RFI: Federal Home Loan Bank Core Mission Activities and Mission Achievement

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The Federal Housing Finance Agency (FHFA) released its report "The Federal Home Loan Banks at 100" in November 2023. The FHFA notes that the Federal Home Loan Bank Act of 1932 (Bank Act) did not explicitly describe the mission of the Federal Home Loan Banks (FHLBs) and requested public comments on the mission of the FHLBs, the measurement on the mission and the core recommendations in their report. We believe this is a critical set of questions and appreciate the opportunity to weigh in.

We believe the mission of the FHLBs should be to support housing finance in two ways:

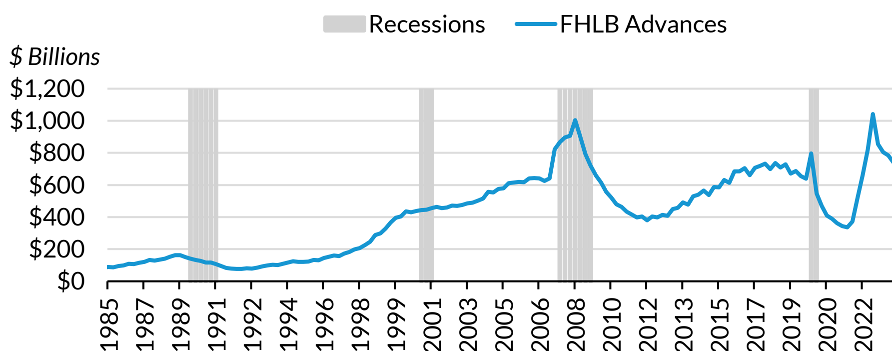
- Indirectly, by providing liquidity to those institutions that support the mortgage market, making the housing finance system that depends on them more stable and affordable.
- And directly, by providing resources for affordable housing and community development

Advances are Critical to System Stability

The first function is particularly critical to the housing finance system. The FHLBs were established to support the provision of liquidity to the mortgage market, and by extension the broader financial system. This function is especially critical during times of stress; Figure 1 below shows the variability in FHLB lending to its members (advances). Note the spikes during the financial crisis (2007-2008) and during the SVB failure (2023), and, to a lesser extent during the pandemic. The advances provide a consistent source of low-cost funding, at a predictable rate of interest. This allows for a smooth functioning of the mortgage market in all circumstances. Funding would otherwise become prohibitively expensive in the absence of this source of liquidity.

Figure 1: Advances are an Important Source of Liquidity

FHLB advances



Source: Board of Governors of the Federal Reserve System, data from FRED.

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This funding has been critical in preventing bank defaults, as shown by Moore, Parrott, Wurm and Zandi (2023)[1]. One thing that we have learned about bank defaults is that it is often not limited to a single institution; a failure of one institution can often lead to a run on other institutions with similar characteristics, threatening their liquidity, solvency, and financial stability. A recent paper from the Federal Reserve Bank of New York, shows that, during the March 2023 banking crisis, 22 banks experienced banks runs. The banks that survived a run did so by borrowing new funds, then raising deposit rates, not by selling liquid assets.[2] Almost all the banks that experienced a run borrowed from the FHLB system.

FHLB advances supplement lending from the Federal Reserve's Discount Window. The Fed allows both member and non-member institutions to borrow at the discount window, at different rates and for different terms. Member institutions can borrow overnight, or for terms up to 90 days; Non-member institutions are permitted to borrow as well, but only for overnight and at a higher rate. The discount window is meant to be available only if banks are unable to borrow from other banks. Figure 2 shows the pattern of discount window usage is much more concentrated than is the FHLBs; it operates much more like an on/off switch.

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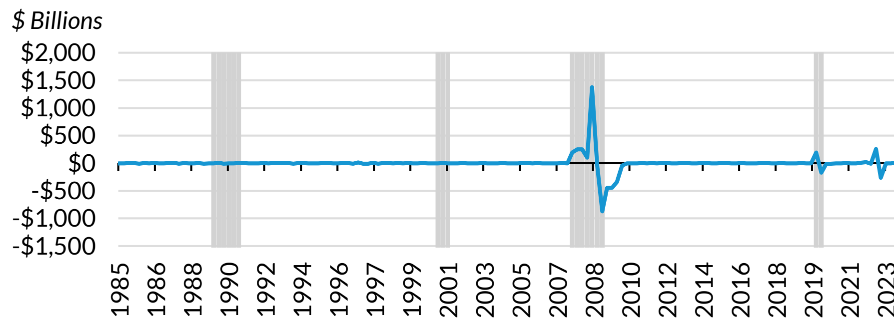
[1] See Damian Moore, Jim Parrott, Maritn Wurm and Mark Zandi "The Federal Home Loan Banks Support Systemic Stability", November 2003. Urban Institute and Moody's Analytics.

[2] See Marco Cipriani, Thomas M. Eisenback and Anna Kover. Tracing Bank Runs in Real Time. Staff Report NO. 1104, May 2024. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1104.pdf?sc_lang=en

Figure 2: Lending by the Federal Reserve's Discount Window is Concentrated

Loans to Domestic Banks through Discount Window, Transactions



Source: Board of Governors of the Federal Reserve System, data from FRED.

