

July 14, 2009

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ATTN: Comments/RIN 2590-AA18

Dear Mr. Pollard,

Opportunity Finance Network (OFN) appreciates the chance to comment on the Federal Housing Finance Agency's (FHFA) request for comments on the proposed rule published in the *Federal Register* on May 15, 2009 regarding community development financial institutions' (CDFIs) membership in the Federal Home Loan Bank System (FHLBank System).

Opportunity Finance Network, the national network of more than 170 financial institutions, creates growth that is good for communities, investors, individuals, and the economy. Its members include CDFIs and other opportunity finance institutions that work just outside the margins of conventional finance to bring those markets into the economic mainstream and to help the economic mainstream flow into those markets. CDFI financing has resulted in significant numbers of new jobs, jobs preserved, quality, affordable housing units, and new commercial and community facility space in all 50 states. Over the past 30 years, the Opportunity Finance industry has provided more than \$30 billion in financing that would not otherwise have happened in markets that conventional finance would not otherwise reach.

The opportunity finance industry is committed to identifying and investing in opportunities to benefit low-income and low-wealth people across the country. CDFI financing delivers both sound financial returns and real changes for people and communities.

This comment letter will address all questions posed by the FHFA regarding CDFI membership. The letter is divided into five sections that cover all suggested comments: financial condition requirements, financial documentation, CDFIs as community financial institutions, and other questions. The letter also includes a section on missed opportunities that would strengthen the FHLBank System's work, particularly in affordable housing and community development.

OFN would like to commend the FHFA and the authors of the proposed rule for the concerted effort, research, and thought that went into its creation. In general, the proposed rule recognizes the unique characteristics of CDFIs and the valuable contribution they make to low-wealth and low-income communities across the nation. On behalf of the industry, I would like to express my sincere gratitude to the FHFA staff who undertook this endeavor to understand CDFIs and their benefit to the Federal Home Loan Bank System.

Background

The Housing and Economic Recovery Act (HERA) of 2008 created the FHFA as an independent agency of the federal government and included among its responsibilities the oversight of the FHLBs. HERA also included a provision to allow CDFIs to become members of the FHLBs. The proposed rule outlines the eligibility requirements for CDFIs and we believe follows Congressional intent.



Financial Condition Requirements

The proposed rule outlines five financial condition requirements that will be unique to CDFIs and proposes appropriate definitions¹ regarding CDFIs in the context of assessing financial condition. It outlines the minimum standards for loan loss reserves and liquidity ratio requirements. We believe that these two ratios are reasonable and more than sufficient. OFN applauds the proposal and would suggest no changes to the proposed rule in this area.

OFN agrees that there is also no need for a self-sufficiency ratio for CDFIs. Since a CDFI is required, as part of the Treasury certification process, to “have a primary mission of promoting community development” *and* “provide development services in conjunction with its financing activities,” a self-sufficiency ratio is counter intuitive. For example, CDFIs that provide significant technical assistance or other programs as part of their missions would have a lower self-sufficiency ratio than an FHLBank System member that provides no such assistance. The more important issue is the reliability of income, regardless of whether it is earned income or grant income.

OFN would like to address in more detail the two other requirements: net asset ratio and earnings measurement.

Net Asset Ratio

The FHFA proposes a minimum net asset ratio of 20 percent for membership eligibility.² This proposal parallels the “Financial Ratio Minimum Prudent Standards” (MPS) used by the U.S. Treasury’s CDFI Fund³ in its funding applications, and the FHFA may have identified this ratio as a reasonable figure for this reason. In its application for funding, the CDFI Fund suggests that an appropriate net asset ratio (net assets divided by total assets) for non-regulated CDFIs is 20 percent.⁴ A CDFI that receives a grant from the CDFI Fund—the most common form of CDFI investment—will see this ratio increase. The FHLBank System cannot use this ratio in a similar way since assistance through the banks will come in the form of borrowed capital and, in fact, will drive down the net asset ratio if a CDFI obtains an advance from the FHLB. A lower net asset ratio for membership eligibility is more appropriate since CDFIs have sound equity bases and use that equity to leverage debt.

