FEDERAL HOME LOAN BANK
OF CINCINNATI

April 20, 2006

Federal Housing Finance Board
1625 Eye Street, NW
Washington, DC 20006

Attention: Public Comments

Federal Housing Finance Board
Proposed Rule: Affordable Housing Program Amendments.
RIN Number 3069-AB26.
Docket Number 2005-23

The Board of Directors ("the Board") of the Federal Home Loan Bank of Cincinnati ("the Bank") submits the following as our formal comments on the proposed revisions to the Affordable Housing Program ("AHP") Regulations (12 CFR Part 951) promulgated by the Federal Housing Finance Board ("the Finance Board") and published in the Federal Register on December 28, 2006.

The Board thanks the Finance Board for giving the members of the FHLBank system and others the opportunity to comment.

The AHP is an indispensable tool to assist FHLBanks and their members to address the increasing need for affordable housing,

The Board takes note of several positive elements, as discussed below:

1. Changing the required submission date of the Advisory Council's Annual Report until May 1 (from March 1) offers the Council a better opportunity to summarize the accomplishments of the prior year.

2. Allowing each FHLBank to develop definitions of "sponsor" and include this definition in its AHP Implementation Plan addresses a concern that some sponsors were not involved sufficiently in an AHP project or that the ownership interest of the sponsor was not sufficient to establish any significant control in the project.

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3. Removal of the definition of "habitable" and removal of the requirement that a member certify habitability of an AHP project removes an unnecessary and unwarranted burden for the member.

4. Although the language and intent is somewhat unclear, the provision that an FHLBank can rely on monitoring by a tax credit allocating agency could lessen a duplicative monitoring burden on an FHLBank.

5. The provision to allow Advisory Council members to be appointed for terms of "up to three years" will allow adjustment of terms to allow for better balance of expiring terms and provide greater continuity and stability of the Advisory Council membership.

6. Removing the prohibition by an FHLBank to exclude projects outside an FHLBank's district and prohibiting FHLBanks from giving preferential scoring treatment to in-district projects levels the playing field and respects the market areas of our members wherever they do business.

These are small steps toward improving the AHP regulation and the Board offers the following additional recommendations and suggestions:

1. The proposed regulation does not seem to acknowledge that advances are the Banks' core business. In fact, the regulation seems to place a member using an advance at a disadvantage over a member using a direct grant.

The Federal Home Loan Bank of Cincinnati has always encouraged our members to request and use AHP funding through subsidized advances. This approach is certainly consistent with the statutory authority for AHP, and in fact, direct grants are not mentioned in the statute. The Board believes strongly that when a member uses an AHP subsidized advance, that member will be more intimately involved in the project for a longer period of time. A member making an advance is making a greater level of commitment than simply passing a grant through to a project. However, the proposed regulation would still create disincentives for member to use AHP advances:

Under the existing regulation and the proposed regulation, if all or a portion of the loan or loans financed by an AHP subsidized advance are prepaid by the project to the member, the member is required to do one of two things: 1) repay to the Bank that portion of the advance used to make the loan or loans to the project, and be subject to a fee imposed by the Bank; or 2) continue to maintain the advance outstanding, subject to the Bank resetting the interest rate on that portion of the advance used to make the loan or loans. Historically, our members have chosen the first option and as a result have been subject to a prepayment fee.

The current regulation allows a project to use AHP subsidy to pay prepayment fees imposed by a FHLBank on a member if the member prepays a subsidized advance, provided that the project continues to comply with the terms of the approved AHP application for the duration of the original retention period and any unused AHP subsidy is returned to the FHLBank and made available for other AHP projects. The proposed rule would eliminate this provision, based on the principle that AHP funds should be used only for purchase, construction, or rehabilitation of housing. We contend that a prepayment fee, in these circumstances, is a fundamental part of the project costs and should be allowed as an eligible use of AHP subsidy.

Eliminating the opportunity to use AHP subsidy to pay prepayment fees would place a greater burden on members, would likely cause members to pass some or all of that burden to projects and/or sponsors, or might have a chilling effect on member participation in the AHP.

We encourage the Finance Board to reconsider its position and remove any disincentives to using AHP advances.

