

Memorandum

August 29, 1991

TO: J. Stephen Britt
Executive Director

FROM: Beth L. Climo
General Counsel

SUBJECT: Authority of State Housing Agencies to Receive Advances

This memorandum responds to a request for an opinion on whether state housing agencies may receive advances from the Federal Home Loan Banks ("FHLBanks") pursuant to the nonmember mortgagee provisions in section 10b of the Federal Home Loan Bank Act ("Bank Act").

ISSUES:

- A) Whether a state housing agency may receive a Bank Act section 10b advance as a "nonmember mortgagee?"
- B) If so, what conditions, requirements and procedures must be met in order to receive section 10b advances?

CONCLUSIONS:

- A) A state housing agency may qualify as a "nonmember mortgagee" under certain circumstances, and receive advances under section 10b. The authority to receive section 10b advances also includes authority to receive letters of credit.
- B) In order to qualify as a "nonmember mortgagee," a state housing agency must:
 - be approved as a mortgagee by the Department of Housing and Urban Development;
 - be a chartered institution;
 - be subject to some sort of examination by a state or federal auditing entity;
 - engage in some sort of mortgage lending of its own funds;
 - secure the advances with mortgages insured by the Federal Housing Administration (it might be able to substitute Government National Mortgage Association bonds backed by pools of FHA insured mortgages).

The usual restrictions on advances regarding purpose, maturity of advances, and limitation to a mortgagee's FHLBank district, do not apply to these advances. However, the Federal Housing Finance Board ("Finance Board") is authorized to determine the terms, conditions and interest rates on advances to such nonmember mortgagees.

DISCUSSION:

I) A STATE HOUSING AGENCY MAY RECEIVE A FHLBANK ADVANCE PURSUANT TO BANK ACT SECTION 10b

Prior to enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), the Bank Act provided for advances to both member and nonmember institutions. FIRREA repealed most references to nonmember borrowings. See 103 Stat. 189, 418 (1989). The sole exception was the provision at Bank Act section 10b. Thus, in order to access the advances window of the FHLBanks, a state housing agency must either be eligible to and become a FHLBank System member or qualify under section 10b.

The Bank Act restricts FHLBank membership to savings and loan associations, savings banks, cooperative banks, insurance companies and insured depository institutions (commercial banks and credit unions). See 12 U.S.C.A. § 1424(a) (West Supp. 1990). A state housing agency is not any of the above and therefore may receive a FHLBank advance only in accordance with the requirements of Bank Act section 10b.

II) BANK ACT SECTION 10b PERMITS ADVANCES TO NONMEMBER MORTGAGEES

A) Bank Act section 10b provision

Section 10b was not enacted with the original Bank Act in 1932, but was added to it in 1935. It was enacted as section 7 of the "Act to provide Additional Home Mortgage Relief." 49 Stat. 295 (1935). Section 10b states:

Each (FHLBank) is authorized to make advances to nonmember mortgagees approved under title II of the National Housing Act. Such mortgagees must be chartered institutions having succession and subject to the inspection and supervision of some governmental agency, and whose principal activity in the mortgage field must consist of lending their own funds. Such advances shall not be subject to the other provisions and restrictions of this chapter, but shall be made upon the security of insured mortgage & insured under title II of the National Housing Act. Advances made under the terms of this section shall be at such rates of interest and upon such terms and conditions as shall be determined by the

(Finance Board¹], but no advance may be for an amount in excess of 90 per centum of the unpaid principal of the mortgage loan given as security.

12 U.S.C. § 1430b (1988).

B) A state housing agency may be a Section 10b "mortgagee"

Section 10b does not define the term "mortgagee," but in its usual meaning the term is not necessarily restricted to a financial institution.' A "mortgagee" is simply one who takes or receives a mortgage. BLACK'S LAW DICT. 1163 (rev. 4th ed. 1968). Accordingly, the term can refer to any person or entity that holds a note secured by a mortgage or deed of trust on real property.

