Building Blocks

A Publication of the Federal Housing Finance Board

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New Rule Passed October 28

Community Investment Cash Advances Approved; Enhances 'Tool Box' for FHLBanks, Members

Rural, Urban Areas Will Benefit

The Federal Housing Finance Board on October 28 approved two final rules that provide new opportunities for the Federal Home Loan Banks to address unmet community lending needs. One rule establishes a framework for Community Investment Cash Advance (CICA) programs and the other codifies standards for the issuance of standby letters of credit (LOC) (see story on page 6).

The FHLBank Act permits the FHLBanks to establish a variety of CICA programs in addition to the Community Investment (CIP) and the Affordable Housing Programs (AHP), which are specifically required under the Act. The CICA rule sets out general standards under which the FHLBanks may establish CICA programs, including two specific CICA programs: the Rural Development Advances (RDA) and Urban Development Advances (UDA) programs. The rule focuses on encouraging community lending,

(See **CICA,** page **6**)

Examples Cited

(On September 28, 1998. Federal Housing Finance Board Chairman Bruce A. Morrison was the luncheon keynote speaker at the Appalachian Economic Roundtable in Nelsonville, Ohio, sponsored by Jesse Jackson's Rainbow/ PUSH Coalition. These remarks are excerpted from that speech.)

Let me now turn to some specifics about the FHLBanks and what they can do now. Nothing that I am about to say, except for the very last thing – requires passing any laws or appropriating any money. It just requires that we mobilize existing capacity.

FHLBanks have the authority to make equity investments in Small Business Investment Corporations (SBICs). You can do a lot of different things with SBICs; some big banks have made a lot of money with them. But let's think more creatively. Let's think, for example, about the FHLBank of Cincinnati --

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Atlanta FHLBank Endorses Concept

By Rita Fair

Chairman of the Board,

Federal Home Loan Bank of Atlanta

The Federal Home Loan Bank of Atlanta was pleased when, last May, the Federal Housing Finance Board announced plans to establish a framework that the individual FHLBanks could use to develop Community Investment Cash Advance (CICA) programs tailored to the needs of their members and their communities.

The Atlanta FHLBank, along with a number of other FHLBanks, began its serious involvement in community investment lending back in the 1980's with the creation of a program called the Community Investment Fund (CIF). This program, along with similar counterparts at the other FHLBanks, was the forerunner of the Community Investment Program (CIP), which was mandated under the Financial Institutions Reform,

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to bring it right down to the Appalachian region, the Appalachian part of Ohio, Kentucky and Tennessee. Let's think about the FHLBank of Pittsburgh, which covers Pennsylvania and West Virginia.

What can these FHLBanks do? They're supposed to empower their member financial institutions, local banks, to be better lenders. What about an Ohio Appalachia SBIC? What about one where the lead investor is the FHLBank of Cincinnati and the other investors are all the members of the FHLBank of Cincinnati that have branches in this region of Ohio?

Their job would be to put capital together and maybe even get an infusion of additional capital from SBA – to put together equity loans. Then they can make investments in this region; they don't have to go making their investments in Phoenix. They don't have to make a 30 percent return, because 10 percent might be good enough because it's local investment. All of the local institutions would get CRA credit for this activity.

And there's more. What is an equity piece for a local lender? It changes the loan-to-value on a deal, so it's good business if I'm a local lender to be able to get an equity piece from my SBIC.

Now, a deal I can't do at 90 percent, I can do at 70 or 50 percent; all of a sudden an unbankable deal is a good, bankable deal, because the collateral works. That's not pie in the sky; that's pie on the plate, and it can be done immediately.

A second activity for FHLBanks is letters of credit. We have a proposed regulation that's been out for comment for the last 90 days and is about to come for final action before the Finance Board. It will free up the power of FHLBanks to issue letters of credit on behalf of their members.

