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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

I appreciate the opportunity to comment on the proposed revisions to the Affordable Housing Program regulations.

It appears as though the proposed regulation is little more than a reorganization of sections. There do not appear to be many rewrites that offer greater flexibility or to resolve any of the issues which have arisen as unintended consequences of the existing regulation that have been identified over time.

The following issues give me cause for concern and I would like to see them removed from the proposal with fallback to the existing regulation unless additional changes can be made to remove the unintended consequences which I foresee occurring.

Advances as core business - The proposed regulation does not seem to acknowledge that advances are the FHLBanks' 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 FHLBank of Cincinnati has always encouraged 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. When a member uses an AHP subsidized advance, that member will be more intimately involved in the project for a longer period of time. However, the proposed regulation would still create disincentives for a member to use an AHP advance.

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.

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 has two options: 1) repay to the FHLBank that portion of the advance used to make the loan or loans to the project, and be subject to a fee imposed by the FHLBank; 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 proposed rule would eliminate the ability to use a portion of the AHP subsidy to pay the prepayment fee, apparently based on the principle that AHP funds should be used only for purchase, construction, or rehabilitation of housing. I would submit that prepayment fees could be considered a customary part of financing the purchase, construction, or rehabilitation of housing and therefore should be an eligible cost of development like other typical soft costs. Eliminating the use of AHP to pay prepayment fees would place a greater burden on members, would likely cause members to pass some or that entire burden to homeowners, project owners and/or sponsors, and could have a chilling effect on member participation.

Flexibility in Scoring - 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 change of any consequence. The prescriptive 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.

Flexibility in Modifications - The proposed regulation provides no greater flexibility in modifying projects. Within the last year, the FHLBank of Cincinnati 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 FHLBank had awarded AHP advances to each project but the advances could not be disbursed though a non-member; however, the FHLBank 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.

The issue is the requirement that the project be rescored as modified and stays within the funded range. In the instance where the only issue is that the member has lost membership in a particular Federal Home Loan Bank and no other member can be found to take over the project, then I would suggest that the rescoring requirement for Member Participation be waived if it presents a problem. This would not put the financial viability of projects in jeopardy, especially if they have been started and are well on their way to completion. The regulation should avoid unintended consequences where possible.

Credit Use Test - The proposed regulation would reverse a current provision and would prohibit an FHLBank from employing a "credit use" test to differentiate members' eligibility for AHP subsidy. Those members who use an FHLBank's credit products contribute to an FHLBank's earnings and therefore generate more funds for the AHP. 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, or lack thereof, in the FHLBank's credit programs. Eliminating the credit use test would prevent the FHLBank from using AHP funding as an incentive to encourage borrowing by members and could foreseeably reduce the size of the AHP pool.

Retention Language – In both the existing regulation and in the proposed regulation, there is an inconsistency in the retention requirements for ownership projects vs. rental projects. In the case of a sale or refinancing of an owner-occupied unit, there is a requirement for pro rata repayment from net gain realized; for rental projects, there is a requirement for full repayment.

Requiring the full repayment of AHP subsidy for rental projects is inconsistent. A pro rata repayment should be considered for use of subsidy over time as well as the possibility of a pro rata per unit subsidy recapture.

A core problem with the existing and proposed retention language is that if one unit in a 100 unit project is out of compliance, the whole project is out of compliance and therefore the subsidy must be repaid in full instead of on a pro rata basis. In year 15 of a rental project's operation, if a unit burns and the insurance company decides not to replace it, the full amount of any AHP subsidy is required to be repaid. This seems punitive and another unintended consequence.

Requiring the full repayment of AHP subsidy could have a detrimental affect on the financial viability of a non-profit sponsor/project owner. Many not-for-profit organizations do not have the financial wherewithal to cover such an expense. The pro-ration of AHP subsidy recapture in rental projects, on a unit and time used basis, is a sound business practice which will keep the housing operational.

Full recapture of AHP subsidy should be used as a punitive measure under the portion of the regulation regarding Remedial Actions for Non-Compliance and not a retention requirement.

Monitoring: Risk vs. Outcome - We are 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 though those terms are not used or defined in the proposed regulation.

Projects face difficulty and failure for many reasons. The Bank is required to monitor, but does 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 an FHLBank can foresee. An FHLBank may approve a HUD 202 or 811 project which could be considered "low risk" as they are monitored and controlled by HUD and have operating subsidies which are considered "stable" although not guaranteed. If HUD pulls its operating subsidy, the project suddenly becomes insolvent – as HUD requires a project operate at a one-to-one ratio and in reality projects frequently operate in the red until it can be demonstrated that more operating subsidy is needed. This is a prime example of a low risk project may fail through no fault of project owner/management or due to lack of monitoring.

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. To base examination on outcome with no tools to direct an outcome is not rational. 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. We are concerned that an interpretation of the proposed regulation might guarantee nothing but examination findings.

