Esperanza
Strengthening Our
Hispanic Community

March 31, 2023

Sandra L. Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: The FHLBank System at 100: Focusing on the Future

Dear Director Thompson:

Thank you for the opportunity to provide additional input on the FHLBank System at 100: Focusing on the Future. I submit these comments on behalf of Esperanza, where I have the honor of serving as its Founder and CEO. Since 1986, Esperanza (https://www.esperanza.us) has confronted poverty, disinvestment, blight, and lack of economic opportunity in the extremely and very-low income, Hunting Park neighborhood of Philadelphia. Esperanza operates as a nonprofit community development corporation (CDC) with an annual budget of $75 million, a real estate asset portfolio of $125 million, and more than 650 employees.

I applaud the FHFA's initiative to engage in this extensive dialogue with key stakeholders and potential new partners that can result in a more vibrant FHLBank system better able to meet the economic challenges of today and tomorrow. The comments submitted today will supplement Esperanza's October 27, 2022, comment letter.

There are two fundamental elements of the FHLBanks' mission – serving as a reliable source of liquidity to FHLBank members to support their affordable housing and economic development lending and applying the statutory requirement that 10 percent of the net income generated by these activities support affordable housing. FHLBanks have recently increased voluntary support of affordable housing (through the AHP and non-AHP initiatives), but in 2022, the total system efforts represented only 2% of net income, as reported in the 2022 Combined Financial Report (CFR).

This letter lays out a way that FHLBanks can make significant increases to their affordable housing efforts without weakening safety and soundness and allowing FHLBanks to continue to declare dividends. FHLBank payment of dividends is not a core mission of the FHLB system but it has become a primary focus for some member banks, member trade associations and some

FHLBank board members. FHLBanks stated in the 2021 CFR (page 11) that dividends are essentially an element of the FHLBanks' mission.[1]

Review of recent bank failures should not delay the FHFA's work

In the weeks since the closing of Silicon Valley Bank and Signature Bank, FHLBanks dramatically increased their borrowing in capital markets with a view to supporting members' needs for liquidity. The FHLBanks have been able to use their government support and capital market strength to access capital markets in the post-crisis period. This important element of the system is working well.

The GAO, the Federal Reserve, the FDIC and congressional committees are performing significant analyses of the run up to this crisis. While these reviews are ongoing, I urge that the FHFA move forward on its mission-focused review.

At the heart of the current FHFA review of FHLBanks is how FHLBanks can better deploy their GSE status, their capital markets position, their tax exemption, line of credit from the Treasury and their network of members to help meet this nation's severe housing challenges. Once the staff review of all the input is completed, the FHFA should not only make legislative recommendations but more importantly issue a series of regulations, supported by existing statute, to re-focus FHLBank efforts in affordable housing and economic development.

FHLBanks closed 2022 with a 133 percent increase in advances over year-end 2021. It has been reported that FHLBanks recently issued hundreds of billions of dollars in debt which should support an increase in advance levels over year-end figures. The income generated by these advances as well as the higher investment income from a rising rate environment suggests that FHLBanks are on their way to strong earnings in 2023.

It is a perfect time for FHLBanks to undertake new efforts to support affordable housing in ways that do not weaken the financial strength of the system.

FHFA should propose a regulatory FHLBank mission

As the foundation for what should be an extensive set of regulatory proposals to re-focus the FHLBanks on supporting liquidity for long-term funding of affordable housing (including rental), the FHFA should first define in regulation the FHLBank Mission.

This mission should direct and empower FHLBanks to develop products and services that address affordable housing credit needs, particularly in low income rural and urban communities. These efforts should be supported by a portion of the profits derived from government-supported

[1] "The FHLBanks seek to manage their primary objective of fulfilling their public purpose by enhancing the value of membership for member institutions. The value of membership includes access to readily available credit and other services from the FHLBanks and the value of the cost differential between an FHLBank's advances and other potential sources of funds, <u>as well as the potential for dividends received on a member's investment in an FHLBank's capital stock</u>."

lending and investments to build liquidity for long-term funding of affordable rental housing.

Apply investment income from restricted retained earnings (RRE) to support affordable housing.

The FHFA, as regulator of FHLBanks and stewards of the public interest should establish a more equitable distribution of wealth generated by the FHLBanks' implicit guarantee, tax exemption and other aspects of government support between the member/owners and the broader public. One way to achieve this would be to apply the investment income from restricted retained earnings (RRE)[2] to support affordable housing. This would not touch the RRE themselves.

This regulation would increase FHLBank financial support for affordable housing without legislation at a time it is desperately needed. It would not weaken the very strong capital position of the FHLBanks, while still allowing the payment of dividends to FHLBank members.