For example, many CDFIs rely on equity equivalent investments (EQ2), which is unsecured debt that has some of the same advantages as equity because it is subordinate to all other debt and carries a rolling term, the investor has a limited right to accelerate payment, and interest is not tied to income. Since these types of investments are subordinate, most audits count EQ2s as capital for the purpose of calculating capital ratios. In the case of CDFIs capitalized with EQ2 investments, perhaps a better identifier would be a capital ratio, which is the percentage of the CDFI’s total assets unencumbered by debt or allow CDFIs to count subordinate debt with indeterminate terms as net assets.

The best solution would be to better align CDFI net asset ratios with those of other financial institutions. According to the Federal Credit Union Act, a credit union is considered well capitalized if it has a net worth ratio of seven percent or greater.⁵ For banks, the FDIC requires for all but the most highly-rated

¹ Definitions are appropriate except in the case of gross revenue, which should not include unrealized gains or losses.

² Net assets are calculated as the residual value of assets over liabilities based on the most recent financial statements.

³ “Supplemental FY2009 CDFI Program Application for Financial Assistance,” Community Development Financial Institutions Fund, U.S. Department of Treasury, www.cdfifund.gov/docs/2009/cdfi (accessed June 22, 2009).

⁴ In addition, a ratio lower than 20 percent does not preclude a CDFI from being considered for assistance from the CDFI Fund; rather, it is a trigger for the CDFI to explain and for the CDFI Fund to review the reasons for the lower ratio.

⁵ Section 216(c)(1) of the Federal Credit Union Act (12 USC 1790d(c)(1)).



institutions that the minimum leverage capital requirement be a ratio of Tier 1 capital to total assets of not less than four percent,⁶ to be considered well capitalized the percentage is five percent.⁷ For a savings association to be considered strong it must have a minimum ratio of core capital to adjusted total assets of three percent and all others must have a ratio of four percent.⁸

OFN suggests that **not greater** than a 10 percent net asset ratio is more appropriate and aligns the requirements for CDFIs more closely with current regulation for other financial institutions.

Earnings Measurement

The FHFA proposes that a CDFI demonstrate that it has generated a positive net income for any of two of the three most recent years to support its earnings measurement.^[1] We request consideration to allow CDFIs to include additional years to support a pattern of positive net income. Given the current economy and the potential time it will take the FHFA to finalize the rule, we believe that it is appropriate to allow CDFIs to provide additional information to prove a history of positive net income rather than relying on just two years.

CDFIs with a 501(c)(3) tax status^[2] that receive grant funding often secure this funding as temporarily restricted, multi-year grants that must be booked as income in the year committed. Nonprofit accounting standards generally call for releasing funds from restrictions when the grant conditions are satisfied. This standard means that nonprofits sometimes have spikes in income from one year to the next and may show losses in the years in which grants are expended at a greater rate than new restricted funds are raised. In this case, many CDFIs have covenants that show a positive net income over a rolling three-year average. Additionally, unrealized income and losses should be excluded from the measurement as these are not true earnings.

We suggest that the FHFA allow CDFIs to demonstrate a pattern of positive net income, excluding unrealized income or losses, using a rolling three-year average as is currently the case for community financial institutions to determine asset size.

Financial Documentation

The financial documentation requirement as proposed works well for CDFIs and would not constitute an unfair burden on the organizations. OFN asks consideration of including "reasonable" in § 1263.16 (b)(iii) allowing the banks to ask applicant's for any other relevant documentation not contained in the applicant's financial statements.

Although nonbank CDFIs are not subject to CAMELS ratings, they may elect to undergo a CAMEL analysis and rating by CARS™ (the CDFI Assessment and Ratings System), an independent, third-party ratings system launched by Opportunity Finance Network in 2004. CARS™ rates the financial strength and performance of CDFI loan funds using a CAMEL methodology. The CARS™ methodology was developed over a number of years based on similar analytic approaches used by bank regulatory agencies and private-sector ratings agencies. Analyses examine five years of historical performance, current financial position, and future risk factors. Audited financial statements, extensive document review, and an on-site examination form the basis of the analysis.

⁶ 12 CFR § 325.3 Minimum leverage capital requirement.

