FHLBBoston

April 25, 2006

Federal Housing Finance Board
1625 Eye Street, N.W.
Washington, DC 20006
Attention: Public Comments

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

The Federal Home Loan Bank of Boston (the Bank) appreciates the opportunity to comment on the proposed Affordable Housing Program (AHP) rule. The proposed rule is intended to improve the overall usefulness of the AHP. It does not, however, accomplish the long-discussed comprehensive restructuring of the AHP regulation.

Some of the proposed changes are easily incorporated or codify current Bank practices. Others have a more far-reaching impact on the Bank, its member financial institutions, and district housing developers.

During 2003 and 2004, the Federal Housing Finance Board (Finance Board) undertook a comprehensive review of the AHP. The result was a thorough and well-documented Systemwide report that made significant recommendations regarding the program and how it could be improved. The proposed amendment does not address a number of the matters discussed in the Finance Board's *Report of the Horizontal Review of the Affordable Housing Programs of the Federal Home Loan Banks* (March 15, 2005).

In particular, the report highlighted the need for each Federal Home Loan Bank (FHLBank) to establish a scoring methodology based on the housing needs of its district. However, the proposed amendment makes no substantive changes to the current AHP scoring system and does not allow an FHLBank to develop its scoring methodology based on the identified affordable housing needs of its district.

This commentary summarizes the Bank's assessment of the amendment and responds to the Finance Board's request for comments. The Bank requests that the Finance Board clarify and revisit several of the proposed changes. The Bank has framed its commentary by responding to the seven changes identified by the Finance Board and by addressing these changes in the section-by-section framework of the proposed amendments to the rule.

Three of the Finance Board's seven principal amendments to the AHP regulation pose no significant impacts on the operation of the AHP. They include:

1. Incorporating additional definitions into the regulation;
2. Reorganizing the regulatory text to separate the operational provision of the competitive AHP and homeownership set-aside programs; and

3. Mandating that an FHLBank's set-aside program (in our case, the Equity Builder Program) must require members to use one-third of those funds only for first-time home buyers, and removing the provision that annually increases the homeownership set-aside program and its maximum allowable dollar acceleration amount under the FHLBank's competitive application, based on the annual inflation rate.

The Bank appreciates the Finance Board's intent to streamline, clarify, and reorganize the AHP regulation to improve the understanding of the program. These changes are administrative and technical in nature and can be integrated into the Bank's business processes with minimal difficulty, cost, or exposure to additional risk.

One principal amendment removes the provision that allows an FHLBank to accelerate contributions from the following year into the current year. While the Bank has not needed to utilize this authority, other FHLBanks have found it beneficial. The Bank believes that preserving this authority in the regulation provides a mechanism that can be useful if the circumstances arise and, therefore, opposes the removal of this provision.

Three of the proposed changes represent significant changes to the Bank's AHP and will require modifications to program operations. They include:

1. Restricting the use of AHP funds by projects located outside an FHLBank's district and scoring preferences for in-district projects;
2. Allowing the use of AHP subsidy by loan funds and loan pools; and
3. Allowing FHLBanks to monitor projects using a risk-based methodology.

Prohibition Against Restricting Out-of-District Projects

This change would require the Bank to allow its members to apply for AHP funds for initiatives outside the district. The Bank is the only FHLBank that prohibits its AHP funds from being used in out-of-district developments. The Pittsburgh and Seattle FHLBanks currently award scoring points for in-district applications. Since 1990, the Finance Board notes that just a little over three percent of the total AHP funds awarded by the other 11 FHLBanks have gone outside the districts that originated the AHP award. In fact, New England has benefited from AHP awards from the New York, Cincinnati, and San Francisco FHLBanks. While the Bank does not embrace this change, there appears to be little support elsewhere in the System for our regional view.

This change will necessitate the expansion of the Bank's AHP-based data and information resources to accommodate market and project information outside New England for the feasibility review of out-of-district applications. It will also require the Bank to increase its monitoring capacity to ensure that projects outside the district are constructed and remain in compliance. The Bank's new state-based mortgage and note templates will require additional amendments in order to comply with the correct use of the prescribed legal-retention mechanism pursuant to each respective state's general real estate and recording laws. Because the Bank's earnings are derived from district-based members, only a few of which have lending areas outside the region, the Bank expects that many members, sponsors, the Advisory Council, and other stakeholders will be opposed to this change. However, the Bank believes it can reasonably make the required changes.