Section 10b further qualifies the term, mortgagee, by referring to title II of the National Housing Act, at 12 U.S.C. §§ 1707 -- 17152-20 (1988). A nonmember mortgagee must be "approved" under title II. Section 1707 of title 12, United States Code, defines "mortgagee" to include both original lenders and assignees. See *id.* at § 1707(b).

So, the fact that a state housing agency is not a financial institution does not preclude it from being a "mortgagee" under either title II of the National Housing Act or Bank Act section 10b. In order to be a nonmember mortgagee, a state housing agency simply needs to hold a mortgage that it originated or purchased.

Section 10b stipulates that nonmember mortgagees be "approved under title II of the National Housing Act." The term "under" means to be subject to the authority, control or guidance of. WEBSTER'S NINTH NEW COLL. DICT. 1285 (1985 ed.); see also BLACK'S LAW DICT. 1695 (rev. 4th ed. 1968). The administration of title II of the National Housing Act is the responsibility of the Federal Housing Administration ("FHA"), a unit of the Department

1. Section 10b continues to refer to the "Federal Home Loan Bank Board." The failure to substitute the Finance Board appears to be a legislative oversight, but it does not diminish the Finance Board's role in section 10b advances. The Bank Act grants the Finance Board all of its predecessor's authority vis-a-vis the FHLBanks. See 12 U.S.C.A. § 1422a(a)(1) (West Supp. 1991).

2. The interpretation of statutory terms starts with the plain and ordinary meaning of the terms used. *Watt v. Alaska*, 451 U.S. 259, 265 (1981). When the meaning is ambiguous, the legislative history of the statute may be used to discern the meaning.

of Housing and Urban Development ("HUD"). So, it would seem that the FHA (viz. HUD) plays a significant -- if not pivotal -- role in approving a state housing agency as a nonmember mortgagee.

In fact, HUD regulations currently permit a state government agency to become an approved "mortgagee" under title If of the National Housing Act and to purchase or hold insured mortgages. See 24 C.F.R. § 203.7(a) (1990).³

C) A state housing agency may be able to fulfill the four conditions for an advance required under section 10b

Section 10b contains four conditions that an approved mortgagee must meet in order to access the advances window of a FHLBank. A mortgagee must:

- be a chartered institution, having succession;
- be subject to (state or federal) governmental inspection and supervision;
- lend its own funds, as its principal activity in the mortgage field; and
- collateralize the advance with mortgages insured under title II of the National Housing Act.

Chartered Institution

The term "institution," without any other qualification, may refer to a public or private entity, and has been commonly used to designate a governmental organization established under law or public authority, 63 So. 616, 618 (La. 1913); Anderson v. Shreveport Gas, Elec. Light & Power Co., (La. 1913); also State ex rel. Blakeslaw v. Clausen, 148 P. 28, 32 (Wash. 1915) (state highway department is public institution")

Although it is mostly associated with them, a "charter" is not necessarily exclusive to corporations. Broadly, a charter is in the nature of a grant of rights, powers or authority to act from a sovereign power to an organized body. See BLACK'S LAW

3. One requirement for HUD approval is that the agency meet HUD criteria for approved mortgages. 24 C.F.R. at § 203.1. One of these includes the responsibility for servicing the mortgages. This could be an obstacle if a state housing agency lacks the ability to service mortgages. One solution, if HUD concurs, would have the state entity purchase insured mortgages from a HUD approved original lender that would retain servicing rights.

DICT. 298 (rev. 4th ed. 1968). It is usually a distinct instrument, but a legislative act creating a corporation can be a charter. See Baker v. Smith, 102 A. 721, 723 (R.I. 1918).

States use charters to organize cities. They are legislative enactments -- recognized as organic laws empowering cities to take certain actions and defining the scope of such actions. Cf. In re: Op. of Justices, 276 A.2d 736, 739 (Del. 1971); see also e.g. City of Lebanon v. Baird, 756 S.W.2d 236, 241 (Tenn. 1988). A statute creating a state housing agency, that defines its mission and duties, can be construed as its charter.

Accordingly, a state housing agency organized pursuant to state statute can be deemed to qualify as a "chartered institution" under Bank Act section 10b.

