

Missouri Housing Development Commission

Credit Profile

Missouri Hsg Dev Com ICR

Long Term Rating

AA+/Stable

Affirmed

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Publication Date

March 23, 2009

Rationale

Standard & Poor's Ratings Services affirmed its 'AA+' issuer credit rating (ICR) on the Missouri Housing Development Commission (MHDC), and affirmed its ratings on all debt supported by the commission's general obligation (GO) pledge. The affirmation reflects the following credit factors:

- The high quality and very low-risk profile of its asset base;
- Very Strong and stable financial performance;
- High debt ratings (around 96% of bonds rated 'AAA'), and minimal GO debt exposure;
- No variable-rate debt exposure;
- Experienced and active management team with strong legislative support; and
- The state's generally strong economic position.

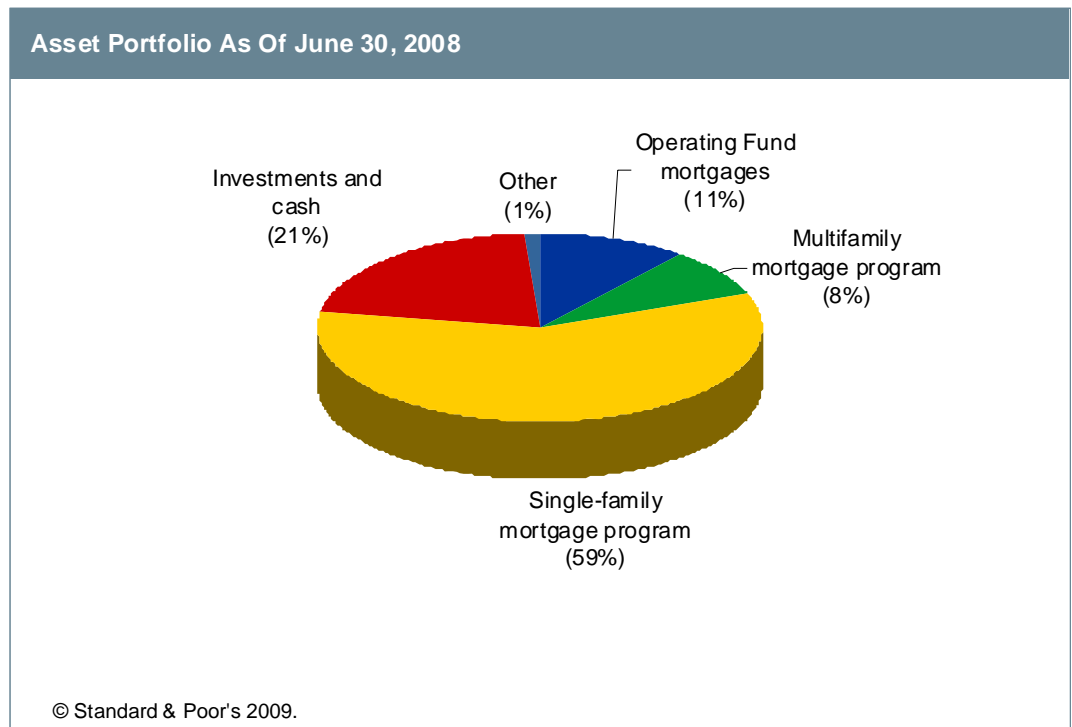
The commission's asset base grew to \$2.17 billion as of June 30, 2008, by increasing its loan production. In Standard & Poor's opinion MHDC has a high credit quality and a low-risk asset base, 78% of which consists of mortgages that are credit-enhanced by Ginnie Mae, Fannie Mae, and Freddie Mac mortgage-backed securities (MBS). During fiscal 2007, the commission made a restatement of assets due to a change in accounting policy. This accounting change caused the commission to carry \$145 million in multifamily HOME loans on its balance sheet which were previously carried off balance sheet. As a result, the loan portfolio increased significantly by 28% in 2007, although after making adjustments for the restatement of assets, the loan portfolio increased by 15% during 2007. This growth trend continued in 2008 during which the commission's mortgage loan portfolio grew by 8%, to \$1.69 billion.

