Federal Housing Finance Board

June 9, 1998

OPINION OF THE OFFICE OF GENERAL COUNSEL

ISSUE: Are "limited obligation" mortgage revenue bonds issued by the __________ ______________________________ (Authority) "direct obligations" of the Authority for purposes of section II.B.11 of the Federal Home Loan Bank (FHLBank) System Financial Management Policy (FMP)?

CONCLUSION:

Yes. Because the bonds are issued by the Authority and are payable from and secured by the assets and revenues of the Authority, they are "direct obligations" of the Authority for purposes of section II.B.11 of the FHLBank System Financial Management Policy (FMP).

Discussion

I. Background

In a memorandum dated April 1, 1998, the FHLBank of _________ asked the Office of General Counsel (OGC) of the Federal Housing Finance Board (Finance Board) to confirm that the purchase of certain "limited obligation" mortgage revenue bonds issued by the Authority would satisfy the requirement of section II.B.11 of the FMP that bonds purchased thereunder be "direct obligations" of a state or local government unit or agency. See Memorandum from ______ ___________ FHLBank of __________ General Counsel, to Deborah F. Silberman, Finance Board General Counsel (Apr. 1, 1998). Upon review of a prospectus of the Authority, relevant state law and FMP background materials, OGC has concluded that the mortgage revenue bonds of the authority constitute "direct obligations" of the Authority (a state government agency) under section II.B.11 of the FMP.

II. Analysis

A. Status of the Bonds Under State Law, the Indenture and the Prospectus

The Authority is a public body, corporate and politic, and an agency of the ________________________ established by statute to eliminate blighted areas through redevelopment, including the construction, rehabilitation or conservation of residential housing. *See* 35 P.S. § 1709. As such, the Authority constitutes an agency of a state government, the direct obligations of which a FHLBank may purchase under section II.B.11 of the FMP. By statute, the Authority is empowered "to issue bonds for any of its corporate purposes, the principal and interest of which are payable from its revenues generally," and which "may be secured by a pledge of any revenues . . . or by a mortgage of any property of the [A]uthority." *See id.* §§ 1713, 1715.

Although the FHLBank has not provided to OGC a prospectus relating to the specific bonds to be purchased, it has provided a prospectus for bonds issued by the Authority that, as represented by the FHLBank, are substantially similar to those that it plans to purchase. See _______________ Authority of __________ Mortgage Revenue Bonds Prospectus (Aug. 27, 1997) (Prospectus). The Prospectus indicates that the Authority issues bonds pursuant to an Indenture of Trust by and between the Authority and______ Bank, N.A. as Trustee, dated October 1, 1979 (Indenture), a summary of which is attached to the Prospectus as Appendix B. *See Prospectus* at 3. This Indenture authorizes the issuance of bonds to provide funds to the Authority to:

> (1) purchase or finance mortgage loans secured by (a) first mortgage liens . . . on housing containing four or fewer dwelling units throughout the City [of __________ (b) FNMA Securities . . . and/or (c) GNMA Securities . . ., (2) provide funds to make deposits in certain funds and accounts created under the Indenture, (3) refund outstanding Bonds and (4) pay the costs of issuing the Bonds.

Id.

The Prospectus indicates that the bonds to which it relates are "limited obligations of the Authority payable solely from and secured by monies and revenues of the Authority pledged under the Indenture." *Id.* at 2, 13. The Prospectus states further that:

> The ability of the Authority to pay principal of and interest on the Bonds . . . depends upon the receipt of sufficient Revenues, including the payment of principal and interest on First Mortgage Loans, GNMA Securities and/or FNMA Securities and the earnings from the investment or reinvestment of moneys held in funds and accounts under the Indenture. The Bond Reserve Fund, the Mortgage Reserve Fund and the Special Hazard and Loss Reserve Fund have been created under the Indenture to provide funds for the payment of principal of and interest on the Bonds if at any time Revenues are insufficient for that purpose.

Id. at 14.

