Congress of the United States
Washington, DC 20515

April 6, 2023

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency,
400 Seventh Street SW., Eighth Floor,
Washington, DC 20024

RE: FHLBank System at 100: Focusing on the Future

Dear Director Thompson

We write to extend our congratulations to the leadership and staff of the Federal Housing Finance Agency (FHFA) for undertaking a comprehensive review of the Federal Home Loan Banks (FHLBanks). This analysis of the practices, mission and benefits of this 90-year-old government-sponsored enterprise is timely and important.

It has become commonplace to assert that our nation has an "affordable housing crisis," but in actuality, we have long had an intolerable condition where we lack homes affordable to families with children, people with disabilities, the elderly, veterans and other low-income people. To address chronic housing needs, as well as other community investments, we need a more robust response from federal, state, local and tribal governments; nonprofits; the private sector and the public. We also need a more robust response from the Federal Home Loan Banks.

The FHLBank system plays an important role in helping community banks, credit unions, housing finance agencies and some non-depository CDFIs meet their liquidity needs so they can serve their communities' credit needs for affordable housing and community economic development. But we think the FHLBanks can do more to help all their members meet the affordable housing and economic development credit needs of the areas they serve.

This trillion-dollar system has a tremendous – and clearly underutilized capacity – to support long-term funding for affordable housing multifamily developments, to assist people achieve and sustain homeownership and to help communities finance community economic development. Providing financing for housing and community economic development are an indispensable requirement of the FHLBanks.

Unfortunately, numerous reports and studies have noted that while FHLBank liquidity is important, the FHLBanks main business product, advances, are no longer adequately supporting housing investment, community economic development or other community needs.[1] As you consider the next steps in your review, including your report, we encourage you to consider the following suggestions.

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[1] Gissler, Stefan, Narajabad, Borghan, and Daniel K. Tarullo. "Federal Home Loan Banks and Financial Stability." *Journal of Financial Regulation 9*, no. 1 (2023): 1-29. Accessed April 6, 2023. https://doi.org/10.1093/jfr/fjad002.
Karen Petrou, https://fedfin.com/karen-petrou-how-fhlbs-miss-the-mission-heighten-financial-risk/; Rob Blackwell and Karen Petrou, "Are the Fhlbs Dangerously off Mission?," Banking with Interest, January 21, 2023, https://bankingwithinterest.libsyn.com/are-the-fhlbs-dangerously-off-mission.;

1. **Consider the innovations suggested by participants in FHFA's FHLBanks roundtables, listening sessions and written comments.**

    - **Tie advances to mission investments.** The treatment of all advances as "mission assets" needs to be reconsidered. Not all advances are equal in terms of mission compliance. FHFA should reconsider what constitutes mission assets and prioritize strategies for member banks to increase the use of the Community Investment Cash Advances, Community Investment Programs and letters of credit to provide the types of low-cost financing communities need.

      The FHFA should strengthen the community support requirements for FHLBank membership. Members benefit from the ability to take advances. In order to retain that benefit, the FHFA should require members regularly meet minimum levels of support for affordable housing and economic development activity. The FHFA should expand required housing investments to include long-term funding for affordable rental housing finance, and possibly include community economic development investments in rural, tribal and low-income urban and suburban areas. Finally, the FHFA should consider if the community support standards should be made more robust and tied to receipt of advances. For members subject to the Community Reinvestment Act, the FHFA should consider if any member bank with a Needs to Improve CRA rating should be required to improve their community support plan to receive above a minimal level of advances.

    - **Publicize innovations to encourage FHLBanks to adopt successful programs from other FHLBanks that have a proven track record.** Numerous participants suggested proactive and mission-related ideas such as establishing loan guarantees or collateral pledges for CDFIs. FHFA should consider expanding FHLBanks' small business loan programs such as the FHLBank of Pittsburgh's Banking on Business and FHLBank of Boston's Jobs for New England as well as special purpose credit programs to address unmet housing and community development needs. Participants also recommended innovations such as using advances, the mortgage partnership program and grants to finance land trusts, manufactured housing, small rental properties and financing for first-time homebuyers. Others have sought legislative changes allowing CDFIs to pledge as collateral small business, small agricultural and community development loans, not just housing loans. This would allow CDFIs to qualify as community financial institutions. Others recommended establishing loan loss reserves for special purpose credit programs or for CDFIs. The FHLBanks should expand their partnerships on tribal land and consider support for Black, Latino, AAPI and Native American housing developers.