Loan Pools and Loan Funds

The Bank recognizes the potential value in loan funds and loan pools as a potential resource for members and sponsors. The proposed rule provides little guidance on the use of AHP funds by loan funds and loan pools. In order to accommodate the proposed rule change, the Bank will have to adopt appropriate policies and procedures, expand its information-technology infrastructure, and develop expertise in underwriting loan pools and loan funds to determine eligibility for participation in the AHP.

In initial discussions with New England-based loan-fund administrators, the majority indicated they would only consider the use of AHP funds if the restrictions were appropriate to the amount of AHP being utilized. If the restrictions are too onerous or burdensome, the value of the AHP decreases substantially for them. Determining the viability of a loan pool or fund essentially requires underwriting the management; financial structure; policies and procedures; and compliance mechanisms of such organizations.

Loan-pool administrators and others have identified several key questions:

1. Why would the Finance Board allow loan funds and loan pools to lend and recycle AHP subsidy, but not allow the Bank's members to do so? Additionally, caution is recommended in developing regulatory language that inadvertently results in loan pools/funds having an unfair advantage to compete with member financial institutions.
2. How does the Bank evaluate/underwrite a loan fund for sound business practices and fiscal sustainability under the proposed amendments and ensure recapture of improperly used subsidy by a borrower if the loan fund or loan pool itself fails?
3. What are the "applicable eligibility requirements" under the AHP regulation? Which of the established requirements will not apply to loan funds and loan pools and which will apply?
4. Would any loan-fund or loan-pool application require that the Bank approve the loan fund's or loan pool's underwriting policies to ensure effective compliance with and confidence in their making eligible loans?
5. Won't there be a clear conflict with the timing requirement of the AHP regulation that the funds are likely used within 12 months?
6. How would the monitoring requirements for loan funds and loan pools impact members and the Bank whose AHP funds will have to be monitored quite differently?

The Bank has had considerable experience in funding AHP-assisted mortgage-financing applications administered by a variety of nonprofit organizations. There are specific issues that need to be addressed. The Bank recommends that the amendment ensure that each FHLBank is able to establish the governing policies that it finds necessary to properly administer such a program. The Bank also recommends that the Finance Board further amend the proposed rule to allow an FHLBank to establish separate set-asides, at its discretion, for loan funds or loan pools, that would be subject to appropriately constructed policies and procedures, reviewed by the FHLBank's Advisory Council, approved by the FHLBank's board of directors, and appropriately incorporated into the FHLBank's implementation plan. However, the Bank's Advisory Council believes that additional separate set-asides only dilute AHP funds, and therefore is not a value-added option.

Risk-Based Monitoring

The Bank recognizes the potential benefits of this amendment and welcomes the ability to monitor projects based on outcomes rather than the current subsidy-level and calendar-driven processes. We believe this change, if designed properly, would result in a more effective monitoring system that could reduce expenses and unnecessary burdens on members and sponsors. The Bank believes that these costs could be reduced for district-based projects under the Finance Board's proposed amendment without increasing the Bank's compliance, financial, or reputation risks.

Section-by-Section Analysis

Definitions – §951.1

The modification of existing definitions and the addition of new defined terms in the proposed amendment bring greater clarity to the rule. Many codify the Bank's current understanding and existing practices. The following are viewed as positive changes:

- The proposed rule would modify the definition of a "sponsor" to require each FHLBank to define in its implementation plan what "ownership interest" and "integrally involved" mean. The Bank believes this is beneficial, as it would give FHLBanks the additional ability to eliminate the possible gaming by nonprofit sponsors for scoring points in rental projects of entities having no more than a nominal stake in a project;
- The proposed rule would also modify the definition of "affordable" to include those units that are subsidized by Section 8 rental assistance, provided the rent at initial occupancy complies with the AHP and continues to comply with the Section 8 agreement for that household; and
- The proposed rule should ensure each FHLBank's ability to establish income definitions and parameters that are consistent with those utilized by larger HUD and Treasury programs.

Further clarification is requested for several terms:

- The proposed rule would add the definition "AHP project" to differentiate households that would receive homeownership set-aside grants from those that would receive competitive funds. The Bank requests that the Finance Board further refine this definition to include what constitutes a project. This has particular implications on rental projects where AHP funds are used to fund multiple buildings within a contiguous area or scattered-site projects for recapture purposes.

- The proposed rule would amend the definition of "retention period" to provide that the five-year retention period for rehabilitation of an owner-occupied project commence upon completion of rehabilitation work. Under the existing regulation, completion is based on the closing date. Most owner-occupied rehabilitation projects do not receive a certificate of completion because of the scale of work. They may not have an actual closing. Therefore, the Bank requests that it be allowed to define "closing" in its implementation plan for purposes of retention agreements for owner-occupied rehabilitation projects.