What's the significance of this? If you're a local banking institution and you're trying to finance a local economic development project -- a fire house, a shopping center, a small manufacturing facility and the deal is too big for you, that's where the letter of credit comes in. You can't just make a loan and hold it on your books because you're too small.

"Most small economic development projects die. . . from the risk of increased cost in the future."

You can take a certain amount of risks, you can do underwriting, but you can't manage this big a loan because of loan-to-one-borrower rules and other regulatory and prudential reasons. It's a good deal and it has a perfectly good piece of collateral and a perfectly good cash flow, and it makes sense.

Now people on Wall Street will tell you about securitization, but they're talking billions of dollars. Don't hold your breath for the securitizing of little economic development projects in Appalachia. What's the answer? What about a private placement bond? If the little bank tries to issue a bond, they're not a rated institution and the pension fund or the state of Ohio or any investor will say, "Sorry." But suppose the bond were AAA. They'd be lining up outside the door.

You can't sell a bond that is unrated, but a AAA bond gets close to the lowest price that the market will offer. So if you've got good collateral and you pledge that collateral and the bank making the loan has that collateral and they pledge it to the FHLBank in their region, the FHLBank can put a AAA letter of credit on the deal.

What was an unrated, priced-out-of-sight transaction becomes a really do-able deal. That's what I call turning lead into gold, and it can be done. The broader authority to do that will be granted before 1998 is over, and it's a tool that people should use.

In the same way as we're doing with letters of credit, we are rewriting the rules on community lending to greatly expand the different ways in which FHLBanks can support economic development lending by local banking institutions. Part of this has to do with the price, but more of it has to do with the structure of the loan.

Most small economic development projects die, not from the interest rate at a given moment, but from the risk of increased cost in the future. They get a loan for prime plus two. You know you can't make that deal work; the people who look at it say, "This could blow up in our face." Most of us are getting out of adjustable rate

(See **EXAMPLES**, page 3)

(**EXAMPLES,** from page 2)

mortgages for fixed rate mortgages because people with limited capital can't manage the swings in interest rate any better than the folks at Long-Tern Capital. So what we need to do to bring a broader array of opportunities for economic development projects is the same thing we did in housing – create longer-term fixed rate lending that will change required cash flows to make a project work. A project that doesn't have any cash flow in years one, two, or three, but has perfectly good collateral and good leases many not be viable for a local bank to do on its own. But it can borrow the money from the FHLBank, which can borrow money in any form from the capital markets.

The risks can be hedged and you can manage a no payment project for three years – capitalize the interest for three years and then pay it out over the next ten – and keep it all fixed-rate. We think that the FHLBanks will have more authority to do that.

There is another thing that the FHLBanks can do that they are doing right now, mostly with single-family mortgages, and that is to share the risks. We have a pilot program going on in the FHLBank of Chicago, where the Bank splits the risk with local banking institutions. The local originating institution takes the credit risk – the risk that somebody won't pay – and the FHLBank takes the market risk – the risk that is caused by the ups and downs of interest rates. That brings competition to secondary markets.

But there's an even bigger idea there. Think about the big problem that somebody who's making a local economic development project here in Appalachia has. The prospect of making a long-term, ten-year loan to a local project that they are going to hold on their books makes bank examiners quake: "What are you doing holding this illiquid loan? What happens if you need cash? You can't sell that to anybody." Now suppose that institution didn't hold that loan; suppose that they could sell it. We've already talked about the inapplicability of the secondary market to most small

"[C]redit and market risk can be split in economic development projects as well as in single-family housing."

economic development projects, but how about a different idea? Suppose the FHLBank takes that asset, that illiquid asset off the books. You don't need a secondary market if the local banking institution continues to hold the credit risk, and why shouldn't local banking institutions take the credit risk on underwriting for their local community? Don't they know best whether the developer doing the deal is creditworthy? Don't they know better than anybody else what the local market conditions are and whether there's a real opportunity for that business or not? They may not always be right, but they're going to be right more often than somebody on Wall Street. So credit and market risk can be split in economic development projects as well as in single-family housing.