A review of the 2022 CFR issued March 24, 2023, by the FHLBank Office of Finance shows that FHLBanks could <u>double</u> their direct support of affordable housing by applying RRE investment income. The critical role of investment income from retained earnings (both unrestricted and restricted) to the direct financial benefit of FHLBank members is highlighted by the data presented in Attachment 1. These data show that in 2022:

- The capital at FHLBanks is well above required levels, with retained earnings (unrestricted and restricted) now over $24 billion and RRE over $6 billion.
- The 2022 investment income from all retained earnings was $1.4 billion of risk-free income for FHLBanks. The investment income from the unrestricted retained earnings was over $1 billion. The investment income from RRE was approximately $350 million.
- FHLBanks paid $1.4 billion in dividends.
- The statutory AHP contribution was $355 million.
- FHLBanks increased their voluntary contributions to AHP and non-AHP efforts with a system total of $61 million, approximately 2% of net income.

The FHFA should direct the FHLBanks to deploy this RRE investment income of $350 million to support new ways of meeting affordable housing challenges. These funds should not be added to the AHP program but should provide credit support and other creative approaches to achieve the highest positive impact.

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[2] When the REFCORP obligation expired in 2011, the FHLBanks moved to capture that income to build RRE, without any public discussion but with the support of the FHFA. Building RRE was one of the few options to build FHLBank capital at that time. If FHLBanks could initiate the building of these RRE **without** legislation and a formal rulemaking process, the FHFA would clearly be within its authority to issue a regulation and invite open comment now 12 years later.

FHLBanks should enhance liquidity for long-term funding for affordable rental housing

The FHFA should direct FHLBanks to apply their market leadership and GSE status to develop approaches that lower the cost and extend the maturity of funding for affordable rental housing that supports tenants making between 40 and 60 percent of AMI.

The FHFA should not direct FHLBanks to undertake explicit programs but to devote significant time and resources to identify and address unmet needs. FHLBank ideas, expertise and ingenuity will be essential for the success of these efforts. The FHFA should support these efforts through board guidance, examinations, and the structure of executive compensation.

In these efforts the FHLBanks should consider the insights and expertise of their Affordable Housing Advisory Councils, large members, small members, non-profit developers serving minority communities, state housing finance agencies, staff at the Office of Finance, Community Development Financial Institutions, tribal leaders and nonmember capital market players.

This effort should lead to replicable pilot programs to serve as proof of concepts for future large-scale programs.

These efforts should:

- Address specific unmet needs such as long-term funding for small multifamily rental housing with 5-49 units or rental developments using single family housing stock such as the row housing prevalent in many communities in the Northwest and Midwest or manufactured housing found throughout the country.
- Fit best within the FHLBank operating environment such as: not dramatically increasing operating risk, not weakening FHLBank capital, using capital market leverage and the implicit guarantee to create liquidity for long-term funding for affordable housing.
- Be supported by increased FHLBank operating budgets to staff these efforts.
- Increase the liquidity for long-term funding for affordable rental housing. To ensure these programs are additive and innovative, they should operate without support from the successful and oversubscribed LIHTC.

In closing, I want to express my appreciation to you and all the staff at the FHFA who have been working so hard to help build a better FHLBank system for the future.

Thank you,

The Reverend Luis Cortés, Jr.
Founder & CEO
Esperanza

FHLBank Investment Income from Retained Earnings

FHLBank	Net Income	Capital Stock	RE[i]	RRE[ii]	Return on Avg Equity	RE[iii] Invest-ment income	RRE[iv] Invest-ment income	AHP	Dividends/ (Rate[v])
Boston	184	2,031	1,690	400	6.47%	109	26	21	42 (3.53%)
New York	417	6,387	2,096	911	6.12	128	56	46	252 (6.13%)
Pittsburgh	227	3,428	1,536	499	6.33	97	32	25	89 (5.45%)
Atlanta	184	5,397	2,283	651	3.18	73	21	21	129 (4.34%)
Cincinnati	252	5,151	1,401	560	4.78	67	27	29	144 (4.31%)
Indianapolis	177	2,123	1,287	323	5.03	65	16	20	67 (2.95%)
Chicago	415	2,989	4,564	786	5.94	271	47	48	112 (5.05%)
Des Moines	430	6,250	2,618	703	6.33	165	44	48	202 (5.27%)
Dallas	317	3,984	1,834	330	6.69	122	22	35	41 (1.65%)
Topeka	241	2,508	1,254	339	7.47	94	25	27	130 (6.47%)
San Francisco	323	3,758	3,994	732	4.67	186	34	36	161 (6.30%)
System	3,166	44,006	24,554	6,232	5.60	1,377	350	355[vi]	1,372

Source: 2022 Combined Financial Report
Dollars in millions

[i] Retained Earnings
[ii] Restricted Retained Earnings
[iii] Based on return on average equity from 2022 CFR
[iv] Based on return on average equity from 2022 CFR
[v] Weighted Average Dividend Rate
[vi] AHP contributions are statutorily mandated at 10 percent of net income. In 2022, FHLBanks made $17 million in voluntary AHP contributions and $44 million in non-AHP and community support programs.