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Federal Housing Finance Board  
1625 Eye Street, NW  
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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. My comments are organized into five areas: 1) general comments about the proposed regulation; 2) general concerns; 3) some specific issues relative to scoring in the AHP competitive program; 4) several areas where some clarification is needed; and 5) some areas that were not addressed.

### **1. General Comments:**

In discussions over the past three years, staff of the Finance Board have promised greater flexibility in scoring, monitoring, and in administering the AHP. The revised regulation does not accomplish those objectives.

There is no significant change in the scoring criteria or requirements.

The monitoring requirements are still burdensome. The FHLBanks are to establish monitoring based on assessment of risk, but apparently will be evaluated based on outcomes.

With regards to administration, the FHLBanks will be required to document more policies and more procedures so that programs are more transparent.

It is disappointing that the proposed regulation is little more than a reorganization of sections; it remains prescriptive and cumbersome.

### **2. General Concerns:**

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

**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 changes 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. As an example, 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 through 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.

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

**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. Members who use the FHLBank of Cincinnati’s credit products more are eligible for more AHP subsidy, even though every member is eligible for at least \$100,000 annually. The Bank has successfully employed this credit use test to encourage members to use credit products, and thereby contribute to the Bank’s earnings. Since the AHP subsidy is derived directly from the Bank’s earnings, I believe that those members who contribute more to the Bank’s earnings should have greater access to AHP subsidy. The proposed regulation would eliminate this long-standing provision and would allow all members to access the same amount of subsidy, regardless of their participation, 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 might 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. In both cases, part of the value of the subsidy has been realized and there is no apparent reason to require full repayment of the subsidy for a rental project.

Also, both the existing regulation and the proposed regulation provide very generous provisions to avoid any repayment of subsidy. If a home is sold, there is no repayment if: 1) there is no “net gain” on the sale; or 2) the home is sold to an income-eligible household. If a home is refinanced, there is no repayment if: 1) there is no “net gain” (no cash out) on the refinancing; or 2) the retention language stays in place, even if there is cash out. The proposed regulation is very clear that there can be no “cash back” at closing. However, the homebuyer could refinance on the day after closing, take out the full amount of subsidy provided, and not be required to make any repayment.

**Monitoring: Risk vs. Outcome** - I am 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.

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. I am concerned that an interpretation of the proposed regulation might guarantee nothing but examination findings.

Projects face difficulty and failure for many reasons, and neither the current regulation nor the proposed regulation gives an FHLBank any ability to intervene in any significant way. 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. Neither the current regulation nor the proposed regulation gives an FHLBank the ability to intervene in a project in a way to mitigate risk or prevent failure.

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

**Consolidation of separate homeownership set-aside programs** - The Supplementary Information narrative states that replacing “the separate first-time homebuyer program with a requirement that at least one-third of a Bank’s aggregate annual homeownership set-aside allocation be targeted to first-time homebuyers” is “functionally equivalent” to the results under the current structure. It is not.

Under the current structure a Bank could set-aside up to 25% of its AHP accrual for a homebuyer set-aside program without any of that amount targeted to first-time homebuyers. However, I do not disagree with the proposal.

### **3. Scoring Issues:**

**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. 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 when a donation was made are regardless of the source of the donation, even if it was a related party. I think that giving points for donated property is valuable, but that there should be the ability to disregard donations made in the far distant past or donations from closely related parties.

I also think that there is limited benefit to giving points for any conveyance of property from the federal government. When the statute was enacted, there was some benefit to encourage the federal government to dispose of property acquired from failed financial institutions. That benefit has long since passed.

**“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 suggest the Finance Board allow the district FHLBanks to identify the priorities they believe are most appropriate to their district, without limitation.

#### **4. Clarifications needed:**

**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 analysis indicates 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 FHLBanks would no longer be required to determine the present value of a sponsor’s mortgage and

include that value as a sponsor's cash contribution in determining the need for subsidy.

