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Iowa Finance Authority; General Obligation

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Table Of Contents

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Credit Profile		
Iowa Fin Auth ICR		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has affirmed its 'AA' issuer credit rating (ICR) on Iowa Finance Authority (IFA). At the same time, Standard & Poor's affirmed its 'AA' and 'AA/A-1+' ratings on the authority's outstanding general obligation (GO) and variable-rate debt. The outlook is stable.

The ratings reflect our view of these strengths:

- The very high quality and very low-risk profile of IFA's asset base;
- The very strong profitability over the past two years, in line with housing finance agencies (HFAs) rated 'AA+' or higher;
- The improved leverage ratio compared with other 'AA' rated HFAs.
- The minimal GO debt exposure; and
- The experienced and active management team, with strong legislative support.

IFA continues to improve its asset quality by originating all single-family loans as securitized mortgage-backed securities (MBS), with support from Fannie Mae or Ginnie Mae (both rated AA+). Since peaking in fiscal 2008, IFA's single-family loan production has declined, which we attribute to lingering effects from the financial crisis, while assets continue to decrease in step with declining MBS and investments. Although IFA still maintains one of the strongest asset quality ratios among all rated HFAs, we are aware of recent increases in nonperforming assets under IFA's Miscellaneous Restricted Programs. However, we do not expect this one-time uptick to lead to material credit deterioration, since the program is due to receive extra security from federal grants and state appropriations. This contrasts with IFA's single-family and multifamily indentures, which correspond to proceeds from mortgages, housing bonds, and investments.

IFA has been placing an emphasis on equity growth, a strategy that has subsequently improved leverage ratios. We attribute low leverage ratios in fiscals 2010 and 2011 to escrow bonds issued under the New Issue Bond Program (NIBP), and a Federal Home Loan Bank (FHLB) limited obligation note that was issued to preserve a private activity bond cap. However, as of June 30, 2012, these issues are no longer outstanding. Audited fiscal 2013 financials show higher equity as a percentage of assets. Furthermore, IFA's capital adequacy ratios reflect a low-risk profile, consistent with the current rating. Based on IFA's five-year average leverage ratio, evidenced by its equity to assets, and continued improvement in fiscals 2012 and 2013, we view the authority as more in line with other 'AA' rated HFAs.

Outlook

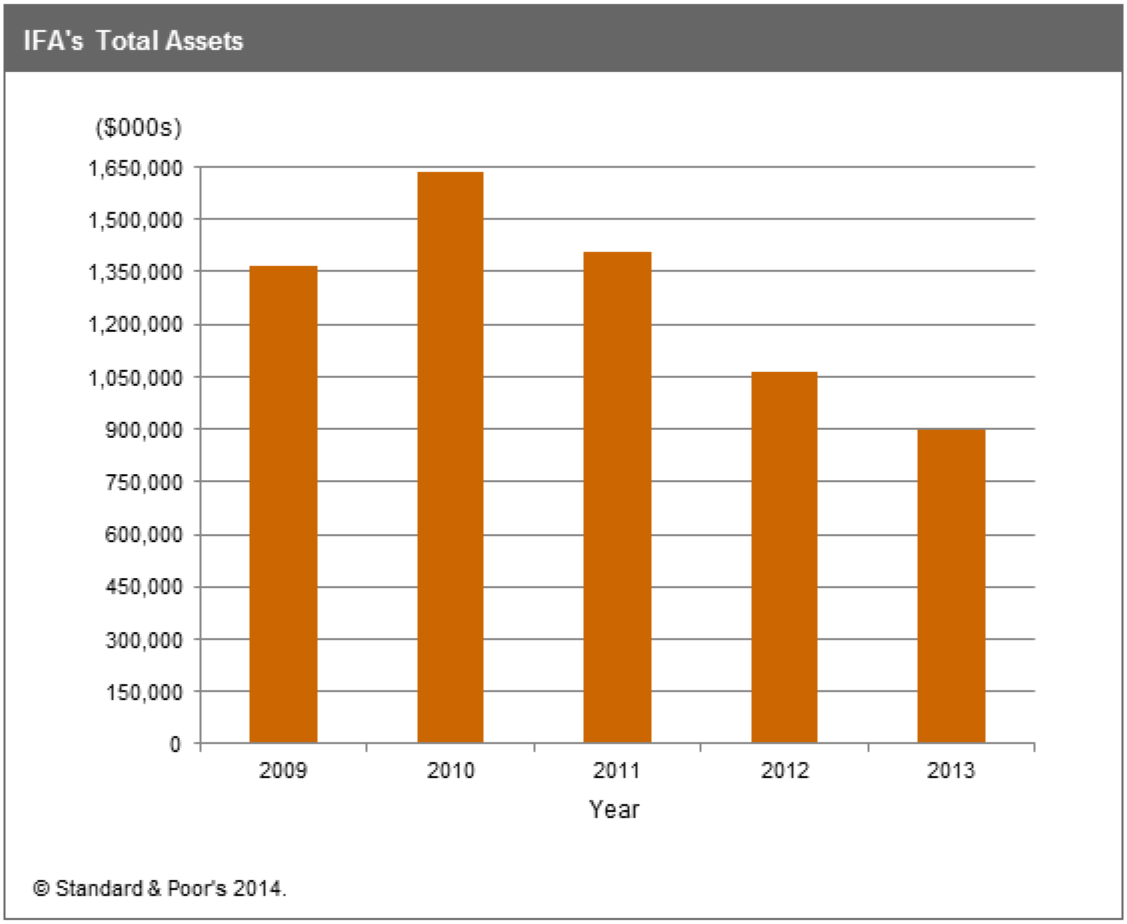
The stable outlook reflects our view of IFA's high-quality asset base, improved leverage ratios, strong management, and minimal GO debt exposure. In addition, IFA's low-risk equity base and high capital adequacy ratios provide additional rating stability, and we expect this aspect to remain a strength of the authority in all real estate markets. Should equity as a percentage of assets decline significantly, we could lower the ratings. Conversely, if equity significantly increases, IFA's ratios could improve to a level more in line with higher rated HFAs, likely resulting in a raising of the ratings.