⁷ 12 CFR 325.103(b).

⁸ 12 CFR 567.8.

[1] Net income is defined as gross revenues less total expenses, based on the most recent financial statements. Gross revenues are total revenues received from all sources.

[2] Nondepository CDFIs are overwhelmingly organized as nonprofit institutions. According to the most recent CDFI Data Project, the survey results included only three for-profit loan funds among 508 CDFIs. www.opportunityfinance.net/industry/industry_sub2.aspx?id=236, (accessed June 22, 2009).



Although participation in CARS™ is elective, a growing number of CDFI investors are requiring CARS™ ratings as a condition for investment in loan funds. Thirty investors currently use CARS™ as part of their investment decision making. OFN suggests that those CDFIs that have a CARS™ rating and wish to submit it with an application should be allowed to do so. The FHLBs should use the extensive data in a CARS™ report in lieu of requiring the same data in another form from the CDFI.

Regarding the community support standards, in order to be certified as a CDFI by the U.S. Treasury's CDFI Fund, a CDFI must have a primary mission of promoting community development and primarily serve one or more target markets (in general, areas of economic distress or low-income populations).⁹ In considering the community support performance of most member institutions, the FHLBs assess activity outside the core purpose of those institutions. Because certification of a CDFI is contingent upon community support activities, CDFIs should be deemed to be in compliance with the community support regulation by certification as a CDFI. Additional paperwork to show compliance with the community support regulation would be superfluous for the FHLB and burdensome for the CDFI.

CDFIs as Community Financial Institutions

In the proposed rule, the FHFA asks if there is any basis in legislative history to construe the new community financial institution (CFI) amendments should apply to CDFIs as well as CFIs. OFN asserts that the FHFA is asking the wrong question. Instead, the question should be:

Is there any basis in legislative history to NOT allow the new CFI amendments to apply to CDFIs as well as CFIs?

The answer to this question is a resounding no. CDFIs should be considered CFIs as they serve the same function and will help the FHFA fulfill its mission of both affordable housing and community investment. The U.S. Treasury Department's CDFI Fund already recognizes the link between CDFIs and CFIs since 43 community banks that are members of the FHLBank System are also Treasury-certified community development financial institutions.

Gramm-Leach-Bliley created community financial institutions within the FHLBank System in 2000. That legislation laid out just two characteristics that defined CFIs: 1) FDIC-insured depository institutions; and 2) assets less than \$1 billion, based on an average of total assets over the three years preceding that date. As the proposed rule notes, many CDFIs are loan funds rather than depository institutions. Congress specifically granted membership in the FHLBank System to CDFIs and authorized the FHFA to propose rules that conform consideration of CDFI members to that of regulated entities. Because the final rule will outline the treatment of CDFIs in a way parallel to FDIC-insured institutions, CDFIs will have met requirements analogous to CFIs and should be considered by the FHFA to qualify as meeting that part of the definition.

This leaves the requirement of size. Of all CDFIs that were not eligible for membership under the prior law, ALL but one has assets less than \$1 billion. If the law and the FHFA presupposes that small institutions have different circumstances simply by virtue of being small institutions, then this assumption should also apply to CDFIs, as they too are small institutions.

Gramm-Leach-Bliley authorized community financial institutions to obtain long-term FHLBank advances for lending to small businesses, small farms, and small agri-businesses. Eligible collateral for community financial institutions receiving any FHLBank advances could include secured loans for small business, agriculture, or securities representing a whole interest in such loans. It also exempted them from the eligibility requirement that at least 10 percent of their total assets be in residential mortgage loans. HERA also added community development to the list of eligible activities.

⁹ 12 CFR § 1805.201(3).



CDFIs should be considered CFIs to allow them to do what they do best: Be *responsible* lenders for low-wealth consumers, small businesses, affordable housing, childcare facilities, community facility developers, and others. Not only would this help CDFIs continue to offer much-needed services, but it would also allow CDFIs to help the FHFA fulfill its mission for *both* affordable housing and community investment.