Subject to Government Supervision, Inspection

Nonmember mortgagees must be "subject to the inspection and supervision of some governmental agency." 12 U.S.C. § 1430b (1988). The current Finance Board regulations (transferred from the former Federal Home Loan Bank Board) interpret that phrase as requiring the entity to be under a legal duty to be examined and supervised regularly "by some competent government agency." See 12 C.F.R. § 935.31 (1991). This definition is flexible and encompasses more than a state bank or thrift examiner. It can refer to any kind of audit or examination.

Whether a particular state housing agency actually satisfies this requirement is a question of fact. However, it seems that a state housing agency that is examined by the state's internal auditing arm is subject to examination by a "competent government agency." Id.

Lending its Own Funds

Section 10b clearly states that a mortgagee's "principle activity in the mortgage field must consist, of lending (its) own funds." The use of the phrase "in the mortgage field" seems to imply that the mortgagee may engage in other activities which may or may not be related to mortgage lending. Moreover, section 10b does not specifically require the majority of the mortgagee's operations to be focused on mortgage lending, or on any particular

4. For example, the New York Department of Audit and Control, run by the Comptroller, audits that state's various agencies. N.Y. EXEC. LAW. §§ 40-50 & § 170 (McKinney 1982).

activity for that matter. But, the mortgagee is required to actually engage in borne sort of mortgage lending and, to the extent it does, it should lend with its "own funds?"

Section 10b explicitly requires that such mortgage lending be done with the mortgagee's own funds. It fails to define "own funds" and no legislative history or caselaw explains it. It may have been intended to exclude mortgage lenders who act as brokers only, lining up borrowers for lenders and retaining origination fees and servicing rights to the mortgages. If so, that type of activity is not consistent with that of a state housing agency.

At any rate, a state housing agency, organized as a self-sustaining operation, loans with its own funds. Likewise, it is reasonable to conclude that a state appropriated fund agency lends with its "own funds" -- once the appropriations are credited to its account.

Collateralize Advance with Insured Mortgages

Section 10b requires that the nonmember mortgagee secure a FHLBank advance with mortgages insured under title II of the National Housing Act.⁶ The mortgagee is not necessarily required to originate such mortgage loans, but need only have them as an asset when the advance is made. In other words, the mortgagee may purchase the insured mortgages from an original lender or other source prior to receiving the advance.

D) Section 10b legislative history shows that Congress was concerned about granting liquidity to FHA insured mortgages and not with the entity receiving the advances

An analysis of the legislative history of section 10b is proper to shed light on the intended meaning of some of its terms that may be interpreted in several ways. -See Rodriguez v. U.S., 480 U.S. 522, 525 (1987). The legislative history of section 10b indicates that Congress intended section 10b to be broadly construed. Congress was not concerned with the kind of entity receiving section 10b advances; it was concerned over whether insured mortgages had sufficient liquidity so as to make them attractive for a mortgage lender to either originate or hold.

5. Use of the term "consists of" differs markedly from use of the term "including" -- which implies other topics not listed in a statutory provision. See BLACK'S LAW DICT. 381 (rev. 4th ed. 1968). By using "consists of," Congress seems to have intended that the approved mortgagee lend its own money as its principal activity in the area of making mortgage loans.

6. For an explanation of title II of the National Housing Act and insured mortgages, see footnote 8, infra.

The committee report on H.R. 6021 (that became the "Act to Provide Additional Home Mortgage Relief" containing section 10b) confirms that its general purpose was to liberalize the Bank Act and the National Housing Act. See H.R. Rep. No. 202, 74th Cong., 1st Sess. (1935).⁷ Such reports are an authoritative source by which to discern Congressional intent. Garcia v. U.S., 469 U.S. 70, 76 (1984).

A supporter of the provision in H.R. 6021 creating section 10b stated the following:

To my mind there is one important amendment to the Home Loan Bank Act, and that is the provision . . . authorizes them to make loans or advances to nonmember mortgagees that have the approval of the [HUD]. You will recall that under Title II of that act the Government was authorized to insure long-term amortized home mortgages.* This provision has not worked satisfactorily for the reason there has been no place to discount that character of paper. It is hoped that this measure making the home loan banks instrumentalities of discount for that purpose will help remove the log jam in the current of our real estate securities.