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The FHLBs are particularly critical to smaller institutions, who have very limited funding alternatives. While there is a small Federal Reserve program, it is limited to filling seasonal needs, and banks cannot be over $500 million in assets to access this. A recent University of Wisconsin paper found the impact of the FHLB system on mortgage rates and lending to be greater for smaller community banks.[3] The FHLB system helps level the playing field, allowing smaller institutions to continue to lend on the same terms as their larger counterparts.

Membership Issues

The FHFA suggests in their FHLB at 100 Report that the ways the FHLBS have been providing support have become untethered from the mortgage finance system, raising the question: liquidity for whom, and for what? This reflects the fact that so much of mortgage lending, especially for single family mortgage lending is originated and serviced by independent mortgage banks (IMBs) who are not currently eligible for FHLB membership. Meanwhile, insurance companies, who played an important role in mortgage finance when the Bank Act became law, were welcomed as charter members of the system, and retain their eligibility to this day, despite their diminishing, and in many cases, de minimis, contemporary role in mortgage finance.

Indeed the FHLB membership has evolved, but has not kept pace with changes in the mortgage market. It should be noted that when the FHLB system was founded in 1932, federal

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[3] See Dayin Zhang, Government Sponsored Wholesale Funding and the Industrial Organization of Bank Lending, University of Wisconsin. 2020. https://drive.google.com/file/d/17Q68-6IrnFYM108TsnLkoaedncIT_9_G/view

savings and loan associations and insurance companies, the predominant sources of mortgage liquidity were the only eligible charter members. Federally insured commercial banks and credit unions were added in 1989, CDFIs in 2007, and non-federally insured credit unions in 2015. Thus, at the current time membership is open to federally insured commercial banks, credit unions, savings and loan associations, CDFIs and insurance companies. IMBs and mortgage real estate investment trusts (REITs) (organizations who must own at least 75 percent mortgage assets) are not authorized to be FHLB members

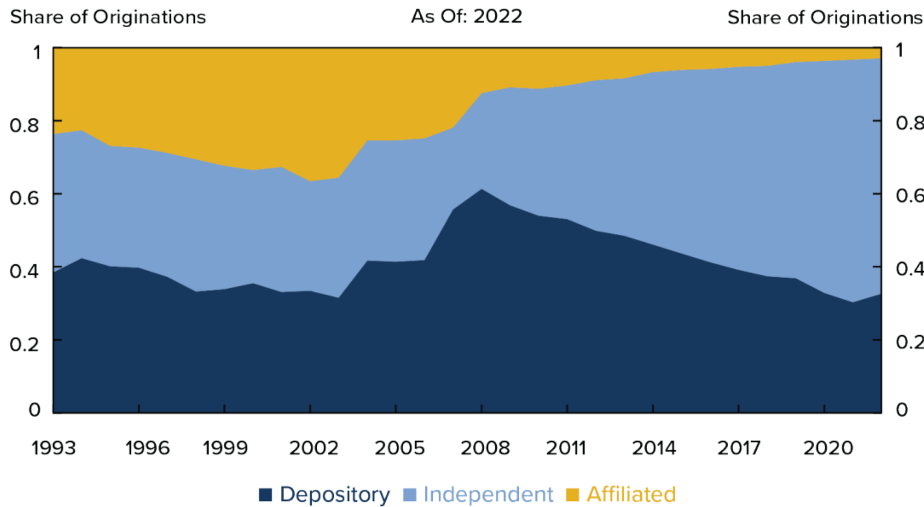
Currently, membership in the FHLB, as the point of initiation, requires that smaller depositories insured by the FDIC must make or purchase mortgages or MBS, and meet various risk management requirements Larger depositories insured by the FDIC and all credit unions insured by the National Credit Union Administration must meet these core requirements and hold at least 10 percent of their assets in mortgages or MBS. Insurance companies and CDFIs must meet the FHLB core risk management requirements, but do not have a statutory minimum requirement for initial admission; the regulations are silent. Rather the institutions must hold mortgage related assets and demonstrate a commitment to housing finance. Each individual bank can set its own requirements.[4]

There are no ongoing member mortgage finance requirements to remain in good standing. Once a member has joined the FHLB system and met their Home Loan Bank-designated minimum stock purchase membership requirement, they are members forever. The FHFA has asked RFI respondents if there should be an ongoing test for membership, and what additional institution types should be considered for membership.

It is useful to look at some numbers to understand the role of each of these players in the mortgage market. First, consider single family originations and holdings. Figure 3 shows the share of the overall single family mortgage market originated by independent mortgage bankers, and how this has changed through time. As of 2022, 64 percent of all mortgage origination was done by independent mortgage bankers, this is up from around 25 percent in 2008. And the IMB origination share of agency securitizations is even larger, on the order of 83 percent, up from around 30 percent in 2013. Newly released data

Figure 3: IMBs are Responsible for a Majority of Mortgage Lending
Loan Origination by Type of Originator

[4] https://www.fhfa.gov/sites/default/files/2024-01/FHLBank-System-at-100-Report.pdf



Note: Depositories include credit unions. Independent refers to nonbank mortgage companies. Affiliated refers to nonbank mortgage companies affiliated with a depository institution.