Michael Stegman, "How the FHFA Can Increase Federal Home Loan Bank Affordable Housing Investments," Urban Institute, March 21, 2023, https://www.urban.org/research/publication/how-fhfa-can-increase-federal-home-loan-bank-affordable-housing-investments.;
Cornelius Hurley, "Is Federal Home Loan Bank Reform a Sure Thing or a Show?," The Hill (The Hill, August 2, 2022), https://thehill.com/opinion/finance/3584052-is-federal-home-loan-bank-reform-a-sure-thing-or-a-show/.; Cornelius Hurley, "Taxpayer Support for Federal Home Loan Banks Is No Longer Justified," The Hill (The Hill, March 29, 2022), https://thehill.com/opinion/finance/600200-taxpayer-support-for-federal-home-loan-banks-is-no-longer-justified/.; Aaron Klein and Daniel K. Tarullo, "Forum on the Future of the Federal Home Loan Bank System," Brookings (Brookings, March 16, 2023), https://www.brookings.edu/events/forum-on-the-future-of-the-federal-home-loan-bank-system/.; Aaron Klein, Cornelius Hurley, and Harrison Fregeau, "Forum on the Future of the Federal Home Loan Bank System: Highlights," Brookings (Brookings, March 9, 2023), https://www.brookings.edu/2023/03/10/forum-on-the-future-of-the-federal-home-loan-bank-system-highlights-from-the-brookings-and-bu-law-event/.; Dennis C. Shea and Owen Minott, "Federal Home Loan Banks Should Do More than the Minimum for Affordable Housing," The Hill (The Hill, March 31, 2023), https://thehill.com/opinion/finance/3928017-federal-home-loan-banks-should-do-more-than-the-minimum-for-affordable-housing/.

Many recommended simplifying the Affordable Housing Program so that it is easier to apply and add to the funding stack for federally-funded projects, especially considering the very small addition AHP makes to rental housing developments. Down payment assistance programs should support community land trusts. With regard to changes to the Affordable Housing Program, it may be more appropriate to express the FHLBanks' commitment to affordable housing as a percentage of assets rather than as a percentage of net income such as replacing the 10% of net revenue assessment with an annual assessment of 15 to 20 basis points on the rolling 12-quarter average of the outstanding balance of FHLBank advances.[2] While others recommended eliminating the AHP and sending a percentage of net revenue directly to the Housing Trust Fund to provide the resources without the complications and disparities that occur in competition. The FHFA's final report should highlight some of these proposals and note which can be achieved through regulation and which need legislation.

- **Identify funding options.** The FHFA's final report should recommend ways to fund mission investments. Options to support new mission-related programs include an additional assessment based on net income or assets, allocating investment income or interest from restricted restrained earnings and litigation awards. FHFA's report should include legislative and regulatory recommendations.

2. **Increase the transparency of FHLBanks' investments and activities.**

- **Voluntary Programs.** The FHLBanks can and should provide much more investment – both loans and grants – as well as credit support, technical assistance and relationship building activities. It would be most helpful if the FHFA updated its annual Low-Income Housing and Community Development Activities of the Federal Home Loan Banks report [3]to include all programs provided by each Federal Home Loan Bank. The report should include not just the Affordable Housing Program, Community Investment Cash Advance, Community Investment Program and CDFIs. The report should also include a detailed analysis of each FHLBank's voluntary programs including any Mortgage Partnership Finance Program investments. The voluntary program analysis should delineate between grant programs, guarantee programs, loans and other types of investments and the financial investment for each. The direct cost of these voluntary efforts should be included in this report which should look back at least ten-years.