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, the FHLBank also needs more ability to intervene.

The following scoring issues should be reconsidered for revision.

Empowerment scoring - Several of the FHLBanks used Empowerment Scoring to include factors which seemed to empower households in ways that were deemed unacceptable by the examiners. Some of these empowerment activities included health and mental health care, transportation services, day care and elder care, etc. Most of the services seemed clearly to connect households better to their communities and empowered the populations

served. Several of the FHLBanks expressed to the examiners and to Finance Board staff the hope that in a revision to the regulation that some of these empowerment services would be included. It appears that there is no change in this section and no acceptance of a broader concept of "empowerment."

Donated property scoring – The proposed regulation makes no changes regarding the scoring for donated property. New interpretations from examiners during 2005 made it clear that points had to be awarded regardless of the source of the donation, even if it was a related party. Giving points for donated property is valuable, but there should be the ability to disregard donations/nominal cost transfers made not as part of this current project or from closely related parties.

"Welfare to Work" scoring " There is no longer any Welfare to Work federal program (according to the Department of Labor, the program officially ended on September 30, 2004) and there has been no guidance from the Finance Board on what other program or elements would qualify to receive such points. In the now defunct federal program, there were people on welfare who needed improved job skills, there were work and training programs targeted to them, and there were tax incentives to employers to hire the workers. What is an allowable substitute for this program?

District priorities – The district priorities in the current regulation, carried intact to the proposed regulation, came from a list of special targeting/priorities in existence among the FHLBanks when the existing regulation was written. Many of the priorities in the list have become obsolete over time and there are many other priorities which FHLBanks would like to identify and use.

I believe that the following areas of the proposed regulation need to be clarified to insure the intention is clear.

Value of donated professional labor and land - The regulation proposes to eliminate the requirement that a project's development budget "include estimates of the market value of in-kind donations and volunteer professional labor or services." The removal of in-kind donations and volunteer professional labor causes a reduction in overall project costs and thereby may severely limit the ability of small, rural, Appalachian non-profits to produce housing because the amount of Developer Fee they could charge could be drastically reduced. Most of these organizations utilize Developer Fee to cover cost overruns and to pay a small support staff crucial to operations. This value can be documented and is "real" even though it may be a wash on paper.

In the narrative to the proposed regulation, it is indicated that "elimination of this requirement would obviate the need for the Finance Board's Regulatory Interpretation 1999-03...". However, that Regulatory Interpretation also states that the "sponsor's cash contribution must include the present value of any

payments the sponsor is to receive from the buyer." It is unclear whether the revision to the regulation means that the procedures outlined in RI 99-03 will be obsolete or that just the in-kind donations and donations of professional labor are obsolete.

Monitoring: Relying on Tax Credit agencies - An FHLBank may rely on monitoring by a state housing credit agency of the income targeting, rent, and retention period requirements applicable under the LIHTC, provided that the compliance profiles of the AHP and the LIHTC continue to be "substantively equivalent." However, it is unclear what "substantively equivalent" means. The Finance Board concluded that currently the standards were similar enough that the state housing credit agency administering the tax credits could perform the monitoring on behalf of an FHLBank. But it is unclear how much the LIHTC's standards could change in the future and still be considered "substantively equivalent" to the AHP standards.

No "cash back" at closing - The regulation is clear that in the homeownership set-aside program there should be no cash back to a homebuyer at closing. However, the regulation implies that funds can be used to "further reduce the principal of the mortgage loan." In effect, the buyer gets cash back in the transaction but is required to use that amount to prepay the mortgage. There is a difference between reducing the original principal amount of the mortgage and prepaying the mortgage. By reducing the original principal amount, the monthly payments to the borrower would be less because the mortgage amount is lower – the mortgage is more affordable. By prepaying the mortgage, the monthly payments would still be based on the original mortgage amount, but the buyer would increase his/her equity by paying down the principal. Having additional equity in the home does not make the home more affordable. The regulation should be clear that there can be no cash back at closing and that the mechanism to accomplish that is to reduce the original principal amount at closing, not to prepay the mortgage at time of closing.

Set-aside eligibility determination – According to the proposed regulation, a household's income eligibility is to be determined at the time that it is enrolled in the set-aside program (not at the time the household is qualified for a loan), even though these timings may differ. Is it your intention that the timings be different or is it your intention that the household's income eligibility be determined based on the income earned at the time the household submits an application to a member for a loan and not future income and/or the income of persons who will not reside in the unit?

Financial incentives in the set-aside program –Proposed 951.6 (c) (6) says "The Bank shall establish incentives for members to provide financial or other assistance in connection with providing the AHP direct subsidy." Do you intend for the FHLBank's to provide financial concessions to members to

participate in the program or do you intend for members to provide incentives to the homebuyers?

Any financial incentive should be determined by an FHLBank in its Implementation Plan and an FHLBank not be required to provide any incentive to members to participate.

Your attention to my comments is appreciated.

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