CDFIs operate in rural and urban communities. In fact, 57 percent of CDFIs operate in both rural and urban communities. Through fiscal year 2007, CDFIs have generated or maintained 240,600 jobs, 612,000 units of housing, 8,954 businesses and microenterprises financed, and 6,600 community facilities. Since fiscal year 2001, CDFIs have also provided approximately 49,000 organizations and 931,000 individuals with group-based training and one-on-one technical assistance.

Many CDFIs make commercial purpose loans for land acquisition, predevelopment, and construction. These loans are often made to nonprofits that build affordable housing for low- to moderate-income people. Since this is the first money into a project, the loan terms are usually from two to five years only. By confirming that CDFIs are indeed CFIs, these types of loans can be made with FHLB advances as small business loans.

Finally, the FHFA should consider CDFIs community financial institutions because they ARE community financial institutions. The FHFA's website in the "A History of Service" section states, "...the FHLBank System makes it possible for lending institutions across the country to help families realize the dream of homeownership, stimulate the creation of affordable housing, and improve the local business environment." All CDFIs want is to help the FHLBs continue this work to improve the lives of Americans every day. By acknowledging that CDFIs are CFIs, together we can make a difference in this country's low-income communities.

Other Comments

OFN concurs with the FHFA that the proposed rule is appropriate to the particular structure, program, and organization of the FHLBs and does not need to conform for the other government-sponsored entities.

Section 1263.7 states, "...in the case of a CDFI applicant, is incorporated under state law." It should be noted that a growing number of CDFIs have been formed by Native American groups. These entities are neither chartered under state nor federal law, but rather tribal law. We ask that the FHFA include this important segment in FHLB eligibility.

Section 1263.17 allows presumptions of compliance or noncompliance with certain membership eligibility requirements to be rebutted, upon meeting certain requirements set forth in the rule. This presumption is backwards. The burden of proving that a CDFI is not eligible should fall on the FHLB, not the CDFI. If an entity is a certified CDFI, possesses a valid 501(c)(3) status and a current Form 990, and is in good standing within state or tribal law, the rules should not create a negative presumption.

OFN agrees with the FHFA on its proposed rule for state-chartered credit unions. OFN concurs with the FHFA in general that bank holding companies that are certified as CDFIs should be excluded from CDFI membership alone since the federally-insured commercial bank that owns the CDFI is already eligible for membership in its own right. However, there are rare instances in which a CDFI owns the bank and would ask for flexibility in certain circumstances. For example, the Midwest Minnesota Community Development Corporation purchased a controlling interest in a reservation-based bank (Community Development Bank) in Northwest Minnesota in 2001. The Office of Thrift Supervision has deemed the CDFI to be an upper-tier bank holding company because of its controlling interest. Community Development Bank is a member of the Des Moines FHLB, but the CDFI is not a member in spite of previous attempts. Community Development Bank's membership in the FHLBank System provides important benefits to the bank, but such benefits cannot extend to its parent company. We suggest that CDFIs that are upper-tier holding companies should be allowed membership.



Missed Opportunities

CDFI membership in the FHLBank System will provide a powerful partnership to meet the financial needs of our low-income and low-wealth people and communities across the country. As stated previously, OFN thinks that the proposed rule, with minor revisions, is a tremendous first step in creating this partnership. However, OFN believes that the FHFA missed some opportunities in the proposed rule to help strengthen the FHLBs, CDFIs, and the communities we serve.

Mission Requirements

As you know, the mission of the FHFA is to promote a stable and liquid mortgage market, affordable housing, and community investment through safety and soundness oversight of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. For years, OFN has asked that the FHLBs be accountable to this mission. Yet the FHFA and its predecessor agencies have taken no steps toward analysis of how the FHLBs meet their community economic development and affordable housing mission requirements beyond offering the CIP and allocating AHP funds. The FHLBs are required to publish their community lending plans, but are subject to no analysis, benchmarking, or accountability for fulfilling the community lending plans. In too many cases, the goals are vague and do not offer a specific target for affordable housing and community economic development investments.

