse to the authority. The increase is in line with the fiscal 2007 trend, when the asset base increased 23% from 2006. Since 2003, the authority's assets have increased by at least 10% every year except 2004, with average growth at 16%.

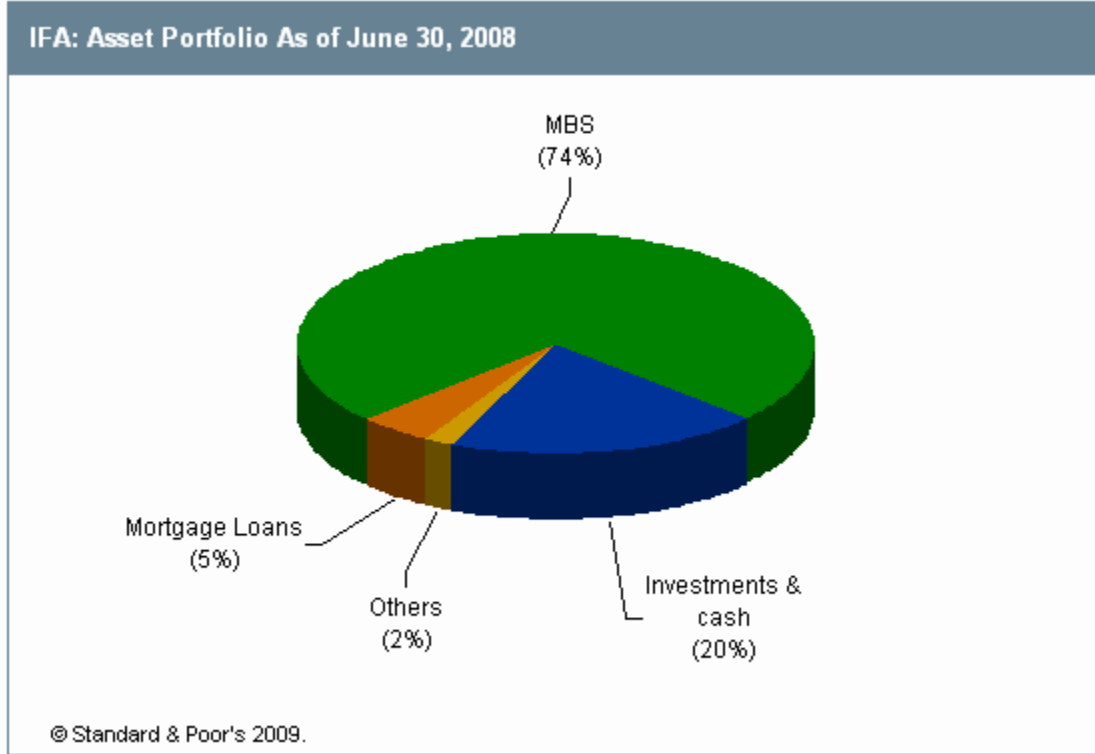
Chart 1



Around 74% of the authority's asset portfolio consist of 'AAA' MBS, and 79% reflects a mix of MBS and other mortgage loans. The proportion of MBS and other mortgage loans in the asset portfolio has risen from a low 48% of total assets in 2000 to 79% in 2008 . This increase is primarily due to the authority's active lending activities. IFA's single-family MBS portfolio has increased substantially in size since 2000 and by 18% from 2007 to 2008. At

the end of fiscal 2008, IFA's loan portfolio consisted of Ginnie Mae and Fannie Mae MBS (94%) and 6% multifamily and single family mortgage loans. This proportion is consistent with prior years. In fiscal year 2004, the authority's loans were 93% MBS and 7% unsecuritized loans.

