AHP Notice of Proposed Rulemaking

Affordable Housing Advisory Council Leadership Group

April 26, 2018

Background

FHLBANKS
A NATION OF LOCAL LENDERS

Background

- In October 2014, the FHLBank AHAC Leadership met with the FHFA to propose AHP regulatory reform and opportunities for change to maintain the AHP's strong reputation and make AHP a more impactful force.
- The AHAC Leadership had five high level requests for modernization.

Background

- Harness the wisdom of our diversity by allowing the FHLBanks flexibility to decide how to invest their resources to best meet the housing and community development needs of their districts by simplifying the prescribed elements of the scoring matrix.
- Redefine “Need for Subsidy” to include supportive services, appropriate reserve levels, and promote long term sustainability of affordable housing.

Background

- Align the AHP with other major funding agencies to align the AHP feasibility benchmarks, reduce redundancy of oversight, and subordinate AHP requirements where conflicts exist.
- Re-orient to a culture of mission-based investment by improving the FHLBanks’ ability to resolve noncompliance with prorated rental recaptures and project restructuring.
- Go beyond housing and allow a portion of the AHP allocation for some economic development.

General Observations

FHLBANKS
A NATION OF LOCAL LENDERS

General Observations

- The AHP proposed rule was expected to offer regional flexibility, taken as a whole, it increases regulatory control, program complexity, and reduces award transparency, for FHLBanks, Members, and Sponsors.
- In effect the proposed rule creates a national, prescriptive program reducing the local responsiveness of each FHLBank and discounts, ignores, and negates the diverse expertise of the Advisory Councils and their partnerships with the FHLBanks' and their Boards of Directors.
- Members are affected in that they will be less likely to apply for awards due to the complexity and administrative burden for small community lenders with the unintended consequence of shutting out those lenders and the communities they serve.

FHLBANKS
A NATION OF LOCAL LENDERS

General Observations

- The proposed rule seems to incorporate “Duty to Serve” ideas. The FHLBank, although a GSE, is not FNMA or FHLMC. AHP is a privately sourced fund generated by the Members of the FHLBank System.
- FNMA/FHLMC creates a source of liquidity for the market as opposed to AHP providing supplemental funding in a niche market. The combination of Boards, AHACs, and FHLBank Staff have a proven record of demonstrating successful program management.
- The AHP provides synergy for projects to happen, but in terms of magnitude or resources, is very small. FNMA/FHLMC has the magnitude to control outcomes but the FHLBanks can merely play a supportive role.

Favorable Proposed Changes

Favorable Proposed Changes

- AHP Set-Aside Maximums
- Concept of Targeted Funds
- Reduced Monitoring Requirements

AHP Set Aside

- Increase in maximum allocation from 35 percent to 40 percent of required annual AHP contribution
- Increase in maximum subsidy per unit from $15,000 to $22,000
- Annual adjustment to maximum subsidy per unit

Targeted Funds

- Provides FHLBanks' ability to target specific affordable housing needs within their districts.
- However, as presented later, the AHACs have concerns about the regulatory priorities requirements, which negate the potential positive impact of allowing FHLBanks to establish Targeted Funds ("TFs")

Monitoring

- Streamlines monitoring requirements for competitive projects using certain federal funds, which recognizes natural synergies between the AHP and other affordable housing funding sources.

Areas of Concern

Areas of Concern

- Insufficient Comment Period
- Regulatory Outcome Requirements
- Expanded Targeted Community Lending Plan Requirements
- Sponsor Capacity
- Need for Subsidy
- Increased Governance Requirements
- Required Funding of Alternates
- Scoring
- Modifications
- Owner-occupied Retention Agreements

Comment Period

- The Proposed Rule introduces new and complex requirements that would result in significant changes to the AHP.
- Given the importance of the AHP to FHLBank members, program Sponsors, stakeholders, and the communities they serve, adequate time is needed to assess and respond to the Proposed Rule.
- The AHP program is intended to be supplemental funding and the partners have had no time to understand the impact of the proposal on their communities they serve, unintended consequences, and provide form an informed response.