This asset and loan portfolio growth contributed to MHDC's financial performance in fiscal 2008. Despite this growth, its profitability and leverage ratios are lower than those of its

similarly-rated peers. However, Standard & Poor's does not view the low profitability ratios as problematic for the commission, given the high quality of its assets, and low-risk loan portfolio. The commission's continued financial strength is evidenced by its 23.4% equity-to-asset ratio in 2008. In addition, MHDC has a strong and experienced management team that has been able to sustain a high-quality, low-risk asset portfolio (see chart 1). The management team has a strong and mutually beneficial working relationship with the state legislature.

Outlook

The stable outlook reflects our expectation that the commission will continue its conservative approach to managing risk, and demonstrate financial strength. Standard & Poor's believes the commission's history of stable profitability and fund equity will provide a solid cushion to cover needs that may arise from ongoing market conditions. While Standard & Poor's expects that profitability may come under pressure in the near term, largely from lower investment income and the cost of financing mortgage loan originations; in our opinion, MHDC is well positioned to absorb the impact of market fluctuations.



Asset Quality: Strong And Low Risk Asset Base

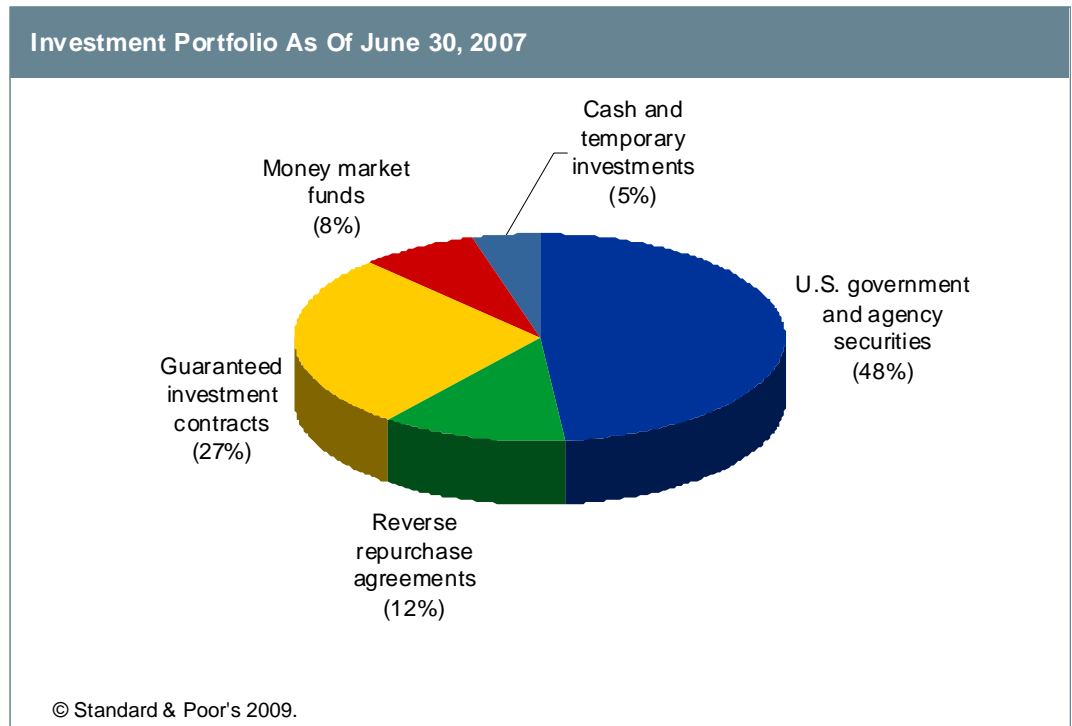
MHDC's strong asset base totaled \$2.17 billion as of June 30, 2008, following a 4% increase over the preceding year. Previously in 2007, commission's asset base has increased by 16% (10% after making adjustments for the restatement of assets) over 2006. At the end of fiscal 2008, approximately 78% of MHDC's asset portfolio consisted of mortgages and 21% represented high quality investment securities and cash. During fiscal 2007, the commission made some restatement of assets due to a change in accounting policy. This accounting change caused the commission to carry \$145 million in multifamily HOME loans on its balance sheet which were previously carried off balance sheet. As a result, the loan

portfolio increased significantly by 28% in 2007, although after making adjustments for the restatement of assets, the loan portfolio increased by 15% during 2007. This growth trend continued in 2008 during which the commission's mortgage loan portfolio grew by 8%, to \$1.69 billion. This increase was largely attributable to single-family mortgage loan originations that exceeded the declining level of loan prepayments. Over the past two years, MHDC has been able to offer competitive loan products through tax-exempt financing, as well as offering down payment assistance. Including both single-family and multifamily loans, around 77% of its mortgages are credit-enhanced by Ginnie Mae, Fannie Mae, and Freddie Mac MBS. About 75% of the commission's loan portfolio is held in the homeownership (single family) loan program, 14% is held in MHDC's operating fund and balance 11% is held in the rental (multifamily) loan program.