Chart 2



We believe that IFA's loan portfolio poses an extremely low risk, due to the authority's conservative approach to collateral. As of June 30, 2008, more than 99% of IFA's single-family loans were backed by Ginnie Mae and Fannie Mae MBS. As Standard & Poor's expected, delinquencies and non-performing assets as of June 30, 2008, were at a low 0.18% of total loans and MBS's, given what we consider the low risk associated with IFA's loans. Since MBS guarantees payment on the underlying loans, no reserves are required. However, for the remaining loans, IFA has provided reserves to cover potential credit losses on the portfolio. In our opinion, these loans are performing well and have sufficient excess assets that cover any credit shortfall or liquidity issues.

IFA's investments as of Dec. 31, 2008, are in our view of high credit quality and provide sufficient liquidity, primarily consisting of investments in government securities and investment agreements rated 'AA-' or higher. We consider IFA's investments to be liquid, with 37% of them maturing in less than a year.

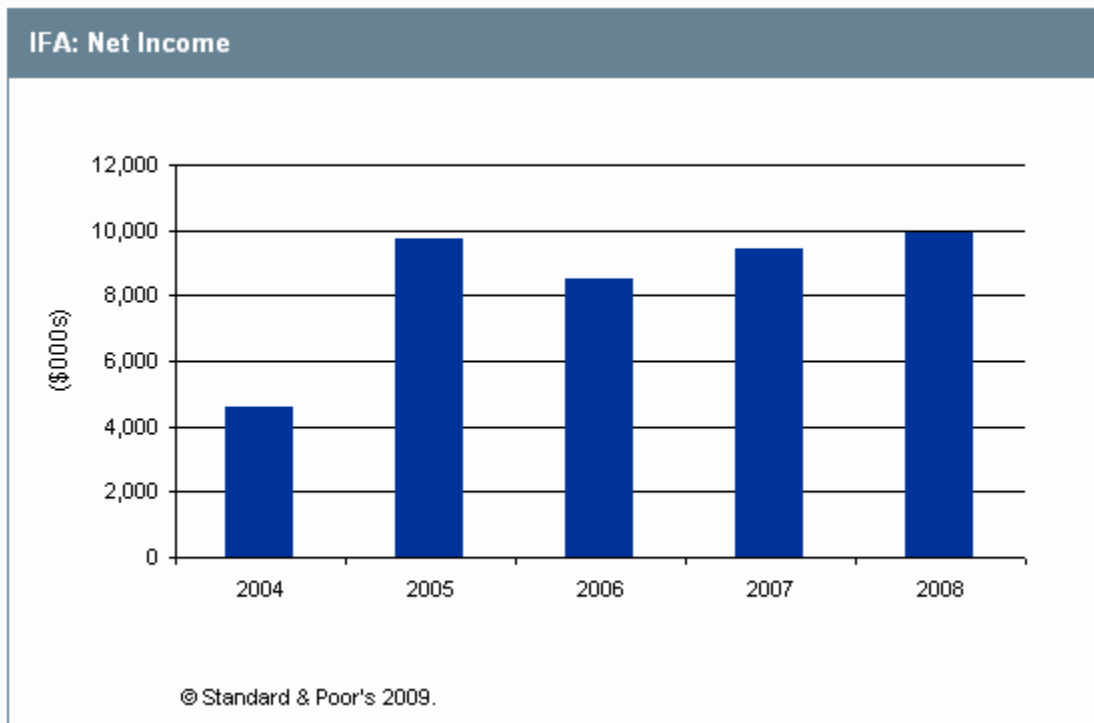
Management takes what we consider a conservative approach to the oversight and monitoring of the authority's investments. IFA's investments provided around 12.7% of total revenues in 2008, which was in our view low compared to the fiscal year 2007 figure of 16.5%. This decline is due to a fall in investment income in fiscal 2008 from lower yields on short-term investments, and is a common occurrence among HFAs.

## Earnings Quality And Financial Strength: Increased Revenues

IFA's total revenues have increased steadily and have more than doubled since 2000. As of June 30, 2008, the authority's total revenues stood at \$89 million, following a 17% increase from fiscal 2007. This increase is attributable to a 31% rise in the authority's interest income from loans. The authority's income from loans has been increasing during past few years, which is evident from 34% increase in fiscal 2007 and 23% in fiscal 2006.