Asset Quality

IFA's total assets have declined for three consecutive years, following a 20% rise in fiscal 2010. The authority's assets are down annually by at least 14% over the last three years, with an average 18.4% decline during that period. Assets and other financial information used for this analysis exclude a state revolving fund that IFA administers, as well as any conduit bond issues that have no recourse to the authority. IFA's housing agency asset base reached an all-time high of $1.64 billion in fiscal 2010, stemming from a large $380 million increase in investments, in turn partly resulting from unexpended NIBP bond proceeds. The FHLB limited obligation note was another contributor, amounting to $122 million as of June 30, 2010.

The authority's assets declined by $168 million to $898 million in fiscal 2013, from $1.07 billion one year prior. Total investments were down 30% ($82 million), while total MBS fell by 17% ($110 million).

Chart 1

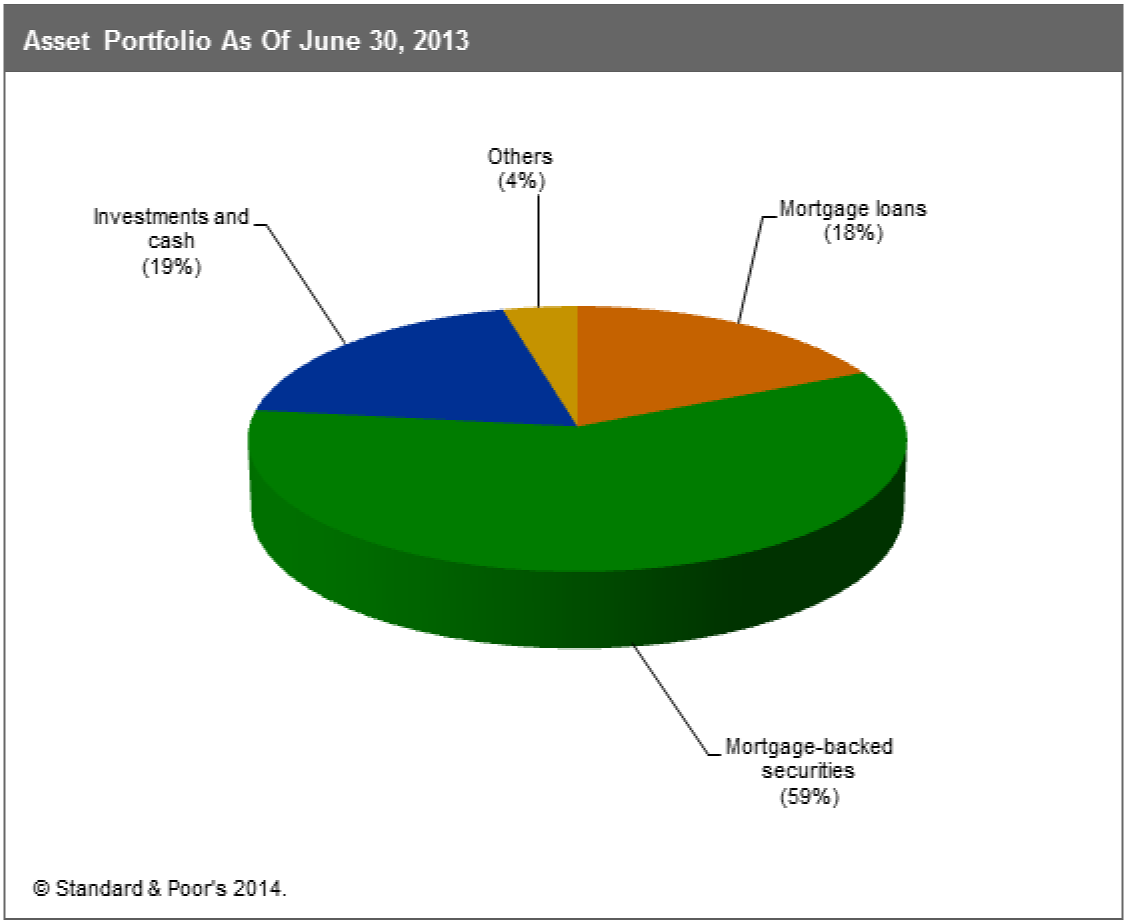


As of June 30, 2013, approximately 61% of the authority's asset portfolio consisted of 'AA+' rated MBS, while its loan portfolio consisted of Ginnie Mae, Fannie Mae, and Freddie Mac MBS (85%), and multifamily and single-family mortgage loans (15%). This proportion of MBS remains high vis-à-vis most HFAs. The decline is attributable to relatively low single-family MBS origination, and the financing of multifamily non-MBS loans.

We believe IFA's loan portfolio poses an extremely low risk, due to the authority's conservative approach to collateral. As of June 30, 2013, over 99% of IFA's single-family loans were backed by Ginnie Mae, Fannie Mae, and Freddie Mac MBS. 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. These loans are performing well, in our view, and have sufficient excess assets to cover any credit shortfall or liquidity issues.

Delinquencies and nonperforming assets as of June 30, 2013, were a very low 1% of total loans and MBS, representing just $6.7 million in fiscal 2013, versus $2.7 million one year prior. As mentioned above, we understand the recent increases in nonperforming assets are related to the Miscellaneous Restricted Programs ($5.8 million). Notwithstanding the higher nonperforming assets, IFA maintains one of strongest asset quality ratios among all rated HFAs.

