

Introduction

This module of the *Examination Manual* provides direction to examiners in assessing a Federal Home Loan Bank's (FHLBank) administration of its Affordable Housing Program (AHP). An FHLBank's administration of its AHP is evaluated as a part of the overall examination of an FHLBank. The findings of this review constitute a portion of the FHLBank's component ratings for Management and Operational risk.

The FHLBanks' AHPs are governed by section 10(j) of the Federal Home Loan Bank Act (Bank Act), as implemented by the Federal Housing Finance Agency (FHFA)'s AHP regulation, 12 CFR Part 1291. On an annual basis, each of the 12 FHLBanks is required to contribute at least 10 percent of its previous year's net earnings to the AHP, subject to a minimum annual combined contribution by the 12 FHLBanks of \$100 million. An FHLBank may accelerate to its current year's program from future annual required AHP contributions an amount up to the greater of \$5 million or 20 percent of its annual required AHP contribution for the current year. The FHLBank may credit this amount of the accelerated contribution against required AHP contributions over one or more of the subsequent five years. The AHP subsidy may be in the form of a grant or a below-cost interest rate on an advance to a member. AHP subsidies must be used to finance homeownership by households with incomes at or below 80 percent of the area median income (AMI), or, to finance the purchase, construction, or rehabilitation of rental housing in which at least 20 percent of the units will be occupied by and affordable for households with incomes at or below 50 percent of AMI. Section 10(i) of the Bank Act requires each FHLBank to designate a Community Investment Officer (CIO) to implement the AHP and other community-oriented mortgage lending programs.

The AHP supports an FHLBank's housing finance mission by providing subsidies to its members for the provision of very low-, low- and moderate-income, owner-occupied or rental housing. The FHLBanks are authorized to offer AHP subsidies through two FHLBank programs. The first is through a mandatory competitive application program administered directly by the FHLBank. The second program is an optional homeownership set-aside program whereby funds are disbursed directly to members to provide assistance to homebuyers or homeowners. An FHLBank may allocate up to the greater of 35 percent or \$4.5 million of the FHLBank's annual statutory AHP contribution to the homeownership set-aside program. Under the competitive application program, a member submits a housing project application on behalf of a project sponsor. To be eligible for funding, proposed projects must meet certain AHP statutory and regulatory requirements. The applications are evaluated for compliance with the statute and AHP regulation and scored applying the scoring criteria established by the regulation and the FHLBank's policies as articulated in its AHP Implementation Plan. The FHLBank awards AHP subsidies starting with the highest scoring applications until the total amount of available subsidy for that round of funding is exhausted.

The homeownership set-aside program was created in 1995 and offering a set-aside is elective to each FHLBank. Set-aside funds must assist households at or below 80 percent of AMI. If an FHLBank elects to offer a set-aside program, at least one-third of the annual set-aside amount allocated by that FHLBank must be reserved for first-time homebuyers. Members obtain the AHP set-aside funds from the FHLBank and then pass through these funds as grants to eligible households. Set-aside funds may be used for down payment, closing costs, counseling or rehabilitation costs in connection with a household's purchase or rehabilitation of an owner-occupied unit.

At a minimum, an effective and responsive AHP is characterized by policies, procedures and operational controls that assure that the AHP funds reach the intended beneficiaries on a timely basis. The FHLBanks are given some latitude under the AHP regulation to tailor their programs to meeting housing needs in their District. As part of the oversight of the AHP, FHFA will periodically evaluate how an FHLBank identifies and responds to affordable housing needs in the communities it serves. It is not FHFA's intent to prescribe a particular outcome. Advisory Council recommendations and other information sources on affordable housing needs should be taken into consideration by the FHLBank but are not binding on the FHLBank.

The following characteristics are elements of a successful AHP. The characteristics of an effective AHP are divided into three broad categories: Identification of Community Housing Needs, Strategy, and Outcomes.