Regulatory Outcome Requirements

- Awarding AHP Funds to meet quotas
  - 10% is awarded for home purchase
  - 55% is awarded for two statutory priorities
    - Donated Properties OR Not-for-profit or Government Entity Sponsorship
  - 55% of all Competitive rental units for households ≤ 50%
  - 55% is awarded to two of three regulatory priorities, with a 10% minimum in each of those two priorities
    - Underserved Communities and Populations
    - Creating Economic Opportunity
    - Affordable Housing Preservation

Regulatory Outcome Consequences

- Proposed requirements are skewed towards very low-income rental projects and the mandated “55 percent” rule reduces flexibility and responsiveness, and means certain types of projects currently funded will be more difficult to fund.
  - New construction projects
  - Ownership projects which target moderate-income households – notably Habitat and self-help projects.
  - Mixed-income rental projects
  - Projects which re-purpose or adapt blighted, substandard non-housing properties

FHLBANKS
A NATION OF LOCAL LENDERS

Regulatory Outcome Consequences

- AHP is supplemental funding which needs to work with numerous federal programs and 52 state funders.
- The proposed threshold amounts for projects to qualify as serving targeted populations, such as the homeless and individuals with special needs, is contrary to national housing trends.
- Unintended consequence is that it attempts to drive national housing policy using a supplemental program that will be ineffective because national and regional priorities are headed in the opposite direction.
- Creates a static rule that may not change for a decade or more.

Regulatory Outcome Consequences

- FHFA promotes access to supportive services under regulatory outcome priorities, but presents unnecessary obstacle by requiring separate supportive services budget.
- Re-ranking of applications to meet the quotas could cause unintended consequences, establish preferences for certain project types, decrease the use of the program, lessens the transparency of AHP, and exposes the FHLBanks to litigation.
- Creates a national, prescriptive program that does not allow flexibility to address local needs or respond to and leverage local opportunities.

Recommendation

- Eliminate the new, complex proposed regulatory outcomes structure or retain what we have now.
- Revert to a scoring based methodology determined by the FHLBanks as opposed to a prescriptive outcome requirements.
- Relinquish control of the program priorities and acknowledge the importance of the existing TCLP which incorporates the wide range of experience of the AHAC and the Board of Directors.

FHLBANKS
A NATION OF LOCAL LENDERS

Targeted Community Lending Plan

- The increased housing needs assessment requirements are superfluous as the outcome requirements create a national program with little flexibility to respond to and leverage local opportunities.
- The required 6 month and 12 month lead times limit responsiveness.
- Limits the ability of AHACs to address emerging needs.

FHLBANKS
A NATION OF LOCAL LENDERS

Recommendation

- Relinquish control of the program priorities and acknowledge the importance of the existing TCLP which incorporates the wide range of experience of the AHAC and the Board of Directors.
- In the absence of relief from the statutory and regulatory requirements, the requirements of the TCLP should remain unchanged from the existing regulation, except in the event that a FHLBank offers a targeted fund and has the discretion to develop its own scoring criteria. In that instance, the need that is being addressed by the targeted fund should be documented in the TCLP.
- The 6 and 12 month waiting periods should be eliminated when targeted funds can be tied to local, state, regional, or national housing initiatives.

Sponsor Capacity

- Expands assessment of Sponsor capacity to include all affiliates and team members such as the general contractor
- Sponsors are required to provide certifications or respond to specific questions about whether they (and affiliates and team members such as the general contractor) have engaged in misconduct as defined in FHFA's Suspended Counterparty Program regulation, or as defined by the FHLBank.
- At application, the Sponsor's entire development team may not be identified.
- The FHLBanks currently have processes in place that monitor project progress and sponsor's performance. In the event that a project fails to meet the requirements of the AHP application, the FHLBank may rescind its grant, demand repayment of the subsidy, and/or suspend or debar the AHP recipient and its employees.

Recommendation

- Maintain the current regulatory language around only sponsor qualifications and ask Sponsors to certify compliance with the FHFA's Suspended Counterparty Program regulation at time of disbursement only.
- Rely on the due diligence and capacity review of sponsor affiliates and team members by the partner funders.

Need for Subsidy

- Proposed Regulation requires review of both the project's development budget and operating pro forma – so long as there is a gap and the cash flow and costs are "reasonable" – there is a need.
- Although not part of the proposed rule, the FHFA has indicated the imposition of overly prescriptive preamble guidance as to how "*FHLBanks should evaluate that a project's cash flow and costs are reasonable, and how the FHLBanks should perform the need for subsidy analysis in cases where (1) capitalized reserves exceed a FHLBank's project cost guidelines; (2) supportive services are provided; and (3) the cash flow or debt coverage ratio exceeds a FHLBank's project cost guidelines.*"

Need for Subsidy

- The theoretical construct that a project can take on additional debt if its cash flows or debt coverage ratio exceed the feasibility guidelines is flawed. Oftentimes affordable housing projects have high expense ratios with negative trending cash flow which requires higher DCR and cash flow in year one to stay financially viable through year 15.
- A project's higher reserve requirements, cash flows and DCRs outside a FHLBank Guidelines should not be assumed to be unreasonable just because the numbers don't fall within a specific parameter.
- The FHLBanks' should have flexibility in addressing whether a rental project can operate in a financially sound manner based on a variety of factors that can influence development costs and operational budgets.