Tracking CDFI Membership

Congress provided CDFI access to the FHLBank System in HERA and the FHFA is to be commended for its prompt and diligent response regarding CDFI membership. However, there is no accountability for the FHLBs in providing access to CDFIs. OFN asks that the FHFA consider holding the FHLBs accountable to ensuring that CDFIs have fair access to the FHLBank System. The FHFA should request a report from each FHLB within 12 months of finalizing the proposed rule that provides information about how many CDFIs applied for membership; how many were accepted as members; how many were rejected and why; and the CDFI members' use of advances.

Regional & National CDFIs

Currently applicants can only become members and seek advances from the FHLB of the district where the institution's principal place of business is located. We request that the FHFA consider allowing multi-state and national CDFIs to join FHLBs in the regions they serve as long as they are making loans and providing collateral in that region. Capital advances should also be used on a national basis, if applicable to the CDFI's service area.

Manufactured Housing

OFN asks that the FHFA ensure that the regulations are clear and inclusive regarding manufactured housing and resident-owned cooperative conversion. CFED, in its comment letter, provides detail on this issue and OFN concurs with CFED's comments. In particular, we encourage the FHFA to include manufactured housing community acquisition loans as home mortgage loans, specifically in the multifamily property criteria, as well as in residential mortgage loans. We also ask that whole first mortgages be expanded to include land loans.

Conclusion

When low-income families with children have high housing expenses (more than 50 percent of income), they spend 30 percent less for food, 50 percent less for clothes, and nearly 70 percent less for healthcare than their counterparts with low housing outlays.¹⁰ It is projected that 2.4 million foreclosures are

¹⁰ "The State of the Nation's Housing 2007: Housing Challenges," Joint Center for Housing Studies, <http://www.jchs.harvard.edu/publications/markets/son2007/son2007.pdf> (accessed April 22, 2008).



expected in 2009 and 8.1 million foreclosures over the next four years.¹¹ The needs of low-income communities and their residents are similarly acute.

Today 99.9 percent of U.S. businesses are considered small, defined as having fewer than 500 employees, and those small businesses employ 50.7 percent of the private-sector workforce.¹² America prospers as its small businesses prosper, and CDFIs help small business and microbusinesses prosper in low-income communities. One study found that low-income entrepreneurs reduced their reliance on public assistance by 61 percent during a five-year study. Both the dollar value of welfare benefits and the percentage of respondents who received them decreased.¹³

In a recent speech, Board of Governors of the Federal Reserve System Chairman Ben S. Bernanke stated, "While community development finance is a small part of our overall capital and credit markets, the Federal Reserve recognizes that these financial flows are critically important for many low- and moderate-income communities. In fact, the Board of Governors has been working with several of the Federal Reserve Banks to promote research on how best to promote CDFIs' effectiveness and financial stability."¹⁴

OFN agrees with Chairman Bernanke when he said, "...the Federal Housing Finance Agency recently introduced its rules for public comment on how certified CDFIs can become members of the Federal Home Loan Bank System and access its lower-cost funds, as permitted under recent legislation. Such funding, with known pricing and terms, would be reliable and would help CDFIs manage their balance sheets more efficiently and inexpensively." The FHLBs and CDFIs together can provide enough flexible funding to support a wide variety of housing and concerted community economic development across the country. This partnership is likely to be one of the best tools available to help our lowest-income people and neighborhoods survive this economic emergency.

Thank you for the opportunity to comment. Please do not hesitate to contact me at 215.320.4304 or mpinsky@opportunityfinance.net if you have questions or need additional clarification. I encourage you to finalize the proposed rule as soon as possible.

Sincerely,

Mark Pinsky
President and CEOs

¹¹ Eric Stein, "Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress," testimony before the U.S. House Judiciary Committee Subcommittee on Commercial and Administrative Law, <http://www.responsiblelending.org/pdfs/stein-testimony-on-subprime.pdf> (September 25, 2007).

¹² U.S. Small Business Administration, "Frequently Asked Questions," <http://app1.sba.gov/faqs/faqindex.cfm?areaID=24> (accessed April 15, 2008).

¹³ Peggy Clark, Amy Kays, Lily Zandniapour, Enrique Soto, and Karen Doyle, "Microenterprise and the Poor: Findings from the Self-Employment Learning Project," Washington, DC: The Aspen Institute (1999).

¹⁴ Global Financial Literacy Summit, Washington, DC, June 17, 2009.