Source: Financial Stability Oversight Council Report on Nonbank Mortgage Servicing 2024, Figure 4. Federal Financial Institutions Examination Council (US), Home Mortgage Disclosure Act.

If we look at the share of mortgages serviced by IMBs we see a similar pattern of rapid growth. The share of the single-family agency mortgage market serviced by non-banks went from 35 percent in 2013 to 65 percent at the end of 2023.

Assets in the single-family residential mortgage market, including mortgages taken out by investors, consists of about $9.1 trillion in agency MBS, $0.45 trillion in non-agency MBS, $4 trillion in unsecuritized first mortgages and $0.5 trillion in unsecuritized second mortgages. That is about $14 trillion in total assets ($13.1 trillion owner occupied, $900 billion investor owned). Figure 4 shows the holders of the approximately $9.5 trillion in MBS; note that the four largest holders are commercial banks, the Federal Reserve, foreign investors, and mutual and money market funds.

Table 1: Mortgage-Related Security Holdings by Investor Type in 2024 Q1

Investor Type	**Total**	**Agency**	**Non-Agency**
US Depository Institutions	3138.85	3061.40	77.44
Commercial Banks	2267.49	2217.07	50.42
Savings Institutions	257.42	246.94	10.48
BHC Trading Accounts	430.89	421.34	9.55
Credit Unions	183.06	176.06	7.00
Federal Reserve System	2380.24	2380.24	0.00

Foreign Investors	1479.87	1268.21	211.66
Mutual & Money Market Funds	1189.29	1172.79	16.50
Public/Private Pension Funds	204.24	199.54	4.70
Life Insurance Companies	200.28	123.28	77.00
Mortgage REITs	173.42	168.46	4.96
Securities Brokers/dealers	165.99	158.99	7.00
Property/Casualty Insurers	146.99	128.99	18.00
State/Local Governments	136.05	134.00	2.05
Fannie Mae/Freddie Mac	51.38	50.42	0.96
FHLBanks	40.48	39.14	1.35

Source: Inside MBA & ABS, June 14, 2024.

Notes: Total MBS outstanding is remaining principal balance, while mortgage-related securities holdings are variously reported as fair-value and amortized cost. Sources include the FFIEC, Federal Reserve System, FHLBanks, Fannie Mae and Freddie Mac. Foreign investor holdings are based on Treasury data. Estimates from REITs, mutual funds, money-market funds, pension funds, life insurers, state & local government and property/casualty insurers based on Fed disclosures of total agency debt and MBS holdings.

Let's first consider the role of insurance companies. They remain significant players in the multifamily area, much less so in the single-family arena.

Most insurance companies' single-family holdings are in MBS form. Table 4 shows that as of year-end 2023 life insurance and P&C companies together hold about $250 billion in agency MBS (out of about $9 trillion outstanding), and about $95 billion in non-agency MBS (out of $450 outstanding). Insurance companies also hold about $93 billion in non-securitized first lien single family mortgages, the market is about $4.0 trillion.

On the multifamily side, insurance companies play a far larger role. The total multifamily mortgage market is $2.2 trillion, including about $1.1 billion in securities. Insurance companies hold $235 billion of unsecuritized multifamily mortgages[5] and about $90-$100 billion in multifamily MBS. [6] Thus they hold about 15 percent of multifamily mortgages, directly and indirectly.

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[5] https://www.mba.org/news-and-research/newsroom/news/2024/03/14/commercial-and-multifamily-mortgage-debt-outstanding-increased-by-37-billion-in-third-quarter-2023

[6] This publication shows insurance holdings of agency MF MBS at $70 billion, with another $220 billion on non-agency MBS. : https://content.n223b isaic.org/sites/default/files/capital-markets-special-reports-cmbs-ye2022.pdf. These non-agency deals tend to co-mingle MF and commercial properties; they are about 12 percent MF on average, hence our $100 billion estimate.

FHFA intends to initiate a rulemaking "to ensure that members continue to support the FHLBank mission"[7] by requiring certain members to have at least 10 percent of their assets in residential mortgage loans or equivalent mission assets on an ongoing basis to remain eligible for FHLBank financing. While we support this general move, we do not think it should be applied to insurance companies; in the section below we propose an alternative.

Industrywide, insurance company mortgage loan exposure totaled $627 billion in 2020, about 8 percent of their total assets under management, with life insurance companies holding 96 percent of the total, and property/casualty companies holding the majority of the rest.[8] Within both life and P&C companies, the overwhelming share of mortgage exposure is held by large companies with total assets under management of $10 billion or more. Suffice it to say that if FHFA were to impose a 10 percent ongoing residential mortgage test for insurance company continued membership, many current FHLB members would likely not pass.