Another thing the FHLBanks can do is bring technical assistance to the table for lenders so they know how to get deals done. FHLBanks are cooperatives, bringing sophisticated expertise and shared expertise to local institutions, especially smaller, community-oriented, community-owned, and community-driven ones. They can help these institutions do difficult-to-do deals.

There are gaps to be filled. Not all deals can be done at the price the market demands, but we have a bad habit of doing all or nothing. We'll write a check for the whole deal – or get a community development grant from HUD for the whole deal – or the deal doesn't get done. We waste a lot of money that way, because usually there's only a little financing gap. It may only require a guarantee that may never be called upon. It may require a small subsidy, perhaps just the difference in the interest rate that the extra risks represent. We don't think that way nearly enough -- in terms of filling small gaps -- because we don't talk about the risks in that disaggregated way nearly enough.

These various tools operating independently don't do nearly as much as they would if they operated in concert. I would urge, as we get to the end of this conference, that we talk about a formula to build

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Recovery and Enforcement Act of 1989. CIP has been a valuable resource giving the FHLBanks unprecedented flexibility in providing low-cost funds for members to lend for a variety of purposes, not limited to single-family home mortgages and rental housing loans. Indeed, a significant feature was CIP's provision for funding of commercial, economic development, and business loans.

The Atlanta FHLBank has actively promoted CIP all through the 1990s. Through its members, the FHLBank has used CIP not only to provide or to promote housing, but also for a wide variety of economic development applications. Our CIP has funded a nursing home in North Carolina, a car wash and motel in Florida, a day-care center in Georgia, a fire truck and other needs of rural volunteer fire departments in North Carolina, a textile plant in North Carolina, shopping centers in Florida and Virginia, a Holiday Inn in south Georgia, and a healthcare facility in Florida. These are just a few examples. In each case, the funding either created jobs or improved community infrastructure. The Atlanta FHLBank currently has nearly $1 billion in CIP advances outstanding.

CIP has been valuable, but it hasn't been a panacea. In Atlanta, we would call CIP a successful program, and we've been proud of what our CIP advances have accomplished. but we have long recognized the need for more and better tools with which to tackle the community investment task. CIP had carved out for itself a useful niche, but the need for a more aggressive, yet flexible vehicle was apparent.

CICA appears to be that vehicle. It expands the ways in which we can use CIP, but more importantly, it enables us to do things with our members and or our communities that just weren't possible previously.

In a recent address, Bruce A. Morrison, chairman of the Federal Housing Finance Board, cautioned against re-inventing the wheel. He said organizations and governmental bodies should resist the urge to create new programs and new ways of doing things and should, instead, use existing structures -- especially if they have shown themselves to be workable. We agree.

In his speech, Chairman Morrison cited one existing structure that has been workable but can be improved upon: CIP. "Out of billions of dollars, 96 percent nationwide has gone to housing. There's nothing wrong with housing, but it's not the only need. We are pushing the envelope farther and farther on housing affordability, but remember affordability has two parts -- how much does it cost, and how much do people earn. If we really want to make housing affordable, our goal shouldn't be to reach poorer and poorer people, but to enable poorer people to get less and less poor. Then more and more housing becomes affordable."

We believe the new CICA regulation will enable the Atlanta FHLBank and its sister FHLBanks to plow new ground, particularly in addressing the economic development part of the equation. Under CICA, each FHLBank may establish a rural development advance (RDA) and an urban development advance (UDA) program. In both, long-term advances can be used to fund economic development projects that serve populations with incomes above the CIP economic development limit of 80 percent of area median income. The ability to make such advances available to our members gives us a needed extra tool.

Additionally, the regulation gives us the flexibility to devise other new programs as we see fit, tailor-made to our own regional needs and specifications. It also gives us the ability to provide some real subsidies for targeted economic development.