Recommendation

- Maintain the bifurcation of the Need for Subsidy and Operational Feasibility as in the current regulation.
- Maintain the current regulatory need for subsidy which considers whether the proposed use of AHP subsidy is eligible under the AHP Regulation (i.e., the AHP subsidy is used for the purchase, construction or rehabilitation of housing) and the project's uses exceed its sources without consideration of the proposed AHP subsidy.
- The smallest portion of the financing should not dictate the project's financial structure and therefore social services and replacement reserves should be treated as standard operating expenses for affordable housing development and should be accepted above the line on the operating pro forma as is the requirement of the larger equity funders.

FHLBANKS
A NATION OF LOCAL LENDERS

Increased Governance

- The proposed rule prohibits the FHLBank’s Board of Directors from delegating to a committee of the Board quarterly meetings with the Advisory Council.
- Poses operational challenges for FHLBanks with large geographic areas.
- Increases Advisory Council travel expenses and conversely reduces net income and therefore annual AHP contributions.

Recommendation

- Maintain the current Board of Directors delegation conditions.

Required Funding of Alternates

- The proposed rule requires the funding of alternates within one year if funds become available.

Recommendation

- Maintain the current provision allowing the FHLBanks the discretion to approve alternates.

FHLBANKS
A NATION OF LOCAL LENDERS

Scoring

- The proposed rule gives the FHLBanks the ability to develop their own scoring methodology; however, the outcome requirements for the statutory and regulatory priorities circumvent the development of a flexible scoring matrix which responds to emerging housing needs and regional individualities.

Recommendation

- Maintain the current scoring based methodology, but with more autonomy for the FHLBanks and Advisory Councils to determine appropriate needs within their Districts.

Modifications

- The proposed rule imposes a “cure first” requirement.
- Some non-compliance during monitoring cannot be “cured” and are obvious candidates for modification.
- Requiring a project to first attempt to cure noncompliance, when the project, as modified is still eligible in all other ways under the current regulation, adds unnecessary administration costs for the FHLBanks, the Sponsor and the Member.
- Project changes related to occurrences outside the control of the Sponsor, Owner, or Member most often cannot be cured and naturally meet “good cause” for modification.

Recommendation

- Remove the “cure first” requirement completely with the understanding that “good cause” would inherently include that the noncompliance could not be cured.

FHLBANKS
A NATION OF LOCAL LENDERS

Owner-occupied Retention Agreements

- The proposed rule eliminates retention agreements for ownership projects.

Recommendation

- Allow the FHLBanks the discretion to implement retention agreements on ownership projects.

FHLBANKS
A NATION OF LOCAL LENDERS

Questions

- The proposed rule dismisses the value of the AHACs. Was that your intention?
- How does this proposed rule enable innovation?
- What prompted the addition of affiliates and team members such as the general contractor to a capacity review?
- What prompted the requirement to have the full board attend quarterly AHAC meetings?
- Why the addition of the “cure first” to modifications when the AHP is typically the smallest funder? Don’t we want our projects to succeed?
- Why require 18 months total for the development and submission/publication of the TCLP?
- What outcome was intended by the Agency in the TCLP changes and the timing?

Conclusion

FHLBANKS
A NATION OF LOCAL LENDERS

Conclusion

- The collaborative effort by the FHFA, FHLBanks and AHACs to modernize the AHP Regulation has taken almost four years.
- Original request of the AHACs was for:
  - Autonomy to decide how to invest FHLBank resources
  - Simplified administration
  - Increase ability to work with other funding sources
  - Increase options for resolving noncompliance

Conclusion

- The proposed rule:
  - Vastly differs from the FHFA AHP Modernization options previously presented to the FHLBanks and AHACs.
  - Establishes such a rigid framework that it limits flexibility in fund allocation and scoring.
  - Increases the complexity of the awards process while removing the transparency and objectivity.
  - Decreases ability to work with other funding sources.
  - Decreases options for resolving noncompliance.
  - Increases administrative burden and operational expenses which inversely decreases the amount of the annual AHP contribution.
  - Compromises the value of the input from the AHACs.

Takeaway

The restrictiveness of the proposed rule is disappointing. The program has been so successful that the AHACs believe now is the time to release the power of the program. The unique ability to unleash the strength and power of the AHP with regional oversight is what will make the program so powerful. The Agency has the opportunity to further the legacy of the success for this impactful program.