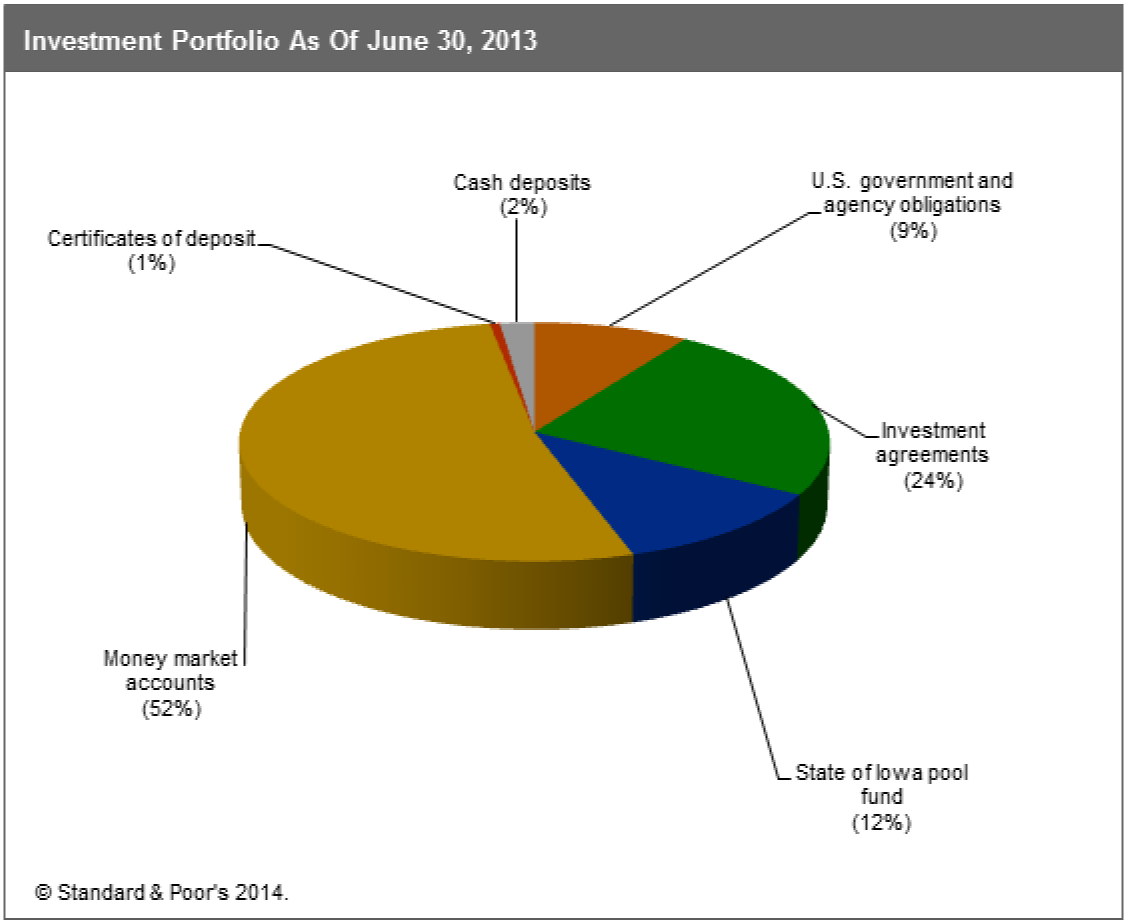
Chart 2



Investments

IFA's investments as of June 30, 2013, are of high credit quality and provide sufficient liquidity, in our view. Roughly 86% of investments are with government securities rated 'AA+'. As mentioned above, IFA takes what we deem a conservative approach to oversight and monitoring of investments. These investments provided 5.1% of total revenues in 2013, down from 7.3% one year prior. This equates to a 52.5% drop-off from $10.8 million in 2012 revenues, preceded by $6.7 million in 2011.