79 Cong. Rec. 3156 (1935) (Remarks of Rep. Williams) reprinted in BRIDEWELL at 614.

Statements of a supporter, while not as compelling as statements of a sponsor or committee report, may have weight in interpreting a statute. Ernst & Ernest v. Hochfelder, 425 U.S. 185, 203-04 at n. 24 (1976); Garcia v. U.S. (supra) at 70; cf. PEA v. Algonquin SNG, Inc., 426 U.S. 548, 564 (1976). This statement and the House report indicate that Congress intended section 10b as a means of giving liquidity to insured mortgagee. Congress was

7. The legislative history on the bill creating Bank Act section 10b was reproduced in large part in a privately published book, now located in the library of the Office of Thrift Supervision: D.A. BRIDEWELL, Ass't Gen. Couns., THE FHLBB AND ITS AGENCIES (H. Russell, Gen. COUns., supr .ed.) (1938) (hereinafter cited as BRIDEWELL]. The committee report is at BRIDEWELL 569-73.

8. Title II of the National Housing Act created the FHA mortgage insurance fund in 1934. Under it, the FHA uses the fund to promote home ownership by low income families. FHA encourages approved lenders to give certain borrowers favorable terms on down payment interest rates or payment terms on loans, by insuring the timely payment of principle and interest on the mortgage. This is now a HUD program, as FHA came under HUD in 1965. Section 10b contains a reference to title II of the National Housing Act, so a resort to the act helps to discern the scope of section 10b. See Engel v. Davenport, 271 U.S. 33, 38 (1926).

not focused on the status of the nonmember borrowers, but on facilitating the FHA insured mortgage market.' Permitting a state housing agency to utilize section 10b to access the FHLBank advances window would not offend this legislative purpose if the advance is secured by FHA insured mortgages.

III) SECTION 10b ADVANCES TO NONMEMBERS MAY BE SECURED BY GNMA SECURITIES OF POOLED FHA INSURED MORTGAGES IN LIEU OF WHOLE FHA INSURED MORTGAGES

A) Finance Board policy permits mortgage backed securities to be considered the equivalent of mortgages

As stated above, section 10b states that the advances to nonmember mortgagees shall be secured by insured mortgages. 12 U.S.C. § 1430b (1988). However, in the context of another issue where the Bank Act or the Home Owners Loan Act required thrifts to hold mortgages in their asset portfolios, the former Federal Home Loan Bank Board permitted mortgage backed securities to count as home mortgages for purposes of determining an institution's qualifications for FHLBank membership. It reasoned that mortgage backed passthrough certificates were in effect undivided interests in home mortgages. See Op. Gen. Couns. FHLBB Oct. 30, 1972; accord: Op. Gen. Couns. FHLBB, Feb. 3, 1977. Eventually, it permitted other mortgage backed securities to count as home mortgages as well. OGC Memo, FHLBB, Jan. 25, 1988.

The Finance Board continues to adhere to the policy initiated by the above Federal Home Loan Bank Board legal opinions. In a similar vein, the Finance Board might allow Government National Mortgage Association ("GNMA") issued mortgage backed securities (backed by insured mortgages;) to count as collateral for section 10b advances to state housing agencies.

There are good policy reasons for this. Purchasing a GNMA security is easier than finding the insured mortgages from lenders willing to sell them. Also, purchasing GNMA securities obviates the need to service an insured mortgage or to contract out such requirement. HUD regulations for approving entities as mortgage lenders under the National Housing Act's title II require them to service the mortgages or provide for adequate servicing under contract. See 24 C.F.R. § 203.1 (1990). Obviously, the insured

9. The overall purpose of statutory interpretation is to give effect to the legislative intent underlying the statute. See Andrus v. Clover Constr. Co., 446 U.S. 608, 619 (1980).

10. The underlying reasoning is that the issuing of mortgage backed securities promotes the secondary market for mortgages, which in turn encourages the making of more home mortgages.

mortgages backing a mortgage backed security are subject to such servicing contracts since no investor of such security ever services the underlying mortgage.¹¹

Section 10b limits an advance to 90 percent of the unpaid principal on the insured mortgage(s) securing it. Similarly, an advance secured by a mortgage derivative security made up of insured mortgages should be limited to 90 percent of the principal on the pooled mortgages backing such security.