We don't think the 10 percent test should be applied to insurance companies for two reasons. First, FHLB membership encourages insurance companies to hold more mortgage assets than they otherwise would, so they can have collateral to pledge. And the bulk of these assets are multifamily, as it better fits life insurance companies' desired asset/liability profile. Thus, insurance companies, especially life companies remain an important investor in the multifamily market, even if mortgages and MBS are a small part of overall insurance industry assets.[9] That said, we should point out that to become a member of the Des Moines FHLBank an insurance company must hold at least five percent of its total assets in residential home loans, residential mortgage-backed securities, or other mortgage-related assets.[10] So, it is possible for individual FHLBanks to impose mortgage-related requirements on their insurance company members, absent FHFA or congressional action.

Second, it important to bear in mind that insurance companies may be more important to the FHLB system, than the FHLB System is to the insurance companies. In 2023, FHLBanks had over 570 insurance company members, [11] increasing more than 5-fold since 2005,[12] a compound annual growth rate of 8.6 percent[13] Importantly, insurance company members have always

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[7]Federal Housing Finance Agency, FHLBank System at 100: Focus on the Future, https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHLBank-System-at-100-Report.pdf

[8] Jennifer Johnson and Jean-Baptiste Carelus , U.S. Insurers' Exposure to Mortgage Loans Continues to Climb Through Year-End 2020, NAIC, https://content.naic.org/sites/default/files/capital-markets-mtgln-special-reports-ye-2020_0.pdf

[9] Life insurance companies dominate the use of the FHLB by volume, holding approximately 90 percent of the FHLB stock across the industry as of year-end 2015. Federal Home Loan Bank Program, New England Asset Management, February 7, 2017. https://www.neamgroup.com/insights/federal-home-loan-bank-program

[10]Federal Home Loan Bank of Des Moines, Insurance Companies Required Agreements and Forms, https://www.fhlbdm.com/member-support/membership/new/insurance-companies/

[11]Federal Home Loan Bank of New York, Insurance Companies, Your Key to Reliability, The New York https://www.fhlbny.com/become-a-member/about-membership/insurance/

[12] Federal Home Loan Bank of New York, Insurance Companies, Your Key to Reliability, The New York https://www.fhlbny.com/become-a-member/about-membership/insurance/

[13] Chicago Federal Home Loan Bank, How Insurance Companies Benefit From an FHLBank Membership: Q2 2019. https://www.fhlbc.com/solutions/details/how-insurance-companies-benefit-from-an-fhlbank-membership-q2-2019

punched above their weight, most recently accounting for 5 percent of all members and 16 percent of all advances.[14]

Regarding the asymmetrical importance of insurance company membership, we should note that, "while traditional Bank membership has been relatively stable in recent years, insurance company membership is steadily growing."[15] Yet just 12 percent of all insurance companies in 2022 were FHLB members, including just "22 percent of U.S. life/annuity insurers and 7 percent of property/casualty firms,"[16] leaving lots of dry powder for additional growth.

This is further reflected by the fact that insurance company use of FHLB advances remains a very small percent of their total liabilities (equaling "just under 2 percent for life insurance companies and .33 percent for property and casualty companies in 2016.)[17] At year-end 2022, about half of insurers that were FHLB members took out advances.[18] "About 56 percent reporting FHLB advances in 2022 were life companies, followed by 35 percent property/casualty companies, and the remaining 9 percent health companies." [19] Finally, the typical insurance company advance is much larger than other member advances, which reduces Bank overhead costs[20].

Moreover, insurance companies provide the FHLBs with a steady demand for advances, that is generally unaffected by turmoil in the banking system. The bottom line is that turning the screws on insurance companies too tightly could seriously undermine the basic FHLB business

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[14] Federal Home Loan Bank Program, New England Asset Management, February 7, 2017. https://www.neamgroup.com/insights/federal-home-loan-bank-program,

[15] Jennifer Johnson and Jean-Baptiste Carelus, Increase in U.S. Insurers' Federal Home Loan Bank Membership and Exposure in 2022, NAIC Capital Markets Special Report, https://content.naic.org/sites/default/files/capital-markets-special-reports-fhlb-ye2022.pdf

[16] Best's Special Report: Insurer Membership in Federal Home Loan Bank Grows as L/A Companies Capitalize on Investment Spreads, October 31, 2023 09:16 AM (EDT)https://news.ambest.com/newscontent.aspx?refnum=253678&altsrc=114

[17] Federal Home Loan Bank Program, New England Asset Management, February 7, 2017. https://www.neamgroup.com/insights/federal-home-loan-bank-program

[18] U.S. Insurance Industry's Mortgage Loan Exposure Rises at Year-End 2022 as Commercial Real Estate Trends Deteriorate Analysts: Michele Wong and Steve Bardzik, National Association of Insurance Commissioners NAIC https://content.naic.org/sites/default/files/capital-markets-special-reports-cre-ye2022.pdf

[19] U.S. Insurance Industry's Mortgage Loan Exposure Rises at Year-End 2022 as Commercial Real Estate Trends Deteriorate Analysts: Michele Wong and Steve Bardzik, National Association of Insurance Commissioners NAIC https://content.naic.org/sites/default/files/capital-markets-special-reports-cre-ye2022.pdf

[20] According to AM Best, "Life insurers use their FHLB membership mostly for spread/yield enhancement, while property/casualty and health insurers use it more for liquidity and short-term working capital/operations," Best's Special Report: Insurer Membership in Federal Home Loan Bank Grows as L/A Companies Capitalize on Investment Spreads, October 31, 2023 09:16 AM. https://news.ambest.com/newscontent.aspx?refnum=253678&altsrc=23

model, sufficiently curtail revenues to undermine the system's overall ability to support its affordable housing and community development mission.