Although the new programs that can be established under the CICA regulation are optional, we believe the regulation's benefits make these programs attractive for the Atlanta FHLBank as we strive to enhance our efforts to improve the communities in our district. Principal among those benefits are the ability to make long-term advances for economic development purposes, the applicability of income limits for the RDA and UDA advance programs that are more generous than the limits under CIP, the option of offering RDA and UDA advances at regular advance rates, the ability to develop new CICA programs, and the ability to set aside special funds to discount CICA advances.

In Atlanta, we have established a CICA task force to plan our involvement with this new regulation. The task force comprises groups responsible for devising our approach in five years:

- Needs and Opportunities Assessment -- looking at the distinct, specific needs and how they can be addressed under CICA:
- Program Design -- figuring out the best approaches consistent with the regulation's requirements;

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__For Native American Homeowners__

Streamlining the Mortgage-Lending Process Discussed

The Federal Housing Finance Board is one of several federal agencies that has recently begun the process to streamline the mortgage-lending process on lands held in trust for Native Americans. In November, a FHFB staff member traveled to the seat of the Navajo Nation in Window Rock, Arizona to meet with representatives of institutions involved in making mortgages on Native American lands to address lending barriers and propose solutions. Attending were officials from regional offices of various federal agencies, tribal members, the Federal Home Loan Bank of San Francisco, members of the FHLBank System, and other lending institutions.

President Clinton, in an Executive Memorandum of August 1998, directed federal agencies in partnership with tribal governments to improve access to loans on Indian reservations. The order further directed the agencies to initiate this effort through a yearlong pilot program on the Navajo Nation and in at least one other location. The agencies have collectively chosen the Pine Ridge Reservation in South Dakota as the second site, with a third site yet to be named.

Four working groups have been established to address barriers in the following areas and to develop solutions to them: variances in federal programs, land issues, creditworthiness of homebuyers, and lack of private participants in the mortgage lending process. The working groups plan to report to the president in September 1999 outlining their accomplishments.

Many of the barriers identified to date by these working groups have been summarized in other studies and reports, the General Accounting Office among them. For example, the Variances in Federal Programs Group has identified a lack of uniformity in federal forms and duplication of processing steps as barriers. The Land Issues Group has identified the inability to alienate land held in trust for Native Americans and the lengthy Bureau of Indian Affairs lease-approval process as barriers. The committee that is examining the creditworthiness of borrowers has cited a need for pre-homeownership counseling that is culturally specific. The group that is examining the lack of private participants in the mortgage lending process has found a need for more appraisers, inspectors, housing stock, Realtors, mortgage insurance, infrastructure, and tribal housing and building codes on Native American trust or allocated lands.

The working group plans to invite representatives of the private sector, tribes, and Native American organizations into discussions to develop solutions to these problems throughout the year. For further information, contact Roberta Youmans in the Finance Board's Office of Policy at 202-408-258 1,or at youmansr@fhfb.gov

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- Discount Fund -- establishing our annual budget for the cumulative discount;
- Technical/Operations -- fitting our plans into the FHLBank's existing operational and information systems; and
- Marketing/Sales -- communicating about the new programs to our members and their communities.

This structure, involving a significant cross-section of the FHLBank's staff, has helped generate an enthusiastic, team-spirited approach to what we all view as a welcome opportunity to build upon a program that, even with its limitations, has served us well.

It's our belief that the various provisions of ClCA will effectively enhance what we, along with our customers, can do to make our communities economically stronger and improve their citizen's lives.

And we won't be re-inventing the wheel. □

BOARD ANNOUNCES 1999 MEETINGS

The FHFB directors have released a tentative schedule for board meetings for the first quarter of 1999.

The meetings are held in the 2nd floor conference room at 1777 F Street in Washington, DC. with all meetings times to be announced at least 7 days prior to each session.

Meetings are scheduled for January 13 and 27; February 10 and 24; and March 10 and 24.

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defined as financing for economic development for targeted beneficiaries.