MHDC's asset base continues to have low-risk characteristics, primarily due to the commission's conservative approach to credit enhancements and insurance for mortgage loans. As of June 30, 2008, almost 100% of its homeownership loan portfolio was credit-enhanced by Ginnie Mae, Fannie Mae, and Freddie Mac MBS, and a significant portion of its rental loan portfolio was backed by FHA insurance. The \$161 million in loans under the multifamily rental loan portfolio were FHA-insured under HUD's Risk-Share Program (§524(c) of the Housing and Community Development Act), whereby MHDC is responsible for 50% of the losses associated with the related loans. Under that program, Standard & Poor's believes that the commission's fund balances demonstrate sufficient net assets to handle the anticipated loss associated with the loans under the bond resolution. In addition to the loans held under the single-family homeownership and multifamily rental resolutions, MHDC held approximately \$274 million of loans in its operating fund and in our opinion, is well capitalized to withstand potential losses on this portfolio. The commission holds approximately \$93 million in uninsured multifamily loans in its operating fund. Additionally, MHDC now carries \$145.5 million in loans financed by the federal HOME Investment Partnership Program on its balance sheet. Close to one-third of these loans allow deferred payments based on the net operating income (NOI) of the multifamily project. Due to the nature of these loans, MHDC has an estimated allowance for loan losses of close to 15% and in our opinion, the commission could withstand higher levels of loan losses on this portfolio if needed. As of June 30, 2008, there were no delinquencies among all of the multifamily projects, including projects with HOME loans. As expected, given the risk profile of MHDC's loan portfolio, nonperforming assets as a percentage of total loans at June 30, 2008, were only.02%.

The commission's loan loss reserves, which are allocated to uninsured loans and related accrued interest on such loans, stand at 2.5% of total loans, and 16% of uninsured loans. Almost half of MHDC's loan loss reserves are attributable to the HOME loan portfolio. MHDC has high-quality investments that are in accordance with its investment policies. As indicated in the chart 2 below, most indenture funds and operating funds are invested in U.S. government and agency securities, as well as investment agreements with providers whose ratings are generally rated at least in the 'AA' category, and collateralized repurchase agreements. Management takes a conservative approach to oversight and monitoring of the commission's investments, emphasizing the preservation of principle. As of June 30, 2008, commission's investment portfolio totaled \$466 million, following an 8% decline over the preceding year. The decline was partially due to MHDC using available cash to originate mortgages. Furthermore, the commission's investment portfolio is adequately liquid, with around 31% of

investments maturing in less than a year. MHDC's investment portfolio accounted for 14.7% of its total revenues in fiscal 2008.



Earnings Quality And Financial Strength: Solid Earnings Profile Maintained

During 2008, MHDC's total revenues increased by 8.67% to reach \$118 million. The increase was primarily due to a 13% increase in the commission's interest income from loans, which was mainly due to a growing mortgage portfolio and lower prepayments. The investment income also increased, but only by 2% over the previous fiscal year, whereas fiscal years 2006 and 2007 saw greater increases in investment income. The smaller increase in investment income was largely attributable to reduced short-term interest rates and a decreasing investment portfolio. Standard & Poor's views this in the context of the high quality of MHDC's assets and the commission's investment policy which emphasizes preservation of principal. Due to the deteriorating credit quality of several investment agreement providers, MHDC limited the use of these investment instruments in fiscal year 2008. Given prevailing short-term interest rates during this period, investment income suffered. However, the decline in the investment income was compensated by a 13% increase in the commission's interest income from loans. Although the close to 12% rise in the interest expenses on bonds placed pressure on the commission's net income, the commission also reduced its general expenses by 13%. MHDC's 2008 net income of \$20.6 million resulted in a significant 27% increase over the previous fiscal year 2007. Due to the increase in the net income, the commission's Return on asset (ROA) rose to 0.96% in 2008 from 0.83% in 2007. Although the net interest margin (NIM) has declined to 1.07% in 2008 from 1.10% in 2007, it is still above its previous five-year average levels.