<u>Required Annual AHP Contributions; Allocation of Contributions – §951.2</u>
The proposed rule would add a proviso to the pro rata sharing formula to prevent any FHLBank from contributing more than the total amount of its net earnings in the previous year. The Bank views this as a technical safety provision for each FHLBank. The Bank requests that the Finance Board add the provision that, if an FHLBank is required to overpay in a given year, that FHLBank will have a carry-forward credit against future required AHP contributions.

<u>AHP Implementation Plan – §951.3</u>
The proposed rule would add the following requirements to each FHLBank's implementation plan:

- Retention-agreement requirements for both the competitive and set-aside programs; and
- Monitoring requirements for both the competitive and set-aside programs.

It also would require that each FHLBank's implementation plan be published on its web site within 30 days after adoption of any amendments to it. The Bank already does so and supports these changes.

The proposed requirements also appear to change the structure of the implementation plan from a high-level governing document to a more detailed technical and procedural document. In this context, there is significant ambiguity in the proposed rule about the degree of information to be included in the implementation plan as policy-level information and apparent drafting variances regarding which policies and procedures are to be acted upon respectively by Advisory Councils and boards of directors within or separately from the Bank's implementation plan.

This is an unusual and unnecessary change from current practices, where FHLBanks have traditionally developed detailed policies and procedures to govern the day-to-day operations of the competitive and set-aside programs. If adopted, the Bank requests that the Finance Board clarify the extent to which operational policies and procedures are required in the implementation plan under the proposed rule.

<u>Advisory Councils – §951.4</u>
The proposed rule would make five relatively minor changes to the structure of Advisory Councils, including:

- Requiring each FHLBank to adopt additional policies governing the appointment process;

- Providing FHLBanks the flexibility to appoint members for terms shorter than the current prescribed three-year term;
- Requiring the Advisory Council to appoint a chair and vice chair;
- Adding a specific listing of matters on which the Advisory Council is to advise an FHLBank's board of directors (allocation of AHP contribution between the set-aside and competitive programs, eligibility criteria for each program, scoring criteria for the competitive program, priority criteria for the set-aside program, and the implementation plan); and
- Extending the annual deadline for an Advisory Council to submit its report on community lending activity from March 1 to May 1, and requiring that it be published on the FHLBank's web site.

In the Bank's view, these changes are positive and are designed to enhance communication among each FHLBank's board of directors, its Advisory Council, and the public.

<u>Competitive Application Program – §951.5</u>
The proposed change to this section consolidates many of the existing regulatory provisions governing the competitive program located in different sections of the current regulation and makes certain changes in the existing regulatory structure. However, without any substantial changes to the AHP scoring methodology, it limits each FHLBank's ability to be flexible in designing a scoring methodology that meets the needs of its respective district. The hard work over many years by the Finance Board, the FHLBanks, and their respective Advisory Councils and boards of directors to accomplish this goal may be lost if it is not incorporated in the proposed amendment at this time.

In this context, the Bank requests the Finance Board consider providing the FHLBanks more flexibility in establishing district priorities and scoring requirements, rather than continuing the prescriptive First and the current Second District priority mechanisms in the existing AHP regulation. Specifically, the Bank requests the removal of the First and Second District priority categories from the regulation and the addition of a single district priority weighted at comparable point values with the current First and Second District priorities. The Bank recommends that the FHLBanks be allowed to identify and assign points within this new district priority for up to five elements agreed to by the FHLBank's Advisory Council and board of directors.

In addition:

- The proposed rule would no longer allow an FHLBank to receive an AHP application from a financial institution whose membership is pending. This does not significantly impact the Bank;
- The proposed rule would also not permit an FHLBank to require a member, as a condition to participation in the competitive program, to use a minimum amount of the FHLBank's other credit products. The Bank requests further clarification as to the necessity of removing this provision and would oppose its removal;

- The proposed rule would prohibit a project from using an AHP subsidy to pay prepayment fees imposed by an FHLBank if the member prepays a subsidized advance, even if the project continues to comply with the terms of the approved application and original retention period. The removal of such authority would limit members' use of subsidized advances because of the increased exposure to prepayment fees. Strategically used, subsidized advances provide long-term benefits to members and projects, and assist in mainstreaming affordable-housing financing. It also effectively leverages AHP and other grant funds; and
- The proposed rule also would modify and separate the eligibility requirements of need for subsidy, project costs, and project feasibility, which will have varying degrees of impact on approving in-district and out-of-district projects. These changes will have information-technology implications, change the structure of the AHP application, and alter how applications will be reviewed and approved.