"This rule could significantly increase the role of the FHLBanks in providing long-term financing for economic development that is generally not being done by the financial community or by System members using the Community Investment Program," said Finance Board Chairman Bruce A. Morrison. "To date, more than 95 percent of CIP advances have been used to finance housing projects. This rule should help direct more resources toward economic development activities that can revitalize communities."

Under the Bank Act, CIP advances can be used to finance commercial and economic development projects that benefit families with incomes at 80 percent or below of the area median and housing projects that benefit families at or below 115 percent of the area median income. Other CICA programs can be used to finance economic development projects that benefit populations not served by the CIP.

For instance, an FHLBank may offer RDA and UDA programs for community lending in rural and urban areas using any combination of targeted beneficiaries and income levels specified in the regulation, without prior Finance Board approval. FHLBanks may also offer CICA programs using targeted beneficiaries and income levels identified by the Bank, with Finance Board approval.

Targeted beneficiaries in the rule include small businesses and specified economic development projects, such as those located in an Empowerment Zone, or involving property eligible for a federal Brownfield tax credit, properties in communities which have experienced NAFTA-related job losses or communities affected by military base closings.

Under the regulation, FHLBanks develop and adopt annually a Community Lending Plan that requires each FHLBank to: conduct market research in the FHLBank's district; describe how the FHLBank will address identified credit needs and market opportunities; consult with its members, local community development organizations and its Advisory Council in developing and implementing the Community Lending Plan, and establish quantitative community performance lending goals.

For more information on the ClCA programs, contact Charles McLean at (202) 408-2537.

Rule Passes Unanimously, 3-0

Letters-of-Credit Approved For Housing, Community Lending

flexibility and discretion than they previously had and facilitates the use of LOCs that support

Letters-of-Credit:

A form ofguaruntee that an FHLBank member will-fulfill its duties under a contract with a third party.

Standby letters of credit are issued by FHLBanks on behalf of a FHLBank member and serve as a form

Up to $5 Million Available

Boston FHLBank Offers Advances for Childcare Facilities

Up to $5 million in discounted advances is being offered by the Federal Home Loan Bank of Boston to its members to help nonprofit childcare centers expand and improve their facilities. The advances will be discounted 100 to 280 basis points under the FHLBank's Community Investment Program.

The FHLBank of Boston created the initiative in partnership with the Child Care Capital Investment Fund, an affiliate of the Community Economic Development Assistance Corporation (CEDAC), which is major provider of technical and funding services for nonprofit childcare centers in Massachusetts.

The discounted advances in this initiative constitute a special offering of the FHLBank's Massachusetts Community Building Program, a partnership program between the FHLBank and the Massachusetts Thrift Fund begun in 1994.

Features of the new program include:

- Members can identify and qualify nonprofit childcare providers, or consult with CEDAC to identify appropriate borrowers.
- Members may lend directly to the nonprofit or it may lend to CEDAC. In the latter, both parties negotiate terms and conditions and CEDAC re-lends the funds to the nonprofit.
- No special application is needed. Members apply to the FHLBank with a letter of request, accompanied by its standard commercial loan write-up.

Funding approvals can be announced as early as 30 days after receipt of applications.

A workshop for interested institutions was held in Waltham, Massachusetts, on October 28 drawing representatives from several member institutions.

For more information on the program, contact Theo Noell at the FHLBank of Boston at (617) 292-9668.

(EXAMPLES, from page 3)

things using all of these potential tools. We have a multitude of programs, but we don't have a tool box; we don't have a sense of which tool fits which projects.

All the ideas I've put forward will only do 25 percent of the job that needs to be done. That would be 25 percent more than what we're doing today, so let's not refrain from taking the first quarter of the journey.

But we will need new gap filling institutions. and I hope when we create them, we will build them onto existing frameworks. I hope we don't have to relearn all of the alphabet soup.