In fiscal 2008, the authority's net income was \$9.9 million, a 5% increase from the previous fiscal year. Net income was impacted by the decline in investment income and increasing interest expenses for bonds as IFA has implemented its strategic plan for growth.

**Chart 3**



IFA's profitability, as measured by return on assets, declined to 0.78% in 2008 from 0.89% in 2007; its net interest margin (NIM) also declined, to 1.10% in 2008 from 1.21% in 2007. The decline in profitability ratios is mainly due to the rising asset base of the authority during the past few years and the lower interest earnings on investments. However, net income has been very consistent in recent years, between \$8.5 million and \$9.9 million from 2005 to 2008 after just \$4.6 million in 2004. As detailed in table 2, the five-year average of the authority's profitability ratios is higher than those of its 'AA' rated peers, despite a low-risk profile.

IFA's equity position increased by approximately 5.0% to \$173 million in 2008, representing 12.4% of total assets. Unlike other (HFAs), this ratio has declined steadily, from 26.61% in 2000, as a result of the rapid increase in assets in accordance with the authority's strategic plan. The authority's equity base is in our view adequate, however, to support its low-risk profile. After adjusting for potential losses, the authority's unrestricted equity as a percentage of debt is 8.6%, above Standard & Poor's threshold of 4.0% and its liquid assets are 155.0% of loans, well in excess

of the 2.0% of mortgage loans outstanding. The authority expects slower growth in the coming years, which should result in stable or growing equity.

## Debt: Moderate Risk

As of June 30, 2008, IFA's debt outstanding totaled \$1.15 billion, up 22% from the preceding year and the highest since the 1990s. The issuance of single-family bonds to finance the purchase of MBS under the authority's First Home Program accounts for the increase in debt. Of the total, 97% are single-family bonds and 3% are multifamily bonds. All single-family bonds issued since 1991 under the single-family MBS resolution, which constitutes more than 99% of the total single-family bonds and around 97% of total debt, are rated 'AAA' and reflects our opinion of the IFA's extremely high quality of pledged collateral, which consists of Ginnie Mae and Fannie Mae MBS, the strong credit quality of investments, and cash-flow sufficiency. The remaining single-family bonds are backed by single-family whole loans and one multifamily bond series 1978A and are rated 'AA' based on the strength of the excesses under the separate indentures. Under the series 1978A bond issue, loans are no longer outstanding and the bonds are solely secured by government obligations escrowed through bond maturity in 2021. The authority's general obligation (GO) debt exposure ratio is 3.73%, or low on Standard & Poor's leverage scale for HFAs. The GO debt was issued under a multifamily resolution opened in 2006.

At the end of June 2008, around 31% of the single-family bonds outstanding were issued at variable-interest rates. For the entire authority, 26% of debt is variable rate. The use of variable-rate debt facilitated a reduction in the authority's cost of debt and origination of mortgage loans at competitive interest rates. However, events since fall 2008 have caused the authority to take action to mitigate the effects of declining strength and support of the credit markets and its participants. The primary action was the removal of Depfa Bank, PLC (BBB/A-2/CWDev) as a GIC and liquidity provider. As of Feb. 25, 2009, the authority successfully remarketed all bonds that were previously held by liquidity banks, a figure that reached approximately \$100 million.

In fiscal 2008, the authority hedged 100% of its floating-rate exposure through interest rate swaps and caps entered into with either UBS AG (A+) or Goldman Sachs Capital Markets LP (A). Following a review of IFA's 19 interest rate swaps and four interest rate caps, Standard & Poor's assigned the authority a Debt Derivative Profile (DDP) score of '2' on a four-point scale, where '1' represents the lowest risk and '4' the highest risk.