**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.

**Income targeting** - The language regarding income targeting scoring is different for ownership and rental projects. For ownership, the language indicates that points should be awarded "based on a declining scale to be determined by the Bank in its AHP implementation plan, taking into consideration percentages of units and targeted income levels." For rental projects, however, the language is very specific that projects "shall be awarded points on a declining scale based on the percentage of units in a project that are reserved for households with incomes at or below 50 percent of the median income for the area, and on the percentage of the remaining units reserved for households with incomes at or below 80 percent of the median income for the area." The approach for ownership lends itself to a calculation of the weighted average income of households to be served. For rental, it would require creation of a matrix, assigning points based on the percent of households at only two income levels: 50% and 80%. The approach for rental projects also ignores the significance of households at 60% of area median income, an almost universal target for tax credit projects, and is different from the approach for ownership.

**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 at the time the household is enrolled in the set-aside program the household may not qualify for a mortgage. However, other guidance from Finance Board staff has indicated that eligibility must require that the homebuyer qualify for a mortgage based solely on that homebuyer’s current income and not the anticipation of some future increase in income. We would recommend that the FHLBanks be allowed to determine income eligibility and not be expected or required to underwrite the mortgages which members will make.

**Financial incentives in the set-aside program** – The language of the proposed regulation is confusing. The 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.” The narrative, however, clearly talks about the incentives to be provided by members. Some clarification is required.

I recommend that only members be allowed to participate in the set-aside program; that the burden on the member not be increased; that any financial incentive should be determined by an FHLBank in its Implementation Plan; and that an FHLBank not be required to provide any incentive to members to participate. It should be sufficient that the member is providing some “concession,” even if that was only relaxing underwriting standards or waiving a small fee.

**Feasibility guidelines** - An FHLBank must determine whether a project’s costs are reasonable by taking into account the location of the project, development conditions and other non-financial household or project characteristics, such as housing for the elderly or persons with disabilities (rather than determine if project costs are “customary” in light of “industry standards” as under the current AHP Regulation). This amendment attempts to provide project by project flexibility in determining the amount of subsidy needed for a project. However, the effect is to “nationalize” feasibility guidelines. It appears that an FHLBank would have to accept as “reasonable” project costs that are customary in other areas but that would be unusually high in our district.

**Household size adjustment** - The proposed rule would amend the household-size adjustment provisions in the definition of “low- or moderate-income household” and in the definition of “very low-income household” by changing the household-size adjustment from an optional to a mandatory requirement, provided that if the source for the area median income data has no methodology to adjust the household income limit for household size, the Bank is not required to make such an adjustment. This change would bring the AHP into conformity with other federal programs that adjust for household size. For those programs that use HUD median incomes, there would be no difficulty since the incomes are adjusted for different household sizes in every

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jurisdiction. For programs using Mortgage Revenue Bond income limits, most housing finance agencies define only two household sizes (“one or two persons” or “three or more persons”) while some define many different sizes. An FHLBank should be allowed how to decide how many household sizes it wishes to define and use the appropriate median incomes for those household sizes.

## **5. Omissions:**

### **Review and approval of AHP Implementation Plans by the Finance Board –**

FHLBanks are required to submit AHP Implementation Plans to the Finance Board. Under the proposed regulation, there would be even greater transparency in that the IPs would be posted on an FHLBank’s website. The 12 FHLBanks already post their IPs.

It would certainly be helpful if there was some commitment by the Finance Board to review and comment on IPs before they became effective. The result would likely be better IPs and fewer exam findings.

**AHP Funding from more than one FHLBank** – Each FHLBank is required to ensure that there is not more AHP subsidy provided than is needed and that a project’s sources and uses match. Why then is a project allowed to apply for and receive funding from more than one FHLBank?

In summary, it is hoped that these suggestions offered along with others will be incorporated into a final regulation that provides a meaningful administrative framework through which the 12 unique Federal Home Loan Bank districts can administer the program.

Respectfully submitted,  
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