- **Expand FHFA's Annual Report.** FHFA's annual report should also provide the percent and total member dividends, the amount paid to member institutions in the calendar year. In addition, funds recovered from litigation should be included as well as amounts paid by each FHLBank to internal and contracted lobbyists and public relations consultants. The report should provide a national list of AHP awards broken down by state, even when those grants may have come from FHLBanks in other districts. The report should also include a report on voluntary programs, including but not limited to CICA, CIP, letters of credit, MPFP and community support programs.

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[2] Stegman.

[3] Sandra Thompson, "Federal Home Loan Bank Reports and Plans FHFA," Federal Housing Finance Agency (FHFA, 2023); https://www.fhfa.gov/search/Pages/reports-plans-results.aspx?k=reports

3. Return to incentive pay practices.

- **Align executive compensation to goals.** Decades ago, executive compensation for FHLBank presidents was aligned with levels of affordable housing and community economic development investments. This practice should be renewed. The FHFA may consider if executive compensation should include goals related to the total amount of CICA/CIP as a percentage of advances, the percent of members utilizing CICA/CIP advances, the total amount of letters of credit allocated and distributed among regions, states, communities and tribes, the percentage of members using letters of credit, and the amount of voluntary program investment. In addition, you may consider if each FHLBank should establish its own goals in its community lending plans. These goals should be measurable, and the results analyzed each year by the FHFA.

  Many affordable housing and community economic development developers, especially those in rural areas, tribal lands and in states underserved by capital markets, struggle to find long-term, low-cost, fixed-rate loans to finance their developments. The CICA, CIP and letters of credit should provide better support for these options; however, many FHLBanks make minimal investments available. Some FHLBanks have made nearly no CIP/CICA investments in 2022. Some FHLBanks provided no CICA or CIP investments for years; in fact, one FHLBank does not even include CIP in its annual community lending plan. By considering linking executive compensation to providing the types of financing for low-income, urban, rural and tribal communities needs, the FHFA can dramatically increase the supply of low-cost and low-risk financing for housing and community development investments.

- **Establish a base salary.** FHFA may wish to consider creating a base executive salary, perhaps equal to that of the nearest regional Federal Reserve Bank president, with increased compensation aligned with meeting affordable housing and community economic development goals. The current levels of executive compensation at the eleven FHLBanks may be disproportionate to the executives' roles and responsibilities as managers of quasi-governmental institutions with subsidized access to capital, tax exemption and low risks on their core business. Moreover, compensation may be inappropriately linked to the volume of advances without consideration of the mission quality of those advances.

4. Strengthen mission oversight at the board level.

- **Consider expanding and clarifying requirements for independent directors.** FHFA should consider if the chair or vice chair of each FHLBank should be an independent director as was previously the practice. FHFA should also consider if they should require each independent director to have careers in their field instead of permitting retired financial services executives who served on a nonprofit housing board for at least four years. The FHFA should consider if the Advisory Council of each FHLBank could act as the nominating committee for board directors, not just act in a consultative capacity to the board. FHFA should ensure that independent directors be responsive to requests for information from Congressional and Agency staff. If an FHLBank board member serves as an executive or on the board of a member financial institution or organization that fails, that board member should be required to resign from the FHLBank board.

- **Consider requiring boards to have a majority of independent directors.** The boards of directors must increase their focus on mission activities to address the dire housing shortages, the inadequacy of our infrastructure and the need for good-paying jobs. For example, for years, most of the FHLBanks made no mention of tribes in their community lending plans despite having tribes residing in the states they served. To address this lack of mission focus, the FHFA should ensure that independent directors have the majority of seats on the FHLBanks' boards.

- **Examine how dividends support the FHLBank mission.** In the fourth quarter of 2022, why did one FHLBank (Dallas) pay the lowest dividend of 1.65% while three FHLBanks (New York, San Francisco and Topeka) paid more than 6%? All FHLBanks enjoy the same government-supported subsidized cost of funds; how does this wide divergence, or dividends in general, support safety, soundness or mission?

  For most financial institutions, capital serves as a restraint on excessive growth. The FHFA should consider how activity investments by members and the generous dividends paid on those investments affect the FHLBanks. It should be very clear that the benefit for belonging to an FHLBank is the advances, the lines of credit and other services, not generous dividends on activity stock. We urge you to give this matter further attention with an eye to ensuring that all states, D.C. and territories in a FHLBank's footprint receive meaningful investments.