The overall score of '2' reflects our opinion of:

- Two adequately rated swap counterparties, both of which are required to post collateral before a credit event occurs;
- Moderate economic viability of the swaps due to the hedge rate being about 68% of LIBOR;
- Low basis risk;
- Low termination risk; and
- Good management oversight.

We believe management is proactive in monitoring risks and benefits associated with swaps, so that the authority's exposure to either of its counterparties does not exceed a defined amount. Standard & Poor's is not factoring in the value at risk as a contingent liability at this time due to what we consider the remoteness of involuntary termination.

## Management: Experienced And Active

The authority is governed by a nine-member board that is appointed by the governor with the approval of two-thirds of the members of the state senate. The board is backed by what we consider an experienced professional staff with more than 80 employees, headed by an executive director who assumed the office in 2005. The executive director had served as the chief financial officer of the authority since 2003 when appointed, and was involved in the initial implementation of the authority's strategic plan.

The authority also administers, in partnership with the Iowa Department of Natural Resources, the State Revolving Fund (SRF), which issues tax-exempt bonds to finance wastewater and drinking water facilities. The SRF bonds are rated 'AAA' based on the large size and diversity of the SRF program's loan portfolios, program coverage and reserve levels, structural features, and a management team with a proven track record. Standard & Poor's analysis of the authority's ICR excludes the activities of SRF, as its funds are legally obligated to the program and hence do not contribute to IFA's finances.

IFA's title guaranty division (TGD) was established in 1985 to guarantee title to property in Iowa. The TGD is considered when evaluating IFA's ICR, as surplus funds from TGD, in accordance with state code, are available to support IFA's affordable housing activities. In fiscal 2008, TGD earned a surplus of \$3.6 million and IFA transferred \$1.8 million to its housing assistance program funds. We believe the risk associated with title guaranty to IFA's ICR is minimal, as adequate reserves and reinsurance are in place to cover potential claims.

Standard & Poor's views IFA's relationship with the state as highly positive and expects this relationship to continue. This is evident through appropriations from the state, which have increased from \$800,000 in fiscal 2004 to \$39 million in fiscal 2009. This current amount includes \$20 million for the Jumpstart Iowa Housing Assistance Program that provides funds for those affected by the floods of 2008. IFA received funds through nine grants in fiscal 2009, an indication that the state of Iowa feels IFA will effectively administer the programs. The authority also is the tax credit allocating agency for the state of Iowa and is administering agency for the Iowa Council on Homelessness.

IFA has been engaged by the state during the years to take on non-housing related activities, including serving as one of the state's primary bond issuing authorities. In addition to its active single-family program, IFA manages a number of housing development and rehabilitation programs designed to provide affordable housing and improve existing housing stock. IFA also administers federal programs, including the Housing Assistance Fund (HAF), Affordable Assisted Living Program, home- and community-based service Program (HCBS), thus strengthening its legislative mandate.

## Economy: Hampered Housing Market

The state economy is grounded in the agriculture, services, and manufacturing sectors. Historically, a tight labor market has hampered Iowa's economy, due to a dwindling number of young people living in small towns and on farms available to take services and manufacturing jobs in the cities and a limited number of people moving to the state. Employment growth in Iowa has been gradually declining for the past two years. In the second quarter of 2008, Iowa registered 0.5% growth (7,600 jobs) year-over-year (y/y), in line with the 0.4% national average. The unemployment rate hit 4.6% in August, in our view considerably lower than the 6.2% national rate, reflecting an

extremely tight labor market. Global Insight expects employment in Iowa to increase by 0.3% in 2008. Global Insight expects the education/health services sector to lead job growth in Iowa, with growth of 1.4% y/y in 2008, followed by 0.8% y/y in professional/business services and leisure and hospitality services. Employment in the manufacturing sector continued to shrink in 2008, eliminating more than 1,100 jobs (a 0.5% decline). Global Insight also expects the slowdown in the housing market to cause growth in the construction and mining sector to decline by 4.2% next year, significantly below the 1.7% decline expected in the current year.