As exhibited in table 2, the five-year averages of MHDC's profitability and leverage ratios are lower than those of other 'AA+' and 'AA' rated housing finance agencies (HFAs). However, this is not an area of concern given the limited risk profile of the commission's existing asset base, which minimizes

potential losses needed to be covered by MHDC net assets. MHDC's strong earnings profile is complemented by its relatively healthy equity base that increased by 5% to stand \$510 million at the end of fiscal 2008. As a result, the commission's equity as a percentage of total assets increased to 23.4% from 23.1% in 2007. MHDC's adjusted capital adequacy, as determined by Standard & Poor's, is extremely strong, signifying that it has sizable available funds to support any risks in its bond programs. After adjusting for potential losses, the commission's unrestricted equity as a percentage of debt stood at close to 24%. Excluding mortgage-backed securities, its adjusted liquid assets are about 32%, of mortgage loans outstanding.

Table 1

Financial Ratio Analysis						
	2004	2005	2006	2007	2008	Five-year average
Profitability (%)						
Return on average assets	0.57	0.57	0.96	0.83	0.93	0.77
Return on assets before loan loss provision and extraordinary item	0.77	0.71	0.97	0.83	0.98	0.85
Net interest margin	0.69	1.05	1.30	1.10	1.07	1.04
Asset quality (%)						
NPAs/total loans and real estate owned	0.04	0.01	0.01	0.01	0.02	0.02
Loan loss reserves/total loans and MBS	1.69	1.88	1.72	2.68	2.52	2.10
Loan loss reserves/NPAs	4,233.18	20,701.00	21,150.00	22,902.00	15,284.00	16,854.04
Leverage (%)						
Total equity/total assets	19.05	20.14	19.02	23.13	23.41	20.95
Total equity and reserves/total loans and MBS	30.29	31.41	29.57	33.50	32.55	31.46
Liquidity (%)						
Total loans/total assets	66.60	68.22	68.27	75.07	77.98	71.23

NPAs-nonperforming assets. MBS-mortgage-backed securities.

Table 2

Five-Year Average Financial Ratios					
	MHDC All 'AA+' HFAs	All 'AA' HFAs	All 'AAA' HFAs	All HFAs	
Profitability (%)					
Return on average assets	0.77	1.17	0.94	1.24	0.82
Return on assets before loan loss provision and extraordinary item	0.85	1.25	1.12	1.25	0.92
Net interest margin	1.04	1.71	1.63	2.49	1.34
Asset quality (%)					
NPAs/total loans and real estate owned	0.02	1.27	4.28	2.49	2.52
Loan loss reserves/total loans and MBS	2.10	1.20	3.20	4.58	1.91
Loan loss reserves/NPAs	16,854.04	4,876.03	89.70	186.45	700.12
Leverage (%)					
Total equity/total assets	20.95	22.61	20.37	27.81	16.79

Table 2

Five-Year Average Financial Ratios (cont. 'd)					
	<i>MHDC</i>	<i>All 'AA+' HFAs</i>	<i>All 'AA' HFAs</i>	<i>All 'AAA' HFAs</i>	<i>All HFAs</i>
Total equity and reserves/total loans and MBS	31.46	34.82	32.52	40.10	26.68
Liquidity (%)					
Total loans/total assets	71.23	68.97	70.35	78.37	67.62

Nonperforming assets. MBS-mortgage-backed securities.