Chart 3



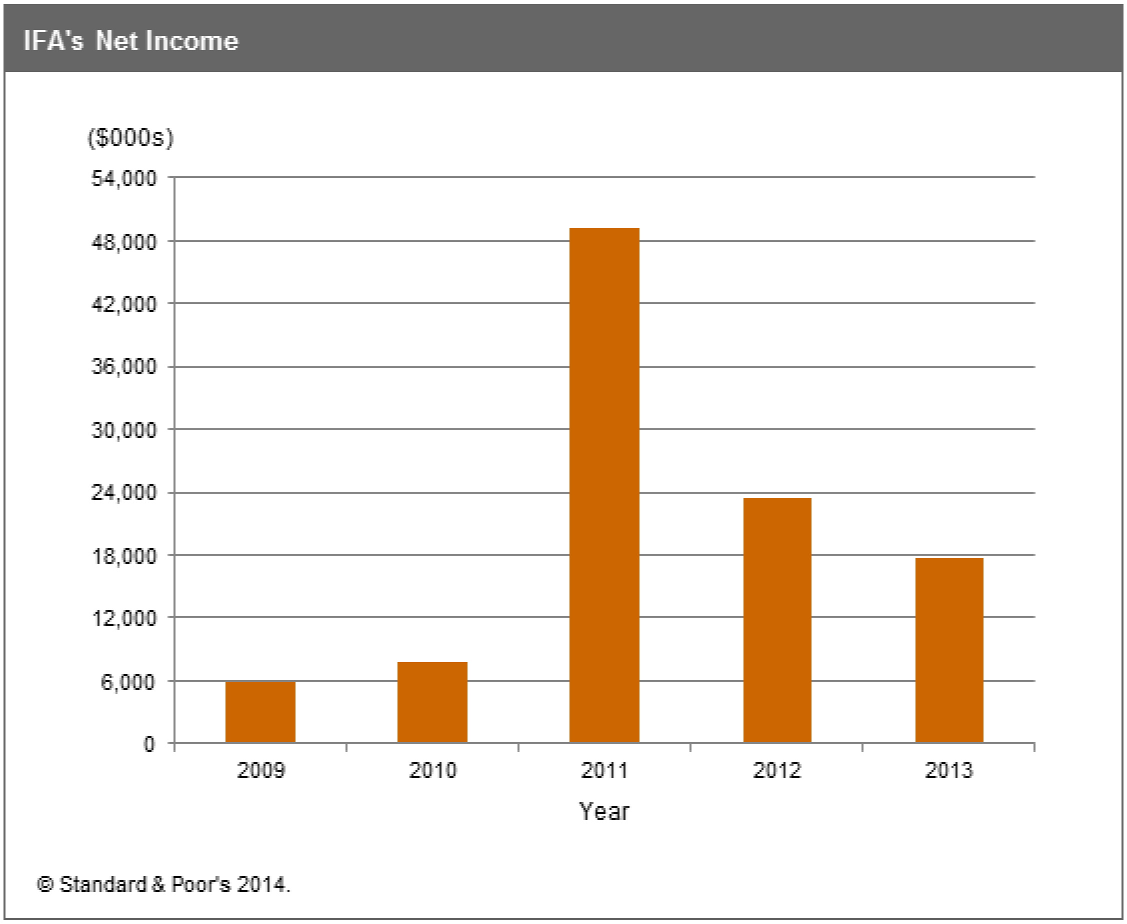
Earnings Quality And Financial Strength

Much of the authority's revenue within the last two years stems from lower interest income derived from high prepayment rates in the authority's MBS portfolio. As of June 30, 2013, IFA's total revenues stood at $101 million, down 32% from 2012.

In fiscal 2013, the authority's housing agency grant income declined by $35 million to $47.4 million, due to the cessation of numerous one-time state and federal programs. The authority recognized $98 million in average grant income over the past three years, in addition to $84 million in grant income for fiscal 2010. However, grant-related expenses fell by $33.4 million to $42.2 million between fiscals 2012 and 2013.

Although income from loans declined by $8.4 million, bond-related interest expenses were down $9.2 million in fiscal 2013. The authority's fiscal 2013 net income was $15.4 million, down 34% from the previous fiscal year and 69% from 2011. Net income was primarily affected by declining grant income from 2011 through 2012.

Chart 4



IFA's profitability measured by return on assets declined to 1.57% in 2013, from 1.90% in 2012, and 3.23% in 2011. Its net interest margin (NIM) fell to 1.26% in 2013, from 1.39% in 2012, yet still exceeded its 0.78% NIM in fiscal 2011. Nonetheless, IFA's profitability ratios for the past three years are still strong, in our view, and in line with its 'AA+' or higher rated HFAs. As detailed in table 2, the five-year average of IFA's profitability is similar to those of its 'AA+' rated peers despite a low-risk profile. However, we also consider that strong profitability resulting from grants received over the past three years does not guarantee consistent future profitability. We will monitor how this pattern develops during the two-year outlook period.