B) A decision to allow mortgage backed securities to secure section 10b advances should have HUD concurrence

The legislative purpose of section 10b is to benefit the FHA rather than the FHLBanks. Whatever the ultimate purpose of a state housing agency accessing FHLBank advances, use of section 10b advances must benefit the FHA mortgage insurance program. The issue of whether substituting mortgage backed securities for insured mortgages to secure a section 10b advance benefits the program, is best answered by HUD as administrative head of FHA.

IV) A SECTION 10b ADVANCE IS NOT SUBJECT TO ANY OTHER RESTRICTION OR LIMITATION IMPOSED ON A FHLBANK ADVANCE

Section 10b states that "(advance made under . . . this section shall not be subject to the other provisions and restrictions of (the Bank Act]." 12 U.S.C. § 1430b (1988). Accordingly, such advance is not subject to the restrictions placed on FHLBank advances under Bank Act section 10 concerning use of the advance funds or the geographical limit imposed on borrowing from a FHLBank.

The Bank Act states that advances must be for home financing. 12 U.S.C.A. § 1430(a) (West Supp. 1990). Despite that language, the state housing agency could use the money received from the advance for any purpose. The Bank Act prohibits a member institution from borrowing from a FHLBank if its district does not include the member's principal place of business. *Id.* at 1424(b). However, a state housing agency, borrowing under section 10b, is permitted by section 10b to apply to any FHLBank for such advance without regard to FHLBank districts.

11. This argument would be similar for either privately issued collateralized mortgage obligations (backed by insured mortgages or GNMA participation certificates of insured mortgages), or real estate mortgage investment conduits, made of insured mortgages.

V) OTHER ISSUESA) Perfection of security interest

Because the state housing agency would not be a FHLBank member, the Finance Board may wish to consider requiring the FHLBank to perfect its security interest by taking possession of the insured mortgages securing the advance.

B) Letter of credit

The ability of a state housing agency to receive an advance under Bank Act section 10b includes, by Finance Board regulation, the ability to receive a letter of credit in lieu of an actual advance. 12 C.F.R. § 935.30 (1991).

C) Finance Board requirements for section 10b advances rates, terms, conditions

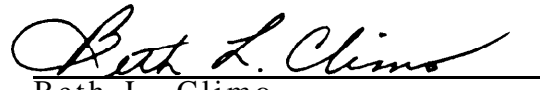
Section 10b empowers the Finance Board to set the rate of interest, as well as other "terms and conditions" of advances made to nonmember mortgagees. The current Finance Board regulations contain several provisions dealing with section 10b advances. These regulations, which were transferred to the Finance Board at the time of the dissolution of the former Federal Home Loan Bank Board, contain the following conditions:

1. In order to qualify as a "chartered institution" under section 10b, an entity must be subject by law to an ongoing examination and supervision by a competent government agency. 12 C.F.R. § 935.31 (1991).
2. The rate of interest for section 10b advances is 1/2 of one percent to one percent higher than rates to a FHLBank's members. Id. at § 935.32.
3. All requests for section 10b advances must be written on forms approved by the Finance Board. FHLBanks may approve or disapprove such advances on terms no more liberal than advances for members. Id. at § 935.33.

None of the above prevents the Finance Board from permitting FHLBanks to make section 10b advances to state housing agencies approved as mortgagees under title II of the National Housing Act.

CONCLUSION:

A state housing agency may be a nonmember mortgagee pursuant to Bank Act section 10b, and be permitted to access the advances window of a FHLBank. In order to so qualify, the state housing agency must meet the criteria in section 10b and applicable HUD regulations. The authority to qualify for a section 10b advance includes the authority to receive a letter of credit. None of the other restrictions or limitations applicable to other FHLBank advances applies to the advances issued under section 10b.


Beth L. Climo
General Counsel

CC: Sylvia C. Martinez
Philip L. Conover