Debt: Increased Debt Backed By Credit-Enhanced Pledged Assets

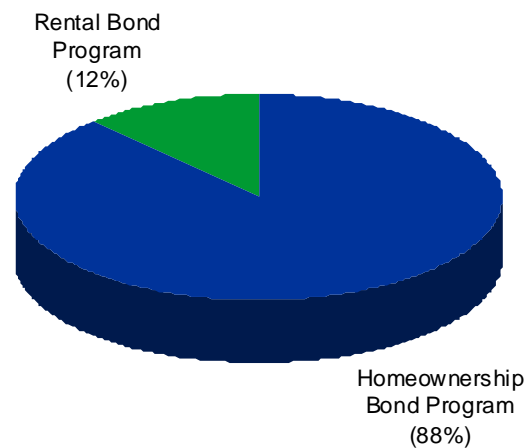
MHDC’s outstanding debt as of June 30, 2008, totaled \$1.56 billion, an increase of 3.6% over the previous fiscal year (see table 3). The commission’s debt levels have continued to increase as they have over the past two years, although not at the levels of 2006 and 2007. This increase reflects the commission’s increased mortgage lending activity through bond financing, although this activity slowed during the second half of fiscal year 2008, due to prevailing market conditions. Of the total debt, around 88% was issued under the Homeownership Bond Program, whose proceeds were used to fund single-family mortgages (see chart 3). The remaining 12% was issued for under the Rental Bond Program, whose proceeds were used to finance multifamily mortgages. In addition to bonds payable, the commission had fixed-rate notes payable totaling \$1.5 million as of June 30, 2008. As all the commission’s debt is issued at fixed rates, MHDC has no variable-rate debt exposure. While, like all HFAs, the commission currently faces a difficult municipal debt market in which to finance affordable mortgage rates; it is not affected by the volatility in short-term municipal bond rates. Additionally, as MHDC is not dependent on variable-rate debt issuance, it does not have to absorb many of the associated costs, such as increased liquidity fees and bank bonds due to the deteriorating credit quality of liquidity providers. Certain restrictions in the Homeownership Bond Program reflect the commission’s response to investor concerns by limiting its ability to cross-call among the various series. The indenture allows the commission to manage the excesses within each series. Once a series attains an asset-to-liability parity ratio of 104%, or 102% in some cases, MHDC can direct excesses to the general resolution’s accumulation fund. The commission can use funds in the general accumulation fund for various purposes, including calling bonds from the various series under the indenture, but only when the general resolution has an asset-to-liability ratio of at least 102%. Almost 100% of MHDC’s single-family bonds are issued under its homeownership loan program and are rated ‘AAA’ as a result of the extremely high quality of the mortgages that are credit-enhanced by Ginnie Mae , Fannie Mae, and Freddie Mac MBS, strong credit quality of investments, and cash-flow sufficiency. A very small amount of single-family bonds are secured by non-credit-enhanced loans and are rated ‘AA+’.

MHDC’s multifamily rental bonds are rated ‘AA’. The rating is attributable to the insurance coverage provided by FHA on the underlying mortgage loans, credit quality of investments, and cash-flow sufficiency. MHDC also has a limited number of ‘AAA’ rated multifamily conduit issues, as a result of the extremely high quality of the pledged assets, consisting primarily of mortgages that are credit-enhanced by Ginnie Mae MBS, high credit quality of investments, and cash-flow sufficiency. MHDC limits the extent to which it pledges its GO to debt. As of June 30, 2008, MHDC’s doesn’t have any multifamily GO debt outstanding.

Table 3

Trend Analysis					
	2004	2005	2006	2007	2008
Total assets	1,657,328	1,614,216	1,800,070	2,093,524	2,179,507
% change	(6.94)	(2.60)	11.51	16.30	4.11
Total debt	1,239,234	1,181,238	1,341,189	1,511,115	1,566,243
% change	(10.10)	(4.68)	13.54	12.67	3.65
Total equity	315,703	325,165	342,311	484,302	510,302
% change	3.12	3.00	5.27	41.48	5.37
Revenues	101,103	96,642	101,414	108,954	118,396
% change	(11.14)	(4.41)	4.94	7.43	8.67
Net income	9,779	9,287	16,341	16,136	20,612
% change	24.24	(5.03)	75.96	(1.25)	27.74
Total loans and MBS	1,103,838	1,101,195	1,228,984	1,571,554	1,699,485
% change	(8.39)	(0.24)	11.60	27.87	8.14
Nonperforming assets	440	100	100	184	280
% change	0	(77.27)	0	84.00	52.17
Loan loss reserves	18,626	20,701	21,150	42,141	42,796
% change	15.52	11.14	2.17	99.25	1.55