If insurance companies are not going to be subject to an ongoing mortgage asset test, what about broadening the FHLB membership base to include IMBs and REITs? We believe this is certainly something that Congress should act on. We discussed the role of IMBs above. Figure 4 shows that mortgage REITS hold about $173 billion of MBS, this, by definition is in excess of 75 percent of their assets. However, it is important to realize that IMBS and REITs are riskier entities than either banks or insurance companies. Fannie Mae, Freddie Mac and Ginnie Mae have minimum capital and liquidity requirements for IMBs to participate in the MBS market, but they are not prudential regulators. IMBs are reliant on the state banking authorities for prudential regulation, and this can be inconsistent. REITS do not have a regulator at all, By contrast, bank members are not only highly regulated, , but they also have FDIC insurance. The FDIC is willing to subordinate their bankruptcy claim to the FHLB, essentially giving the FHLB super lien status. As a result, the FHLB has never taken a loss on an advance.

These challenges can be overcome. For example, several states are considering workarounds for insurance company lack of priority lien status in the event of an insolvency. To cite one example, Kentucky House Bill 171, would give Home Loan Banks first priority on collateral pledged by member insurers.[21] With respect to IMBs and REITS, Congress and FHFA could require that at the point of initial membership that these entities have in place sound risk management systems in place, just as other members do. In addition, given the lighter regulation and the greater potential risk of loss to the FHLBs, the FHLBs should require that the IMBs and REITs to hold more collateral against their advances than other members to compensate for the additional risk. That is, the FHLBs would advance less per dollar of collateral for these entities. In short, the FHLB system can adapt their practices to safely accommodate these entities.

The larger problem for the IMBs is that their largest asset is mortgage servicing rights. They don't have a lot of other collateral for FHLB advances. MSRs are not acceptable collateral for the FHLBs; if Congress were to allow IMBs to become members, they would need to expand the collateral universe to include MSRs. However, MSRs are illiquid volatile assets, and the FHLBs would need to apply an advance rate and haircut on such collateral that is consistent with the price volatility of the asset. This is not an insurmountable problem but is one that will pose operational challenges. And Ginne Mae MSRs are especially illiquid, as the acquirer of the MSRs essentially assumes the liabilities, including the obligations to advance principal and interest payments and liability from prior issuers servicing errors. Moreover, at the point the member defaults on their advance obligation the FHLB will have to transfer the servicing to an approved servicer with the appropriate GSE or an approved Ginnie Mae issuer. The Chicago HLB is the only FHLB- approved Ginnie Mae issuer.

An alternative approach to requiring ongoing membership requirements

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6. William Rabb, Few Insurers Offer Input on Future of the Federal Home Loan Bank System, Insurance Journal, October 24, 2022. https://www.insurancejournal.com/news/southeast/2022/10/24/689524.htm

Due to widespread member opposition,[22]in its most recent 2016[23] membership rulemaking, FHFA unsuccessfully tried to impose a ten percent ongoing mortgage-related asset test for a large swath of FHLB members to remain in good standing. Before going down that same road, there is a simpler and more effective way of strengthening the link between the FHLB's liquidity and housing finance twin mandates. To explain, requires a brief historical detour.

Recall that the Bank Act as amended identifies two different housing finance asset thresholds for eligible members at the time of initial admission. All members must demonstrate that they make long-term *home mortgage loans*, which by regulation FHFA set at one percent of total assets. And, in 1989 when Congress expanded potential membership to federally insured commercial banks, lawmakers required them to hold a minimum of 10 percent of their assets in the form of a much broader category of mortgage-related assets called *residential mortgage loans* which they had to meet along with meeting the one percent home mortgage loan test when they first join the FHLBank system.[24] Congress left it to the FHLB regulator to determine the allowable housing finance-related assets that went into each bucket. In addition to including home mortgage loans, FHFA included in the residential mortgage loan bucket manufactured housing mortgages, funded construction loans, and junior liens, among other mortgage-related assets.[25].

The problem is that both buckets count as eligible assets mortgage-backed securities (MBS) which are far less directly connected to the expansion of affordable mortgage credit than most other eligible assets. The applicable regulation allows, for example, the full one percent home mortgage loan asset test and the entire 10 percent residential mortgage loan asset test to be met just with holding sufficient MBS acquired in the secondary market and purchased with a portion of member advances, which have far less impact on expanding the overall supply of available mortgage credit than the other mortgage instruments. That is, the institutions are purchasing mortgage loans that have already been made. Moreover, insurance holdings of SF MBS are so small it is hard to argue that these purchased bring rates down at all; there may be a small effect in the GSE multifamily MBS market; but even here they own less than 8 percent of outstanding securities.