The Prospectus further states that the bonds to which it relates "will be secured on a parity basis with the Bonds currently Outstanding under the Indenture." *Id.* at 2. Specifically, the security for these outstanding bonds includes:

> all of the Revenues [of the Authority], as defined in the Indenture, which includes all amounts received by the Authority or the Trustee from or with respect to any First Mortgage Loan and any fully modified mortgage backed security guaranteed as to timely payment of principal and interest by GNMA or FNMA and any Repurchase Agreement . . . [,] any other amounts (including proceeds of the Bonds) held in any fund or account established pursuant to the Indenture . . . [and] all of the right, title and interest of the Authority in each First Mortgage Loan and each GNMA Security and/or FNMA Security, and in each Origination and Servicing Agreement . . ., which are pledged and assigned to the Trustee to secure the payment of the principal and interest on [all outstanding] Bonds in accordance with their terms and the provisions of the Indenture.

Id. at 13-14.

B. Bonds of the Authority Are "Direct Obligations" Under the FMP

Section II.B.11 of the FMP authorizes FHLBanks to invest in:

> Marketable ***direct obligations of state or local government units or agencies,*** rated at least Aa by Moody's or AA by Standard & Poor's, where the purchase of such obligations by a FHLBank provides to the issuer the customized terms, necessary liquidity, or favorable pricing required to generate needed funding for housing or community development.

FMP § II.B.11 (emphasis added). This paragraph was added to the FMP as one of a series of amendments adopted by the Finance Board at the July 3, 1996 meeting of its Board of Directors. See Finance Board Res. No. 96-45 (July 3, 1996).

The Action Memorandum that accompanied the Office of Policy's (OP) recommended FMP revisions (OP/FMP Action Memo) (which is the only statement of the staffs or the Finance Board's intentions at the time section II.B.11 was adopted) indicates that section II.B.11 was intended to permit the FHLBanks to invest in "double-A rated bonds issued not only by state housing finance agencies, but also by local government units and agencies involved in housing and community development activities." See OP/FMP Action Memo at 4 (July 3, 1996) (emphasis added). Because the bonds described in the Prospectus are issued by the Authority, these bonds appear to constitute "direct obligations" of the Authority under section II.B.11.

In addition, as mentioned above, each series of bonds issued by the Authority appears to be payable from, and secured by, the entire pool of mortgages loans, mortgage backed securities and other investments held by the Authority, and the revenues derived therefrom. The Independent Auditor's Report of the Authority, which is attached to the Prospectus as Appendix A, indicates that such loans, securities and other investments comprise substantially all of the assets of the Authority and that the revenues arising therefrom comprise substantially all of the revenues of the Authority. As such, the bonds described in the Prospectus appear to be "limited obligations" only in the sense that they are not backed by any governmental power of taxation, but only by the assets and revenues of the Authority, which lacks the general taxing power of a state or local government. However, because neither the plain language of the FMP nor the OP/FMP Action Memo indicates that section II.B.11 was intended to limit FHLBanks to investment in general obligation bonds,' the "limited obligation" status of the bonds does not render them impermissible as investments under section II.B.11 of the FMP.

Therefore, to the extent that the bonds that the FHLBank proposes to purchase are identical, in all of the relevant aspects discussed herein, to the bonds described in the Prospectus, they also will qualify as "direct obligations" of the Authority for purposes of section II.B.11 of the FMP.

III. Conclusion

Section II.B.11 of the FMP authorizes FHLBanks to purchase "[mlarketable direct obligations of state or local government units or agencies." FMP II.B.11. The OP/FMP Action Memo prepared by Finance Board staff in conjunction with the adoption of section II.B.11 indicates that the term "direct obligations," as used therein, refers to obligations "issued by" state or local government units or agencies. Nothing in the plain language of the FMP, or in the background material set forth in the OP/FMP Memo, indicates that the term "direct obligations" was intended to refer only to general obligations backed by a governmental power of taxation.

The bonds described in the Prospectus provided to OGC by the FHLBank of ___________ are issued by the Authority, which is an agency of the state government, and are both payable from and secured by (on a parity basis with other outstanding bonds of the Authority) substantially all of the assets and revenues of the Authority. Accordingly, although the Prospectus refers to these bonds as "limited obligations" of the Authority, such bonds nonetheless are "direct obligations" of the Authority for purposes of section II.B.11 of the FMP. Assuming that the bonds that the FHLBank proposes to purchase possess all of the legally relevant characteristics of the bonds described in the Prospectus, they also will qualify as "direct obligations" of the Authority for purposes of section II.B.11 of the FMP.

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[1] A general obligation bond is a "municipal bond backed by the full faith and credit (which includes the taxing and further borrowing power) of a municipality." See Barron's Finance and Investment Handbook (2d ed. 1987).