Equity was 30.9% of assets in 2013, up from 23.5% in 2012, and 16.9% in 2011. Based on IFA's five-year average leverage ratio, evidenced by the aforementioned equity to assets, we view IFA as more in line with other 'AA' rated HFAs due to the authority's steady improvement in fiscals 2012 and 2013. Furthermore, the authority's equity base is adequate to support its low-risk profile, in our view. After adjusting for potential losses, the authority's unrestricted assets are 41.7% of debt, above our 4.0% threshold, while liquid assets to total mortgages are 170% of loans, in excess of 2.0% of mortgage loans outstanding. Although we are comfortable with IFA's capital adequacy and equity, we will continue to monitor the pattern to gauge whether it merits a rating change.

Debt

As of June 30, 2013, IFA's outstanding debt totaled $553.5 million, down 22.4% from the preceding year and 46.1% from 2011. IFA's debt level peaked in fiscal 2010. As of the aforementioned date, IFA had $503.3 million in single-family (91%) and $50.2 million in multifamily (9%) GO bonds outstanding.

The authority's outstanding single-family bonds are under two master indentures. A single-family mortgage bond resolution, adopted in 1991, is rated 'AA+', reflecting our view of the extremely high quality of IFA's pledged collateral consisting of Ginnie Mae, Fannie Mae, and Freddie Mac MBS; the investments' strong credit quality; and sufficient cash flow. The 1991 indenture accounts for 60% of IFA's total single-family bonds outstanding and 55% of IFA's total debt. The remaining single-family bonds are issued under a single-family mortgage revenue bond resolution adopted in 2009, and also backed by MBS.

IFA's multifamily GO bonds are likewise issued under two master indentures, adopted in 1978 and 2005, respectively. The authority's GO debt exposure is 9%, which we consider low based on our HFA leverage scale.

The authority remains proactive in its efforts to mitigate the impact of variable-rate counterparty exposure. IFA has hedged nearly all of its floating-rate exposure via interest rate swaps and caps entered with UBS AG, RBC, and Goldman Sachs Capital Markets LP, with a guarantee from The Goldman Sachs Group. In August 2013, the authority novated its entire derivative portfolio with UBS AG to Bank of New York Mellon.