5. **Require accurate analysis from the Federal Home Loan Banks.**

The FHLBanks are government-sponsored enterprises created by Congress. They have numerous special privileges not available to private entities. These include a line of credit from the U.S. Treasury Department, an implicit government guarantee of all debt, a requirement that the FDIC and NCUA compensate the FHLBanks for any losses from advances to failed financial institutions and exemption from local, state and federal income tax both on the income of the FHLBanks and on interest paid on the FHLBanks' debt.

- **Publicize taxpayer subsidy for FHLBanks.** The FHFA should analyze and publicize the taxpayer subsidy of the FHLBank system. According to one expert[4], based on FY 2022 data recently released by the FHLBanks' Office of Finance,[5] the annual taxpayer subsidy of the FHLBs is $7.3 billion a year. This includes

  - 50 basis points = Value of the government guarantee of FHLB debt per Fed economists
  - $1.2 trillion = Total FHLB debt outstanding on 12/21/22
  - $1.3 billion = Annual value of the FHLBs' tax exemptions per CBO
    - 50 bps X $1.2 trillion + $1.3 billion = $7.3 billion/year

  The FHFA should not tolerate any disinformation from the FHLBanks denying their mission requirements or the government benefits they accrue from their federal charter. The implied federal government guarantee, access to low-cost federal funds, tax exemption, first-lien status on advances and emergency credit line from the U.S. Department of Treasury are some of the many government-provided benefits to the FHLBanks.

- **Calculate and publicize mission investment on assets**. Any analysis of the taxpayer subsidy of the system must be compared to the affordable housing and community economic development investments made by the 11 FHLBanks. Member banks are familiar with the metric, ROA (return on

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[4] Cornelius Hurley, "Comment Letter on FHFA Review of the Federal Home Loan Banks," Hurley, "Weighing the Costs and Benefits of Federal Home Loan Banks."

[5] Sandra Thompson, "For Immediate Release - Fhlb-Of.com," Office of Finance Announces Fourth Quarter and Annual 2022 Combined Operating Highlights for the Federal Home Loan Banks (FHFA, 2023), https://www.fhlb-of.com/ofweb_userWeb/resources/2022Q4FHLBCombinedOperatingHighlights.pdf.

> assets). Going forward, FHFA should consider providing a comparable metric, MROA: affordable housing and community development investment [mission] return on assets. Such a yardstick would serve as a useful indicator of each FHLBank's performance in their purpose-critical activity. Some assert that in 2022, the FHLBs' mandatory assessment for affordable housing was only 0.03% of its assets.[6]

When you began this review, you asked if the FHLBanks were meeting the affordable housing and community economic development needs of the communities they were created to serve. Clearly, people all over the nation have expressed a deep desire to see the FHLBanks use their tremendous financial clout and depth of membership to provide assistance for affordable housing and community economic development in more robust and creative ways.

The visionary public commentators and roundtable and listening session participants see a Federal Home Loan Bank system that should remain an important liquidity resource for community banks and credit unions so they can meet the lending needs of their communities. They also want the FHLBanks to play a much bigger role in addressing housing and community economic development needs in our nation at a scale and creativity that is currently unimaginable based on their previous and current investments.

You are to be commended for encouraging local governments, tribal leaders, affordable housing developers, community economic development professionals, policymakers and the public to think of how this trillion-dollar system could use its core products to provide long-term, fixed low-interest rate flexible capital for housing and community economic development investments.

At a recent forum in Washington, DC,[7] the head of a leading fair housing organization urged FHFA to be "bold" and not "incremental" in its recommendations. We echo those sentiments.

Sincerely,

Catherine Cortez Masto
United States Senator

Ritchie Torres
Member of Congress

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[6] Cornelius Hurley, "Weighing the Costs and Benefits of Federal Home Loan Banks."
[7] Lisa Rice, "Forum on the Future of the Federal Home Loan Bank System," Brookings (Brookings, March 16, 2023), https://www.brookings.edu/events/forum-on-the-future-of-the-federal-home-loan-bank-system/.