We believe that IFA's loan portfolio is well-positioned, given its nearly exclusive securitization from 'AAA' MBS with U.S. government support. One area of our concern is the demand for housing, which Global Insight expects to decline. Global Insight predicts total housing starts will decline to 6,300 in 2009 before increasing to 7,400 in 2010. This is in comparison to 11,200 housing starts in 2007 and 7,700 in 2008. We believe a decline in housing demand could impact the size of the loan and asset base, but would not affect the agency's real estate, which is mostly guaranteed from the 'AAA' MBS.

Table 1

IFA: Financial Ratio Analysis						
Profitability (%)	2004	2005	2006	2007	2008	5-year average
Return on average assets	0.68	1.35	1.00	0.89	0.78	0.94
Return on assets before loan loss provision and extraordinary item	0.67	1.45	0.97	0.88	0.71	0.94
Net interest margin	0.98	1.22	1.22	1.21	1.10	1.15
Asset Quality (%)						
NPAs/total loans and real estate owned	0.05	0.08	0.10	0.10	0.18	0.10
Loan loss reserves/total loans and MBS	0.45	0.42	0.33	0.28	0.21	0.34
Loan loss reserves/NPAs	1,000.63	520.13	314.15	292.40	113.40	448.14
Leverage (%)						
Total equity/total assets	19.84	19.27	16.41	14.07	12.48	16.41
Total equity and reserves/total loans and MBS	31.11	26.87	22.09	17.36	15.61	22.61
Liquidity(%)						
Total loans and MBS/total assets	62.84	70.63	73.22	79.76	78.91	73.07

Table 2

IFA: Five-Year Average Financial Ratios					
Profitability (%)	2003-2007				
	IFA	All 'AA' HFAs	All 'AA-' HFAs	All 'AA+' HFAs	All HFAs
Return on average assets	0.97	0.95	0.61	1.20	0.83
Return on assets before loan loss provision and extraordinary item	0.99	1.11	0.65	1.27	0.92
Net interest margin	1.17	1.57	1.15	1.71	1.34
Asset Quality (%)					
NPAs/total loans and real estate owned	0.07	3.75	1.25	1.27	2.52
Loan loss reserves/total loans	0.45	2.86	0.77	1.20	1.91
Loan loss reserves/NPAs	425.46	131.67	97.15	4,876.03	700.12
Leverage (%)					
Total equity/total assets	17.84	20.05	13.56	22.61	16.79
Total equity and reserves/total loans	26.06	31.72	20.92	34.82	26.68



**Table 2****IFA: Five-Year Average Financial Ratios (cont.)****Liquidity (%)**

Total loans/total assets	68.97	70.18	66.77	68.97	67.62
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**Table 3****IFA: Trend Analysis**

	2004	2005	2006	2007	2008
Total assets (\$000s)	684,161	754,715	949,853	1,166,925	1,388,394
% Change	2.45	10.31	25.86	22.85	18.98
Total debt (\$000s)	522,321	583,944	765,578	953,971	1,159,587
% Change	2.11	11.80	31.10	24.61	21.55
Total equity (\$000s)	135,727	145,435	155,876	164,191	173,330
% Change	3.55	7.15	7.18	5.33	5.57
Revenues (\$000s)	46,454	55,826	60,969	76,383	89,382
% Change	12.86	20.17	9.21	25.28	17.02
Net income (\$000s)	4,605	9,708	8,531	9,450	9,915
% Change	(21.10)	110.81	(12.12)	10.78	4.92
Total loans and MBS (\$000s)	429,948	533,060	695,508	930,732	1,095,557
% Change	10.29	23.98	30.47	33.82	17.71
Nonperforming assets (\$000s)	195	426	720	894	2,008
% Change	0.00	117.85	69.00	24.22	124.57
Loan loss reserves (\$000s)	1,956	2,215	2,261	2,614	2,276
% Change	(32.81)	13.24	2.08	15.61	(12.93)

N.A.: not applicable

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