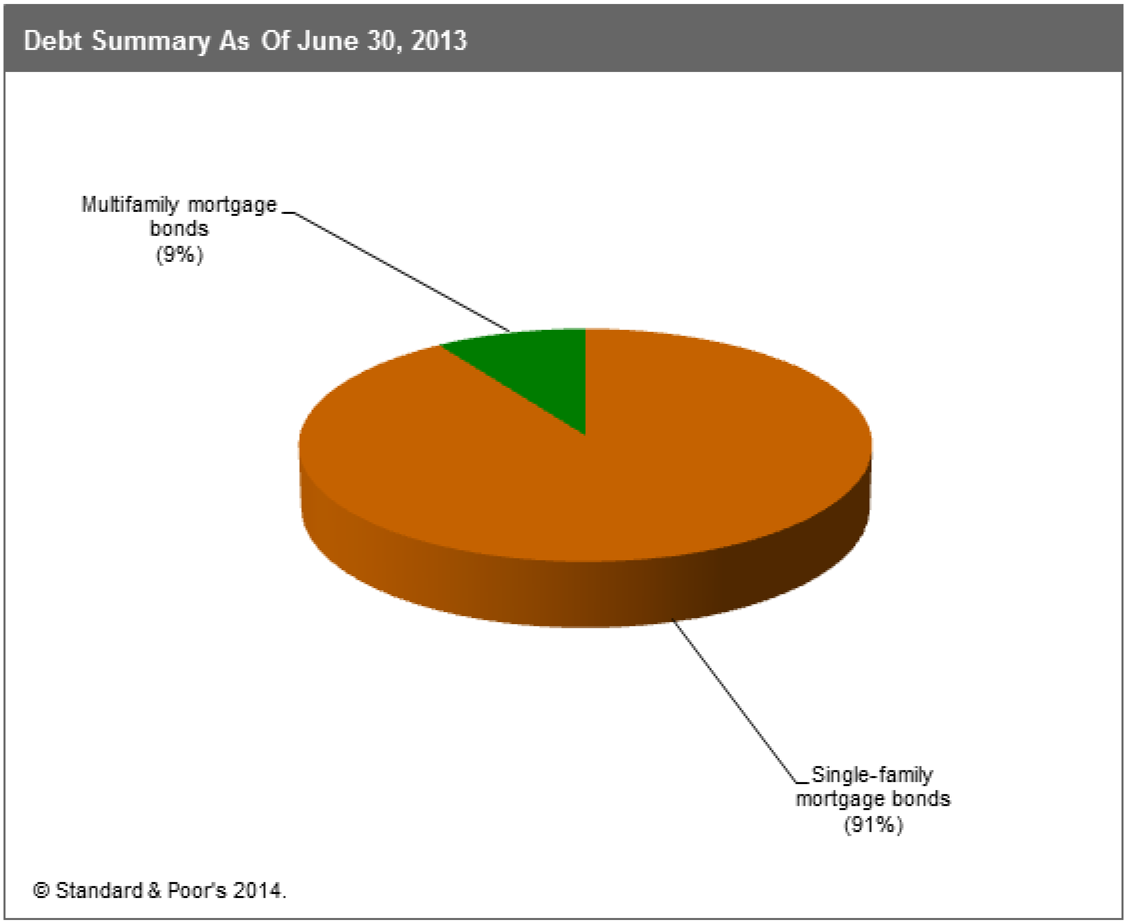
As of June 30, 2013, the total derivative notional amount is $278 million.

Following our review of IFA's 18 fixed-to-floating interest rate swaps, two basis swaps, and four interest rate caps and corridor transactions, we assign the authority moderate risk, reflecting our view of:

- The two adequately rated swap counterparties, both of which are required to post collateral before a credit event occurs;
- The low basis risk;
- The low termination risk; and
- The good management oversight.

We believe management is proactive in monitoring risks and benefits associated with swaps, so that IFA's exposure to either counterparty does not exceed a defined amount. We are not factoring the value at risk as a contingent liability at this time due to what we consider the remote likelihood of involuntary termination.

Chart 5



Management

The authority appointed a new chief financial officer in September 2012. The new CFO has served previously as a senior consultant at Cfx Inc. (a company dedicated to providing quantitative and strategic support for state HFAs), and earlier as a research assistant for the Board of Governors of the Federal Reserve System.

We view IFA's relationship with the state as positive and likely to continue. A tangible sign of this strong relationship is IFA's growing grant funding and associated responsibilities in fiscals 2011 and 2012. The added funds resulted from state funding for disaster relief, water quality, and infrastructure projects, and increased federal funding from the American Recovery and Reinvestment Act.