To rectify this problem, for initial membership into the system, FHFA should limit MBS to no more than 25 percent of qualifying home mortgage loans, under the one percent test. In

Commented [LG1]: Mike, I don't know if you want to leave it as (25/ 50%). I would suggest the initial test by 25% and the collateral test by 50%.

Commented [MS2R1]: done

[22] FEDERAL HOUSING FINANCE AGENCY 12 CFR Part 1263 RIN 2590–AA39 Members of Federal Home Loan Banks, December 27, 2010. https://www.gpo.gov/fdsys/pkg/FR-2010-12-27/pdf/2010-32467.pdf; FEDERAL HOUSING FINANCE AGENCY 12 CFR Part 1263 RIN 2590-AA39 Members of Federal Home Loan Banks AGENCY: Federal Housing Finance Agency ACTION: Notice of Proposed Rulemaking; request for comments. September 2014.

[23] Members of Federal Home Loan Banks, A Rule by the Federal Housing Finance Agency on 01/20/2016 https://www.federalregister.gov/documents/2016/01/20/2016-00761/members-of-federal-home-loan-banks

[24] The "10 percent" requirement does not apply to CDFIS, insurance companies or any "community financial institution" (CFI), which the statute defines as an FDIC-insured depository institution with less than $1 billion in average total assets (adjusted annually for inflation) over the preceding three years.
FHLB%20Membership%20Notes/2016%20Final%20Membership%20rule_Federal%20Register%20__%20Members%20of%20Federal%20Home%20Loan%20Banks.html

[25] Members of Federal Home Loan Banks, A Rule by the Federal Housing Finance Agency on 01/20/2016 https://www.federalregister.gov/documents/2016/01/20/2016-00761/members-of-federal-home-loan-banks

addition to imposing a 10 percent ongoing residential mortgage loan asset test on most depositories, FHFA should also limit the composition of a member's collateral securing each advance to no more than 50 percent in mortgage-backed securities. These two administrative changes should help shift member mortgage related investments more toward direct investments that expand mortgage lending, rather than collateral that does nothing more than incrementally increase liquidity to the mortgage finance system, which is now the case.

Acquired Member Asset Programs

FHFA should expand the capacity of the FHLB Mortgage Partnership Finance and the Mortgage Purchase programs. Members are reluctant to portfolio 30-year fixed rate mortgages because of the difficulty in managing the interest rate risk. The MPF and MPP programs have proved to be very successful in allowing members to originate 30-year fixed rate mortgages that meet the unique needs of their local communities, and the member does not have to manage the interest rate risk of the mortgages. The FHLB were forced to shrink the programs in the early 2000's because they were not able to effectively hedge the interest rate risk of the mortgage acquired from their members. The FHLB need to have the authority to issue MBS as a vehicle to transfer the interest rate risk of all or part of their portfolios to the capital markets on an as needed basis. (They currently issue only Ginnie Mae mortgages, they don't have access to the capital markets for conventional product.) This authority will allow the FHLBs to better support the local lending needs of their members.

Affordable Housing (AHP Program), Community Development Activities

Each FHLB must operate an Affordable Housing Programs (AHP), which provides grants and subsidized advances to finance homeownership or rental housing for low and moderate income households. Between 1990 and 2023, the FHLBanks awarded approximately $8 billion in AHP subsidies to assist in the purchase, construction, and rehabilitation of over 1 million housing units.[26]

The Bank Act requires each FHLB to contribute at least 10 percent of its prior year's earnings to support its AHP. The FHLBs are authorized to operate two programs: (1) a competitive, predominantly rental-property funding program where a member of an FHLB submits an application to the FHLB on behalf of a nonprofit or for-profit sponsor and is evaluated in comparison to other applications under the FHLB's scoring system; and (2) a homeownership set-aside program where the FHLBs make grants available to their members, who provide the funds as a down payment or closing cost or counseling assistance to homebuyers or as rehabilitation assistance to homeowners. The competitive application program is required, the homeownership set aside program is voluntary, and by FHFA rule is generally capped at 35 percent of available AHP funds, with individual grants in 2023 limited to $29,000..

[26] Request for Input: The Federal Home Loan Bank Affordable Housing Program Competitive Application Process https://www.fhfa.gov/sites/default/files/2024-06/FHLBank-AHP-Application-RFI.pdf

Under substantial pressure from a variety of stakeholders, including FHFA, to do more, the FHLBs collectively committed on a voluntary basis to "increase their support for affordable housing and community development to 50 percent above the statutory AHP levels on a go-forward basis, resulting in approximately $180 million in additional contributions, in 2023.[27] Underscoring the pressure for the FHLBs to up their game, recent congressional testimony by the FHFA director included a recommendation that the AHP minimum required funding contribution be doubled to 20 percent.[28]

In addition to AHP, each FHLB is required by law to offer a Community Investment Programs (CIP), which provides low-cost advances to finance targeted affordable housing nd economic development programs. The Community Investment Cash Advance Program (CICA) provides advances for targeted economic development. FHFA reports that in 2022, through CIP discounted advances, FHLBanks directed $3.5 billion in targeted affordable housing resources that will help about 20,000 households, and through CICA directed $1.4 billion to help build infrastructure and create and preserve jobs to strengthen local neighborhood economies.[29] So far, so good. While total CIP and CICA investments rose significantly over the prior year, taken together, they still amounted to less than one half of one percent of total advances ($819 billion) in 2022, which is at best disappointing. As in the previous year, two FHLBanks did not even participate in CIP in 2022, despite it being a statutory FHLB requirement.