Section (6) *Timing of AHP subsidy use.* This part makes no changes to the 12 months from the date of approval that a project has to draw or use AHP funds to procure other financing. It is the Bank's belief and experience that this should be increased to 24 months given the increased complexity of assembling funding, receiving zoning approval, and achieving a project's construction start. To this end, the Bank requests that the Finance Board revisit its decision to leave the threshold at 12 months.

Sections (13) and (14) *Use of AHP subsidy by revolving loan funds* and *Use of AHP subsidy in loan pools.* This part presents significant scoring and monitoring challenges for an FHLBank's AHP and would require significant overhaul of its information-technology infrastructure. The proposed amendment requires that each project be comparable on an individual basis with other projects using the same scoring criteria. The reality is that loan funds and loan pools use a single grant to benefit multiple projects or persons that are not identified upfront, and, therefore, would be difficult to compare against projects with predetermined locations and beneficiaries.

Loan funds and loan pools are simply not projects and should not be confused in the regulation as such. The Bank also believes the structure of loan funds and pools would make monitoring them unworkable, or at a minimum, extremely difficult. Even though our Advisory Council does not favor additional set-asides, the Bank recommends that the amendment allow each FHLBank, at its discretion, to establish separate set-aside programs for loan funds and loan pools, subject to appropriately established policies and procedures incorporated as required in each FHLBank's implementation plan.

One potential solution to overcoming some of the challenges of administering loan funds and loan pools is to ensure that the first generation of beneficiaries is specifically assisted with AHP funds. This would require the establishment of benchmarks at the beginning of a loan-pool or loan-fund structure articulating how beneficiaries would be benefited. Thereafter, it would be a matter of establishing an effective policy for recycling and risk-based processes for loan-fund and loan-pool structures benefiting successor generations of beneficiaries.

<u>Homeownership Set-Aside Program – §951.6</u>
The proposed amendments to this section are interpreted as changes to provide each FHLBank some flexibility with administering its homeownership set-aside program. There are two changes to note:

- The proposed rule would no longer allow an FHLBank to receive an AHP application from a financial institution whose membership is pending. This does not significantly impact the Bank; and
- The proposed rule would make completion of a home-owner or home-buyer counseling program optional. The Bank's existing set-aside program requires that home buyers receive prepurchase and postpurchase counseling and education on the characteristics of predatory lending. This education is a valuable tool in assisting all home buyers transition to homeownership and it is expected that the Bank will continue this practice.

The Bank also requests clarification and further amendments to the following:

- Section (3) *Maximum grant amount.* This part allows a cap of $15,000 in AHP subsidy per household to write down the cost of purchasing a home. It is the Bank's belief that this amount should be increased to appropriately account for the high cost of homeownership housing in certain areas. At a minimum, an FHLBank should be given the discretion to establish in its implementation plan a limit based on specific factors in its district, including other available funding sources, the amount of affordable housing inventory for sale, and other economic determinants that impact the cost of housing. The Bank requests that the Finance Board revisit this issue;
- Section (6) *Member financial incentives.* This part says that a "…Bank shall establish incentives for members to provide financial or other assistance in connection with providing the AHP subsidy." This language is ambiguous and as written appears to suggest that an FHLBank provide incentives for its members. The Bank requests clarification from the Finance Board on exactly what it expects with this provision. There is no comparable requirement in the current regulation and no discussion of the Finance Board's rationale for this requirement in the preamble of the proposed amendment. The Bank's understanding of this provision is that an FHLBank must establish a list of eligible and acceptable incentives for its members to provide to home buyers and the FHLBank must list those incentives in its AHP implementation plan; and
- The Bank also requests clarification on whether its set-aside program may be limited to in-district use by members. The proposed amendment's prohibition of in-district project preference appears only to apply to the competitive application program.

With regard to the Finance Board's specific request on financial incentives, the Bank's Advisory Council is steadfast in its policy that members, regardless of their size, provide incentives to home buyers when originating end-mortgages. These incentives are not viewed as burdensome because members are able to choose from categories that include financial and nonfinancial incentives. Members provide a variety of relevant and effective concessions to home buyers.

In addition, the Bank's current set-aside program, the Equity Builder Program, requires that members who want to participate in the program partner with an experienced counseling organization to provide prepurchase and postpurchase counseling and education that alerts borrowers to the characteristics to predatory lending. The Bank and its Advisory Council view this threshold as an important component of the set-aside program.