The state has periodically asked IFA to handle non-housing-related activities over the years, including serving as one of the state's primary bond-issuing authorities. In addition to its active single-family program, IFA manages numerous housing development and rehabilitation ventures, meant to provide affordable housing and improve existing housing stock. IFA also administers several federal housing programs, thereby strengthening its legislative mandate.

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. SRF bonds are rated 'AAA' based on the large size and diversity of SRF's loan portfolios, program coverage and reserves, structural features, and management team with a proven track record. Our analysis of the ICR on IFA excludes activities of SRF, as its funds are legally obligated to the program and therefore do not contribute to IFA's finances.

IFA's Title Guaranty Division (TGD) was established in 1985 to guarantee title to property in Iowa. We consider the TGD when evaluating the ICR on IFA, as surplus funds from TGD, in accordance with state code, are available to support IFA's affordable housing activities. We believe risk associated with the title guaranty to the ICR is minimal, as adequate reserves and reinsurance are in place to cover potential claims.

Economy

Iowa remains more concentrated than the U.S. as a whole in agriculture and manufacturing employment. In 2012, 14.0% of the state's nonfarm payrolls were in the manufacturing sector, compared with only 8.9% of U.S. payrolls. Iowa's main agricultural products are corn, soybean, and hogs. Iowa's farmers benefit greatly from demand generated by the production of ethanol (made from corn) and biodiesel fuel, which is produced from soybean oil. The state is home to many ethanol plants, which benefited from a record corn crop in 2013, although potential Environmental Protection Agency mandates on ethanol could hurt growth in future demand. Federal farm legislation could also affect the agricultural sector and related companies.

According to IHS Global Insight, Iowa's total nonfarm payroll growth will average 1.3% annually over the next five years, somewhat below the 1.6% national rate. The state regained its pre-recession employment level in mid-2013. The state's unemployment rate remains among the lowest nationwide, at 5.2% for 2012, and 4.6% for October 2013. While Iowa's employment growth may be slower than the nation's in the medium term, we believe slower population and labor force growth will keep Iowa's unemployment rate low relative to the U.S.

Housing starts are projected to increase sharply in 2014, and average around 14% growth in five years. Home prices are also expected to rise 3% on average by 2017. Construction has picked up, mainly due to the housing sector's recovery and steady growth rate. According to Mortgage Bankers Association data, 10.8% of Iowa's subprime mortgages (compared with 11.2% nationally) entered foreclosure in 2013, along with 1.2% of prime mortgages (versus 2.0% nationally). With these rates, Iowa ranked fifth-lowest in subprime foreclosure rates nationwide in 2013.

Table 1

Financial Ratio Analysis

	2009	2010	2011	2012	2013	Five-year average
Profitability (%)						
Return on average assets	0.43	0.51	3.23	1.90	1.57	1.53
Return on assets before loan loss provision and extraordinary item	0.42	0.51	3.49	2.16	1.85	1.68
Net interest margin	0.70	0.69	0.78	1.39	1.26	0.96
Asset quality (%)						
Nonperforming assets (NPAs)/total loans and real estate owned	0.23	0.01	0.38	0.35	1.00	0.39
Loan loss reserves/total loans and mortgage-backed securities (MBS)	0.19	1.11	1.94	2.92	3.57	1.95

Table 1

Financial Ratio Analysis (cont.)						
Loan loss reserves/NPAs	81.22	19,811.11	511.29	840.15	358.37	4,320.43
Leverage (%)						
Total equity/total assets	13.28	11.39	16.90	23.48	30.88	19.19
Total equity and reserves/total loans and MBS	16.72	18.93	24.53	29.28	37.77	25.45
Liquidity (%)						
Total loans and MBS/total assets	78.56	58.88	63.86	72.92	74.70	69.78

Table 2

Five-Year Average Financial Ratios (2009-2013)

	IFA	All 'AA' HFAs	All 'AA+' HFAs	All 'AA-' HFAs	All HFAs
Profitability (%)					
Return on average assets	1.53	0.85	0.39	0.27	0.47
Return on assets before loan loss provision and extraordinary item	1.68	1.23	0.62	0.37	0.71
Net interest margin	0.97	1.07	1.53	0.79	1.03
Asset quality (%)					
Nonperforming assets (NPAs)/total loans and real estate owned	0.39	3.61	3.55	4.42	3.99
Loan loss reserves/total loans	1.95	3.13	2.37	1.37	2.50
Loan loss reserves/NPAs	4,320.42	738.98	5,363.47	42.50	1,172.74
Leverage (%)					
Total equity/total assets	19.19	19.00	26.78	13.43	18.21
Total equity and reserves/total loans	25.45	29.03	40.93	20.70	28.06
Liquidity (%)					
Total loans/total assets	69.78	72.83	70.97	72.36	72.16