When we inquired how it could be that a mandated program, could have zero participants, the answer we received is that FHLBs are required to offer CIP, but they are not obligated to make CIP advances, which depends upon their members willingness to apply to the program. This is no way to run a railroad. In the private sector, when the demand for a product falls, those in charge assess their marketing strategies, price structure, and related strategies to make their product or service more attractive. The response is rarely, "oh well!"

While noting significant increases from the prior year, FHFA notes that CIC and CICA programs are quite small, with less than $5 billion in total advances between the two programs in 2022; this was less than 0.1 percent of total advances. The report also noted only 175 of the 6500 FHLB members obtained a CIC or CICA loan in 2022.[30]

While the FHLBs have CDFIs as members, there are many obstacles to using the FHLB programs. The result, only about 70 of the 600 non-depository CDFIs have opted to join the system, and in June, 2023,only 28 had outstanding advances[31]. Indeed, the two largest issues

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[27] FHLBanks, Affordable Housing and Community Development, https://fhlbanks.com/affordable-housing-2020-awards/

[28] Written Testimony of Sandra L. Thompson Director Federal Housing Finance Agency Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs "Oversight of Federal Housing Regulators", April 18, 2024. https://www.banking.senate.gov/imo/media/doc/thompson_4-18-24.pdf

[29] FHFA, REPORT ON 2022 FEDERAL HOME LOAN BANK TARGETED MISSION ACTIVITIES, November 2023. https://www.fhfa.gov/sites/default/files/2024-02/2022-FHLBank-Targeted-Mission-Activities-Report.pdf

[30] FHFA, Report on 2022 Federal Home Loan Bank Targeted and Mission Activities, November 2023. https://www.fhfa.gov/sites/default/files/2024-02/2022-FHLBank-Targeted-Mission-Activities-Report.pdf

[31] https://www.fhfa.gov/sites/default/files/2024-01/FHLBank-System-at-100-Report.pdf

noted in FHFA's FHLB review, were that the FHLBs are not familiar with CDFI business models and many don't have real estate assets to pledge for collateral.

We believe these programs are overengineered and inflexible, and do not allow the FHLBS to adequately leverage the funds. In the report, FHFA discussed streamlining specific programs. In our view, there is an even better solution. **The affordable housing goal should be increased to 20 percent, but what counts should be dramatically expanded, with an eye toward increasing flexibility and impact, with the incremental funds operating outside the strictures of the highly regulated AHP requirements, similar to how the FHLBs' voluntary contributions are administered.** Here are additional thoughts.

- Mission-oriented advances, either to CDFIs or advances to finance housing and economic development projects for targeted income level or advances to finance targeted economic development should be given "credit" toward the AHP requirement. Since these are advances, they should be credited as the differential between the market rate of interest and the interest rate offered on the loans. The FHLB would receive credit as long as the loan is outstanding.[32]

- Reduce haircuts on collateral-securing advances for CDFIs, backstopping potential losses with creation of either a FHLBank-by-FHLBank or system-wide first-loss reserve fund that would be capitalized by earnings on FHLBanks' retained earnings. These earnings totaled more than $28 billion at the end of 2023.[33]

- Many affordable multifamily projects often have very complicated capital structures to get the deals to "pencil out". The FHLB could enter into an arrangement to finance a piece of the capital structure at a below market "impact investing" interest rate, and the AHP could be credited by with the differential between the market rate of interest and the rate at which they have provided the capital. It the investment is written down, the write-off could count toward the AHP goal.

- Finally, competitively awarded AHP rental housing funds typically fund only a very small share of total development costs, ranging in 2022 from a low of 2.2 percent by the San Francisco FHLBank to a high of about 40 percent in Topeka AHP awards, which raises the question of the overall purpose and impacts of AHPs in expanding the supply of affordable rental housing.[34] With 6 of the 11 FHLBs AHP programs

[32] The FHLB Chicago Community First fund makes direct, low interest loans to CDFIs, and has been highly successful. See https://www.urban.org/urban-wire/federal-home-loan-banks-can-act-now-better-support-community-development
[33] FHLB Office of Finance, Investor presentation, July 2024, https://www.fhlb-of.com/ofweb_userWeb/resources/fhlbankpresentation.pdf
[34] FHFA, Report on 2022 Federal Home Loan Bank Targeted and Mission Activities, November 2023. https://www.fhfa.gov/sites/default/files/2024-02/2022-FHLBank-Targeted-Mission-Activities-Report.pdf

funding less than 5 percent of total development costs,[35] it is an overstatement to say that the FLHBs *create* the tens of thousands of new affordable housing units through their AHP programs that the FHLB system takes credit for.[36] Rather than most AHP funding going to fill the small, remaining final funding gap in a project's capital stack, FHFA should amend the AHP application process directing FHLBs to award significantly more points to member proposals who would use their AHP funding to provide the "first-in capital of sufficient scale to attract and leverage other funding sources, which would truly enable the FHLBanks to take credit for catalyzing and creating new rental housing developments that would not happen but for AHP.