2. The proposed regulation would prohibit an FHLBank from employing a "credit use" test to differentiate members' eligibility for AHP subsidy. Those members who use the FHLBank of Cincinnati's credit products more are eligible for more AHP subsidy, even though every member is eligible for at least $100,000 annually. The Bank has successfully employed this credit use test to encourage members to use our credit products, and thereby contribute to the Bank's earnings. Since the AHP subsidy is derived directly from the Bank's earnings, the Board believes strongly that those members who contribute more to the Bank's earnings should have greater access to AHP subsidy. The proposed regulation would eliminate this long-standing provision and would allow all members to access the same amount of subsidy, regardless of their participation in the Bank's credit programs. Eliminating the credit use test would prevent the Bank from using AHP funding as an incentive to encourage borrowing by members and might reduce the size of the AHP pool.

We would encourage the Finance Board to reconsider its position on this matter.

3. The Board is concerned about the purported change from "prescriptive" monitoring requirements to what is described as "risk-based" monitoring. In the narrative to the proposed regulation, there is also reference to "outcome based" monitoring and a focus on "project outcomes" even those terms are not used in the proposed regulation.

The Board believes that an FHLBank should be able to determine for itself what risks an AHP project faces and/or poses and how to monitor and manage those risks. The Board is concerned that an interpretation of the proposed regulation might guarantee nothing but examination findings. If a project has a negative outcome, will the examiners take that as evidence that the risk was not assessed properly?

Projects face difficulty and failure for many reasons, and neither the current regulation nor the proposed regulation give an FHLBank any ability to intervene in any significant way. We are required to monitor, but do not have sufficient tools to help stabilize a project. Some projects fail because of unforeseeable natural disasters – the outcome is failure but no reasonable risk assessment would have predicted it. Some projects lose marketability over a 15-year period. That is not something we can foresee. And if we determine that a project is at risk, what are we to do? Neither the current regulation nor the proposed regulation gives an FHLBank the ability to intervene in a project in a way to mitigate risk or prevent failure.

If a project fails, despite increased monitoring, the Finance Board retains total control over whether funds have to be repaid from the project to the FHLBank or even from the FHLBank to the AHP pool from current earnings. If an FHLBank is to be more involved in identifying troubled projects, we also need more ability to intervene.

We encourage the Finance Board to reconsider its position, allow more flexibility in monitoring, and consider giving FHLBanks more ability to intervene to prevent projects in difficulty from failing.

4. The Board had some expectation that the regulation would be completely rewritten to offer FHLBanks greater flexibility. That does not seem to be the case, especially in two significant areas:

a. The regulation proposed only minor changes in AHP scoring. There are still seven prescribed areas with minimum scoring prescribed and none has been made more flexible. In fact, there is little change in the language, and no changes of any consequence. The scoring would still allow two district priorities, but the list for the first district priority is unchanged as is the language for a second priority. The scoring is still prescriptive.

The Board would urge the Finance Board to allow greater flexibility in determining the areas to be scored, how many points could be allowed in each area, and how the points would be awarded. Regarding the district priorities, the Board would encourage the Finance Board to allow the FHLBanks greater latitude in determining priorities for their districts and allow FHLBanks to define up to six different priority areas.

b. The proposed regulation provides no greater flexibility in modifying projects. Within the last year, the Board was faced with two projects which could not be modified within the existing regulatory provisions. For both projects, the only thing that had changed was that the member merged into an out-of-district member. The Board had awarded AHP advances to each project but the advances could not be disbursed though a non-member; however, the Board also could not modify the projects to make them all grant projects because the projects would not have continued to score high enough after the modification to still qualify for funding.

Nothing changed about the projects – the location, unit mix, sponsor, developer, AHP funding needed, and all other substantive elements of the projects were unchanged. The only change was the member. But because of the lack of flexibility in the existing regulation, the projects could not be modified and were, therefore, no longer eligible for funding. The proposed regulation offers no changes in the modification requirements or procedures.

For these two projects, the Bank formally requested a waiver of the relevant regulatory provisions. However, staff provided a "no action" letter instead.

The Board encourages the Finance Board to allow greater latitude to FHLBanks to modify AHP projects under extraordinary conditions, even if the modifications would not ordinarily be permitted.

The Board encourages the Finance Board to reconsider the proposed regulation and address issues of flexibility in scoring and modification, the disparate treatment of different project types, and give more support to the FHLBank's core lending business.

Respectfully submitted,

Charles J. Koch, Chair