Debt Summary As Of June 30, 2008



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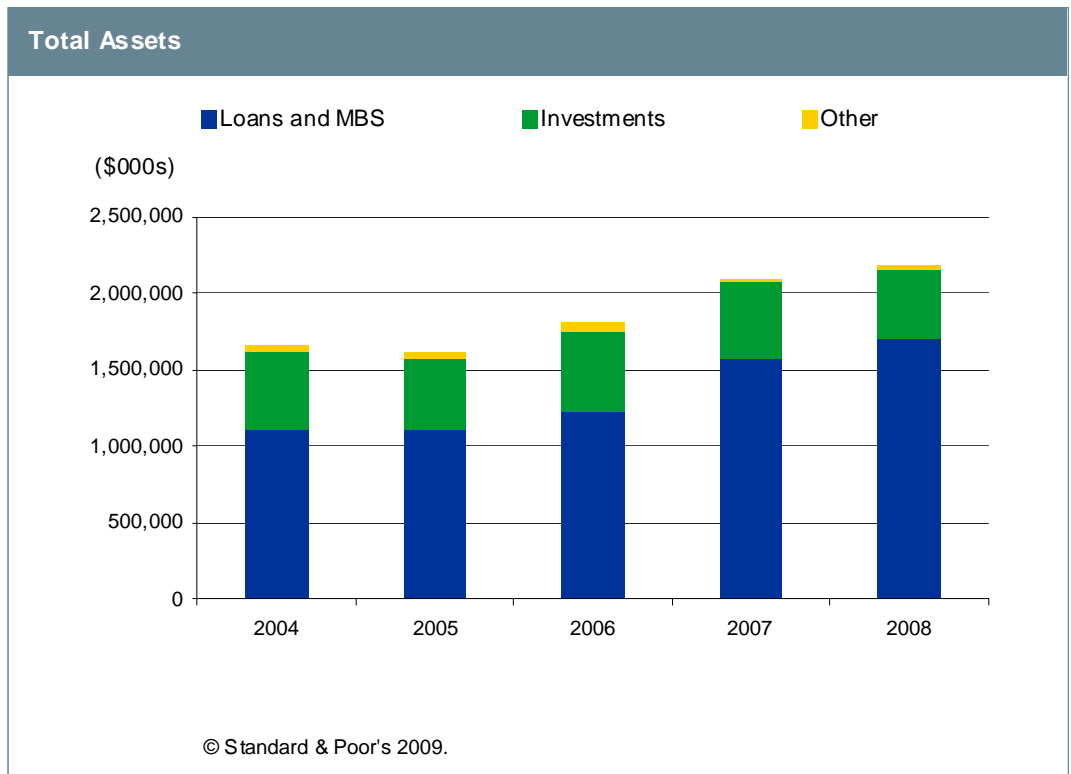
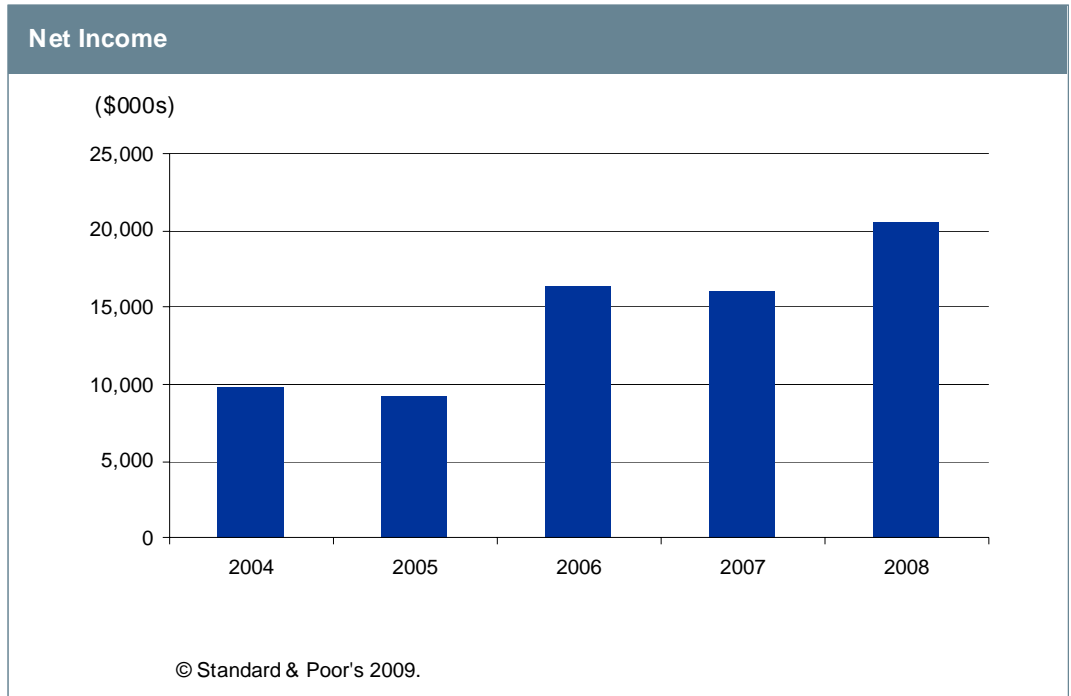
Management: Stable Management Team