Identification of Community Housing Needs

- 1) The FHLBank has an effective process for identifying community housing needs in its district and establishing priorities.
- 2) The FHLBank is actively engaged in AHP outreach with its members and the community.
- 3) The Advisory Council informs the FHLBank's board and management about the housing and community needs of the district and is a resource to the FHLBank regarding trends and practices in housing and community development.
- 4) In consultation with its Advisory Council and additional sources of information, such as independent studies and, as appropriate, the views of other community stakeholders, the FHLBank regularly evaluates the district's affordable housing needs and assesses how the AHP can be used to help address these needs.
- 5) The FHLBank considers the range of identified housing needs and establishes priorities for its AHP competitive and set-aside programs.

- 6) The FHLBank utilizes various resources, including, but not limited to, FHLBank directors, Advisory Council members, management, staff, FHLBank members, and other AHP stakeholders to monitor the needs of the housing community in its district on an ongoing basis.

Strategy to Achieve Results

- 1) The FHLBank's board of directors, management, and staff play a meaningful role and exercise due diligence in the administration of the AHP. Board directors and Board Housing Committee members understand their responsibilities to the AHP in identification of affordable housing needs, approval of the Implementation Plan, and AHP applications, and timely response to problems. Their engagement is not merely perfunctory.
- 2) The FHLBank's AHP policies, such as the AHP Implementation Plan and its ancillary documents are thorough, current and substantive. The FHLBank's AHP Implementation Plan is responsive to community affordable housing needs identified by the FHLBank and with AHP program requirements.
- 3) The AHP is administered by qualified management and staff. From identification of housing needs, through approval of applications, disbursement of subsidies, and monitoring of projects, staff and management assure sound program operations and strive toward continual improvement. The FHLBank has good internal controls and segregation of risk-sensitive duties. Effective procedures are clearly written, understood and applied. Written agreements between the FHLBank, members and project sponsors or owners protect the interests of the program.
- 4) Effective program operations include a reliable Management Information System (MIS), and established protocols. The MIS facilitates staff and management's monitoring of AHP-assisted projects, so that problems are addressed promptly, and AHP data are entered accurately.
- 5) AHP fund accounting can be reconciled and accurately reflects the status of the AHP fund.
- 6) The FHLBank periodically reviews and adjusts the AHP to better assure the program's responsiveness to changing housing conditions and community needs; while evaluating the status of current AHP program goals. The FHLBank periodically reviews the members' use of AHP funds to assure that AHP subsidies are efficiently used.

Affordable Housing Program

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- 7) Information on program policies under the AHP competitive and homeownership set-aside programs is transparent and accessible. Program documents convey the necessary information to the stakeholders. All prospective applicants and project sponsors have equitable access to program information. The FHLBank's internal policies and procedures are easily understood and followed by FHLBank personnel.
 - 8) The FHLBank files AHP data reports in an accurate, complete and timely manner consistent with reporting requirements under 12 CFR part 914.

Outcomes

- 1) The FHLBank has articulated and can justify its selection of program priorities and objectives.
- 2) An effective AHP complements the FHLBank's overall community lending and housing finance mission and the FHLBank can provide some evidence that it has reached the desired outcome, taking into consideration the strengths and limitations of its AHP program and conditions in its District. An FHLBank's failure to reach an objective is not necessarily a program deficiency as long as the FHLBank has made a conscientious effort to meet community housing needs. There may be external reasons why certain policy objectives are not met, such as low demand from members or sponsors, lack of project financing or other subsidies, weak sponsor capacity, or the relative strength of applications.
- 3) The FHLBank's policies, programs and goals for the AHP are in alignment with the identified policy priorities. In the competitive program, the FHLBank uses its discretionary criteria as outlined in the AHP regulation to reflect its District's affordable housing needs. For example, an FHLBank can target identified needs by the scoring criteria it selects, the manner in which it allocates points among the scoring criteria, and the discretionary definitions and optional District eligibility standards it adopts. In the set-aside program, the design of the FHLBank's program(s) responds to the FHLBank's identified policy priorities.
- 4) The FHLBank administers its AHP in a fair, transparent, and impartial manner toward members, prospective and actual applicants, and awardees.
- 5) The FHLBank has allocated the necessary personnel and funds to maintain an effective and efficient program. The FHLBank continues to evaluate the effectiveness of its AHP with the ongoing needs of the community. To measure its success, the FHLBank is able to demonstrate the effect of its AHP projects in serving identified community needs and priorities and that funds have been appropriately deployed.