Monitoring – §951.7

The proposed amendments to this section make several changes to monitoring for competitive applications and homeownership set-aside programs. In particular, the Bank supports the provision that allows for the development of a flexible monitoring scheme, including the ability to employ a risk-based monitoring system. The proposed amendment also changes several key procedures:

- It replaces the existing calendar-driven deadlines under the initial monitoring scheme, replaces it with "reasonable period," and requires each FHLBank to adopt policies and procedures for owner-occupied and rental projects;
- It removes the existing requirement to monitor for habitability;
- Its long-term monitoring requirements allow for the consideration of certain risk factors, including the amount of AHP subsidy, type, size, location, sponsor experience, and any additional monitoring by federal, state, or local entities; and
- It expands the FHLBanks' ability to rely on monitoring by other governmental agencies in connection with the administration of federal Low Income Housing Tax Credits.

The Bank requests that the Finance Board clarify the following:

The proposed amendment uses the term "reasonable period" for determining reporting requirements. This language is ambiguous and is subject to interpretation. Differing interpretations potentially expose the FHLBanks to unnecessary examination scrutiny. There is no discussion in the preamble of what is "reasonable." The Bank requests clearer language and recommends that each FHLBank, after consultation with its Advisory Council, establish its monitoring system for its competitive and set-aside programs in its implementation plan. The Bank also recommends that the implementation plan be reviewed, approved, or recommendations made for changes by the Finance Board within 30 days of an FHLBank's submission of the plan or changes to it.

Remedial Actions for Noncompliance –§951.8

The proposed amendments to this part are interpreted as giving the FHLBanks flexibility to recover subsidy directly against a project sponsor/owner in the event of noncompliance, whereas the existing process requires the member to collect the subsidy from the sponsor/owner. The Bank has used its authority to recapture under this existing regulation and welcomes the additional authority to recapture funds directly from project sponsor/owners as warranted.

Agreements – §951.9

Section (5)(i) *Project monitoring by the member* requires an FHLBank's AHP agreement with a member to require the member to comply with an FHLBank's monitoring policies and procedures as set forth in the agreement. The Bank believes this to be unnecessary as the AHP regulation and requirements are incorporated by reference in the AHP agreements. The adoption of any new amendments to the regulation or policies or procedures to an FHLBank's monitoring requirements could then require an FHLBank to obtain amendments to each outstanding AHP agreement.

This proposed rule adds another layer of complexity to the retention requirements for rental projects by allowing a project owner to potentially escape recapture liability with the sale of a rental project if the owner relocates the benefited households to another property made subject to the terms of the approved AHP application and to a new retention mechanism.

In this context, it may provide noncompliant owners the ability to delay repayment of misused AHP funds or encourage owners to relocate tenants to less desirable properties for the purposes of developing the subject property for market use. The Bank recommends that this provision become an option for an FHLBank, but not provide a means in the regulation for owners with the right to relocate tenants at their option and in all circumstances to avoid recapture.

Conflict of Interest – §951.10

The Bank's board of directors and Advisory Council already have adopted strong conflict of interest policies. The additional regulatory language to cover their respective family members is included in the Bank's extant policies.

Temporary Suspension of AHP Contributions – §951.11

The proposed amendments to this section are interpreted as technical changes with which the Bank expects it can reasonably comply.

Affordable Housing Reserve Fund – §951.12

The proposed amendments to this section are interpreted as technical changes with which the Bank expects it can reasonably comply.

While the proposed amendment is intended to provide flexibility and clarity for FHLBanks, it falls short of this goal in many instances. New authority with respect to risk-based monitoring and loan funds and loan pools, for example, comes with little initial direction for implementation and raises many questions. The Finance Board has invited comments. The Bank requests that those comments and further amendments or additional provisions that result be made available in draft before promulgation of the new AHP regulation.

In addition, although the proposed regulation has been streamlined, it blurs the distinction of which provisions should be enforced through each FHLBank's AHP implementation plan and which should be implemented through policies and procedures. It creates the potential for unwise and unnecessary conflict between FHLBanks and Finance Board examiners regarding program basics.

Many of the operative changes and new opportunities proposed by the regulation will require the Bank to invest in additional resources, including upgrading its information-technology infrastructure, providing increased training, and hiring additional underwriting staff.

In closing, the Bank thanks Finance Board members and staff who have worked diligently on bringing these proposed amendments to a comment period. The Bank looks forward to further discussions with the Finance Board on this important matter.

Sincerely,

Michael A. Jessee
President and Chief Executive Officer