The executive director was appointed by the board of commissioners in June, 2007, but was the acting executive director since 2005. The commission is also served by an experienced, stable senior staff and MHDC's strong management continues its mission to actively improve financial performance and

programmatic operations. The commission reviewed a five-year strategic plan for 2008-2012 that calls for maintaining a 5% annual growth rate in total assets, and a 4% return on equity, achieving a 1% annual return on assets, and maintaining its bond and issuer credit ratings. As can be seen in the commission's net income and equity levels, management has been able to accomplish these goals so far (see charts 4 and 5). While Standard & Poor's expects profitability ratios to come under pressure over the next year, given current market conditions, MHDC's management has thus demonstrated the capacity to manage its financial portfolio in order to limit risk and preserve equity. The commission has begun to use more of its operating fund equity to finance homeownership activities, such as providing down payment assistance loans, as it has become increasingly difficult to utilize bond financing for these programs. However, MHDC has been measured in allocating funds for these activities, as well as reserving for potential losses.

The commission is governed by a 10-member board of directors, which includes the state's governor, lieutenant governor, attorney general, treasurer and six members who are appointed by the governor, and subject to the advice and consent of the state senate.

Standard & Poor's continues to view MHDC's relationship with the state as positive, and expects the strong relationship to continue in the future. The commission remains aggressive in seeking ways to increase new housing stock in the state and to preserve, through rehabilitation, older housing communities. In addition to its active homeownership and rental programs, the commission strengthens its legislative mandate through various activities and programs, such as homelessness prevention, Down Payment Assistance Program, Home Repair Opportunity (HeRO) Program, First Place Loan Program, Disaster Assistance, and Project Based Rental Assistance. The commission has assumed the role of administering Continuum of Care, a program previously administered by the Department of Housing and Urban Development and another state agency. It was determined that the commission had the resources and experience to effectively carry out the responsibilities associated with this program. MHDC's ability to meet its mandate is due, in part, to the support it receives from the state. Additionally, the state has never appropriated funds from MHDC.



Economy: Challenges In Near Future

The greatest strength of Missouri’s economy is its diversity, which is based partly on its location at the geographic center of the nation, giving it an economic advantage in trade and manufacturing. However, the state is now being affected by the economic conditions faced by U.S. According to IHS

Global Insight, payroll growth declined at the end of 2008. The state will experience this employment contraction for the first time since 2003. According to IHS Global the manufacturing sector experienced difficulties in 2008 because of the struggling automobile market, and further deterioration is expected.

The continued weakness in the housing market, which has had a limited impact on the state this far, is beginning to exert pressure on the state’s economy. The construction and finance sectors have posted net job losses in the first half of 2008 and still have further room to fall through 2009. According to IHS Global The two well-performing facets of the U.S. economy—international shipments and natural resources and mining—are lacking in Missouri, and so offer little cushion. The National Association of Realtors reported a 6.2% decrease in the median sales prices of existing single-family homes for the Kansas City area in the third quarter of 2008 compared to the corresponding quarter of 2007. The National Association of Realtors also reported a 7.7% drop in existing home sales for Missouri in the third quarter of 2008 compared with the corresponding quarter of 2007. The combination of a high percentage of subprime loans and a slowing economy has increased foreclosure activity over the past four quarters.

Notwithstanding the latest quarter, home values had steadily appreciated, preserving homeowner equity and providing homeowners with more options during difficult financial times. Payrolls in the state contracted in 2008. A slumping state economy could put upward pressure on foreclosure activity. According to IHS Global Insight, Missouri was isolated from much of the price speculation that occurred during the height of the housing boom. Still, according to the Office of Federal Housing Enterprise Oversight’s (OFHEO) purchase-only index, home prices are on the decline-down 0.6% quarter-on-quarter in the third quarter of 2008-and new-home construction fell 54% year over year in the fourth quarter.

<i>Ratings Detail (As Of 23-Mar-2009)</i>		
Missouri Hsg Dev Comm single-fam mtg rev bnds (Rur Growth Homeownership Loan Program) ser 99 I		
<i>Long Term Rating</i>	AA+/Stable	Affirmed

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