I hope we take full advantage of the relationships and capacity that already exist. I hope that we maximize the "bang for the buck" by having the public sector take the risks that the private sector can't manage, but make the private sector step up to the table for as much risk as the market place can manage. If we do that, then we're essentially leveraging public money to the greatest extent.

Too often public money does not get leveraged: it just gets spent. And that's the difference between spending and investing, and investment is what makes wealth grow. It takes risks, but it reaps returns. □

CDFI Fund Makes Awards of $75 Million

Department of the Treasury Secretary Robert E. Rubin announced recently that 190 banks, thrifts, and community development financial institutions will share $75 million awarded by the Community Development Financial Institutions (CDFI) Fund.

The awards are being made through the CDFI's Bank Enterprise Award Program and the CDFI Core Program and Technical Assistance Component. The awards were announced September 28. Since 1996, the CDFl fund has provided $1 82 million to promote community and economic development.

For additional details or a complete list of the CDFI award recipients, contact John Longbrake with the Department of the Treasury at (202) 622-2960, or Helen Szablya with the CDFl Program at (202) 622-8401. □

RESOURCES

"Principles and Practices of Community Development Lending," has been updated by the Federal Reserve Bank of Minneapolis. The second edition ofthis book is designed to provide a better understanding of community development lending for bankers and as a guide for community developers lacking experience working with financial institutions. The $25 book is available from the FRB of Minneapolis, BSD, Community Affairs, P.O. Box 291, Minneapolis MN 55401-0291 or by calling (612) 204-5074.

The Office of Thrift Supervision has published a document "Best Practices in Rural Development" providing background on public- and private-sector rural development organizations around the country, and some of the organizations' projects. **For** copies of the publication contact the OTS External Affairs Office, 5th Floor, 1700 G Street NW, Washington D.C. 20552, or call (202) 906-6288.

"Out of Reach: Rental Housing at What Cost?" is a new report from the National Low Income Housing Coalition that concludes that fair market rents are unaffordable for large numbers of renters, including many working families. The report is available from the NLIHC at Suite 610, 1012 14th Street NW, Washington DC 20005 for **$15** (members) and $25 (nonmembers).

"Directory: Community Development Investments," an updated publication from the Federal Reserve System, provides profiles of community development investments in 1997 by bank holding companies and state-chartered banks supervised by the FRS. The publication is free at www. bog.frb.fed. us/DCCA/Directory or by contacting the community affairs office at the nearest Federal Reserve Bank.

"Jobs and Economic Development: Strategies and Practice," a recent Sage Publications work, is a collection of essays from both scholars and practitioners in the field of community-based initiatives to connect disadvantages adults to family-supporting jobs. The book can be ordered from local bookstores and is carried under ISB: 0-7619-0914-1.

"Harvesting Hometown Jobs: The New Small Town Guide to Economic Development," is available from the National Center for Small Communities and covers strategic planning, retaining and expanding existing businesses, recruiting business and industry, attracting tourists and retirees, managing growth and partnership. The book costs $19.95 and is available from the NCSC by calling (202) 624-3553.

"Strategies for Raising Operating Funds," is a guide for rural housing nonprofits. It includes a list of institutions that have provided support for rural housing in the past. The $3.50 report is available by calling Luz Rosas at 9202) 842-8600 for details.

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"CDBG: An Action Guide," a new publication from the **Center for Community Change** presents information on CDBGs for community leaders and advocates in straightforward, nontechnical language. Copies are free to low-income community groups, $15 for others. For more information, contact the CCC at (202) 342-0567.

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"Leveraging Funds for Section 514/516 Farmworkers Housing Development," a new publication from the **Housing Advisory Council**, summarizes interview with experienced farmworker housing sponsors, focusing on the impact of changing how program funds are awarded and the role of leveraging in evaluating applications. Copies are available free from *www.ruralhome.org* or in printed form for $5.50 by contact Luz Rosas at the HAC at 9202) 842-8600. ☐

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Chairman

Bruce A. Morrison

Editor/Writer

Dennis O. McGee