Table 3

Trend Analysis

	2009	2010	2011	2012	2013
Total assets ($000s)	1,368,915	1,636,475	1,406,000	1,065,289	897,593
% change	(1.40)	19.55	(18.41)	(30.61)	(15.74)
Total debt ($000s)	1,129,109	1,324,270	1,022,791	712,820	553,487
% change	(2.63)	17.28	(22.77)	(30.31)	(22.35)
Total equity ($000s)	181,819	186,397	237,628	250,141	277,209
% change	4.90	2.52	27.48	5.27	10.82
Revenues ($000s)	127,903	159,896	233,336	148,382	101,014
% change	43.10	25.01	45.93	(36.41)	(31.92)
Net income ($000s)	5,916	7,736	49,197	23,487	15,412
% change	(40.33)	30.76	535.95	(52.26)	(0.34)
Total loans and MBS ($000s)	67,747	93,837	142,760	155,125	160,092
% change	2.01	38.51	52.14	8.66	3.20
Nonperforming assets ($000s)	2,497	54	3,400	2,700	6,680
% change	24.37	(97.84)	6,196.30	(20.59)	147.41

Table 3

Trend Analysis (cont.)					
Loan loss reserves ($000s)	(2,028)	(10,698)	(17,384)	(22,684)	(23,939)
% change	(10.90)	427.51	62.50	30.49	5.53

Table 4

Industry Economic Outlook For U.S. Public Finance Housing (2014-2015)							
	--Forecast/scenarios--						--Actual--
	--Pessimistic--		--Baseline--		--Optimistic--		
	2014	2015	2014	2015	2014	2015	2013
Macroeconomic indicators							
30-year fixed mortgage rate (%)	4.09	4.41	4.63	4.98	5.40	6.49	3.96
10-year treasury note yield (%)	2.00	2.41	3.03	3.30	4.18	4.85	2.32
Unemployment rate (%)	7.59	7.68	6.47	5.82	6.05	5.00	7.45
Real GDP (% change)	0.58	1.84	2.77	3.25	4.13	4.01	1.68
Total nonfarm payrolls (% change)	0.75	0.78	1.76	2.03	2.46	2.58	1.64
Consumer price index (% change)	0.80	1.95	1.44	1.77	2.13	1.61	1.44
Households (mil.)	122.84	124.20	123.10	124.72	123.29	125.02	121.41
Median single-family existing home price ($000s)	194.80	190.37	198.71	198.47	202.09	200.72	195.57
Median new-homes sale price ($000s)	261.67	254.38	265.77	266.02	263.72	252.29	264.53
Existing single-family home sales (mil. units)	4.42	4.70	4.70	5.12	5.22	5.28	4.52
Single-family housing starts (mil. units)	0.56	0.74	0.82	1.05	0.90	1.19	0.62
Multifamily housing starts (mil. units)	0.26	0.33	0.35	0.43	0.36	0.49	0.29
Federal government spending	(3.00)	0.10	(1.10)	0.00	(0.60)	0.90	(4.60)

Note: Standard & Poor's U.S. economic team's forecasts are constructed using IHS Global Insight's model of the U.S. economy. Forecasts are from "U.S. Economic Forecast: Two Economies Diverged In A Wood", published Dec. 5, 2013, on RatingsDirect.

Related Criteria And Research

Related Criteria

- USPF Criteria: Single-Family Mortgage-Backed Securities Programs, June 13, 2007
- USPF Criteria: Housing Finance Agencies, June 14, 2007
- USPF Criteria: Assumptions: Update to Cash Flow Analysis for Public Finance Housing Bonds, March 3, 2009
- U.S. Government Support In Structured Finance And Public Finance Ratings, Sept. 19, 2011
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012

Ratings Detail (As Of February 27, 2014)		
Iowa Fin Auth multifam hsg bnds ser 2006A		
Long Term Rating	AA/Stable	Affirmed
Iowa Fin Auth var rate multifam hsg		
Long Term Rating	AA/A-1+/Stable	Affirmed
Iowa Fin Auth var rate multifam hsg bnds ser 2007A&B		
Long Term Rating	AA/Stable	Affirmed

Ratings Detail (As Of February 27, 2014) (cont.)		
Iowa Fin Auth Multifamily hsg bnds 2008 Ser A (AMT-var rate)		
Long Term Rating	AA/A-1+/Stable	Affirmed