The advantage of these structures is that the AHP funding is being leveraged. That is, the funding is being used to attract other funding to complete the project, which allows the FHLBs to use the funding to complete more projects.

Centers for Excellence

We support the suggestion in the FHLB at 100 Report to have Centers of Excellence, where individual Home Loan Banks create Centers of Excellence for particular activities for which they develop deep expertise and effective management strategies to in order to operate specific initiatives on behalf of all 11 Banks. It does not make sense for every FHLB to be able to serve every business model. It is important to realize that if a given FHLB sends activities to a center of excellence, the home bank needs assurance that they are not giving away business, but will get "credit" for it. We have a few specific suggestions in this regard.

Center of excellence for CDFIs—CDFIs comprise 1.1 percent of the FHLB institutions and hold 0.1percent of the capital. As mentioned above, the CDFIs don't think their respective FHLBs understand their business model. Having one FHLB as the CDFI center of excellence would allow that FHLB to develop products that fit the CDFI community. They could also break down barriers to the use of existing products. The FHLB CDFI center of excellence would approve new CDFI membership applications on behalf of the "home" FHLB.

Center of excellence for small multifamily lending—It is often hard to find financing for small (5-50 unit) properties, especially 5-20 unit properties. Census data has found that a disproportionate amount of naturally occurring affordable housing is in this type of housing.[37] However, because loan sizes are smaller, and in many cases the lender is evaluating both the financials of the borrower and the property, the evaluation is more cumbersome. The center for

[35] FHFA, Report on 2022 Federal Home Loan Bank Targeted and Mission Activities, November 2023. https://www.fhfa.gov/sites/default/files/2024-02/2022-FHLBank-Targeted-Mission-Activities-Report.pdf

[36] FHLBanks, 2023 Impact Report, June 2024 https://fhlbanks.com/wp-content/uploads/2024/06/2023-Impact-Report-FINAL.pdf

[37] See, for example, https://www.urban.org/sites/default/files/2020/05/15/small_multifamily_units_0.pdf

excellence could offer several types of products to increase financing in this space. A few thoughts:

- The Center for Excellence for small multifamily lending could offer a small multifamily fund; FHLB members would buy into this fund and could use the fund shares as collateral for advances.
- The Center for Excellence for small multifamily lending could develop a MPP/MPF type program for small multifamily mortgages, in which the FHLBs share the credit risk with the originating entity.

Center for excellent for construction lending—Banks have historically been the largest lenders for AD&C (Acquisition, Development and Construction) financing. However, this lending is very capital intensive, and with higher capital requirements pending and regulators looking closely at the loans already on the books, particularly in light of falling prices on multifamily properties, it is not unreasonable to think commercial banks, particularly the midsize commercial banks, could pull back from this market. The FHLB Center for excellence could step in with products very similar to those we have sketched above for small multifamily lending.

We want to emphasize again, in order for centers of excellence to succeed the "home" FHLB that is referring a member needs to be compensated for the referral. We would suggest, at least initially, that some of these activities allow for full credit to both referring bank and the center of excellence. After the programs are better established, a determination can be made if this is too generous, and if so, how the referring FHLB and the center for excellent should share the credit.

Conclusion

The two missions of the FHLBs: are to

- provide liquidity to those institutions that support the mortgage market, making the housing finance system that depends on them more stable and affordable
- provide resources for affordable housing and community development

Among the two missions, the first is perhaps less well appreciated than the second but no less important. Without it, we would need some other form of government-backed support for these institutions to provide liquidity through the cycle. Without *something* playing that stabilizing role, we would see more instability among lenders, more defaults, and more volatility in the price and level of their lending, including their mortgage lending. This would have a particularly detrimental impact on communities with less resources.

And these missions are inextricably linked. If there were no advances, or the advances were too costly, burdensome or restrictive, there would be no affordable housing program.

FHFA is right to suggest that the way that the FHLBs have been providing this support has become too unmoored from the housing finance system. Not because the advances their members use don't always go directly into housing finance (that would be too limiting a restriction), but because those institutions that benefit from the liquidity support don't always have much of a role in housing finance. And those that *do* have a central role in housing finance often can't be members (independent mortgage banks and mortgage REITs).

FHFA should tighten the nexus between the liquidity support the FHLBs provide and housing finance in two ways:

- Limit the use of MBS as collateral for insurance company advances.
- Expand membership to include those that the housing finance system has come to rely on, including independent mortgage banks and mortgage REITs, which would require Congressional action.
- Expand the use of the MPP and MPF products.

FHFA should also strengthen the direct support the FHLBs provide for affordable housing in several ways:

- Increase the affordable contribution from 10 percent of profits to 20 percent and dramatically expand what counts with an eye toward increasing flexibility and impact, with the incremental funds operating outside the strictures of the highly regulated AHP requirements.
- Create centers of excellence, including one for CDFIs, one for small multifamily lending and one for construction lending. It is very important that both the referring FHLB and the center of excellence receive "credit" for the loans.