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- 6) The FHLBank manages its portfolio of competitive projects such that it addresses potential or existing problems with projects, sponsors, owners or members in a timely manner. The FHLBank takes action, as necessary, to ensure compliance with the AHP regulation and FHLBank policy. Approved projects are monitored for compliance with AHP requirements and the FHLBank reacts promptly when problems are found. The FHLBank monitors its projects to ensure that the AHP reaches the intended beneficiaries, the subsidy is used to assure affordability standards are met, and the applicant and sponsor fulfill the commitments made in the AHP application.
 - 7) The FHLBank manages its set-aside program(s) such that the FHLBank's programs are consistent with the FHLBank's priorities, the funds are effectively utilized, and the members' use of the set-aside funds is consistent with the community development principles of the AHP.
 - 8) An effective internal audit program responds to program risk and protects the AHP from noncompliance with the AHP regulatory requirements and FHLBank policies, mismanagement, fraud or abuse. The FHLBank's Community Investment staff responds to both internal and external audits in an appropriate and timely manner.
 - 9) The FHLBank reports accurate and timely AHP data to FHFA.

Regulatory Environment

The primary regulatory authority governing AHP operations is 12 CFR Part 1291, which sets out FHFA's rules governing the program. The AHP regulation is designed to implement the Bank Act by ensuring that each FHLBank provides AHP subsidies to eligible projects and households, that members and projects use the subsidies only for eligible purposes, and that the FHLBank pursues corrective action or repayment when a member, project sponsor or project owner does not use the subsidy in accordance with the AHP regulation and FHFA and FHLBank policies. The regulation sets out parameters by which an FHLBank establishes policies and procedures designed to produce the desired results. The regulation's key provisions are:

- 1) AHP Implementation Plan:
- 2) Responsibilities of the FHLBank's Board of Directors
- 3) Advisory Councils
- 4) Competitive Application Program
- 5) AHP Homeownership Set-Aside Program
- 6) Monitoring
- 7) Allotment of Annual Contributions
- 8) Remedial Actions for Noncompliance

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- 9) Agreements
 - 10) Temporary Suspension of AHP Contributions
 - 11) Affordable Housing Reserve Fund

1) AHP Implementation Plan (12 CFR 1291.3)

A Bank's AHP Implementation Plan (Implementation Plan) is the guiding document for the FHLBank's operation of its AHP, and the primary document reflecting the Bank's AHP policy priorities and objectives. The AHP regulation sets forth the elements that must be included in the Implementation Plan. These elements include, but are not limited to, the FHLBank's policies by which its AHP subsidies will be awarded, disbursed and monitored, and its retention agreement requirements. The FHLBank's policies and priorities must be described in substantive detail for both the competitive and set-aside programs. An FHLBank's policies and requirements in the Implementation Plan must be consistent with the AHP regulation, based on sound processes and objectives, and reflect the Bank's policy priorities, as determined by the FHLBank's assessment of the affordable housing needs in its District.

The FHLBank must have written internal operating procedures, but they need not be included in the Implementation Plan. Changes to a scoring criterion must be clearly communicated through the Implementation Plan.

At a minimum, the Implementation Plan must include the following elements required by the AHP regulation:

For both the AHP Competitive and Homeownership Set-Aside Programs:

- 1) The applicable median income standard or standards adopted by the FHLBank, consistent with the definition of median income for the area (AMI) in 12 CFR 1291.1.
- 2) The Bank's requirements, including time-limits, for re-use of repaid AHP direct subsidy, if adopted by the FHLBank, pursuant to 12 CFR 1291.8(f)(2).
- 3) The Bank's requirements for monitoring under its competitive application program and any homeownership set-aside programs established by the FHLBank, pursuant to 12 CFR 1291.7.
- 4) The retention agreement requirements, pursuant to 12 CFR 1291.9(a)(7) and (a)(8).

AHP Competitive Program:

- 1) The Bank's requirements for its competitive application program established pursuant to 12 CFR 1291.5, 1291.6 and 1291.8. These include the Bank's funding round schedules, scoring guidelines (including the First and Second District Priorities, the method of awarding points for owner-occupied projects, and related definitions, as further described below), project feasibility and cost guidelines, monitoring requirements, and retention agreement requirements.
- 2) The Optional District Eligibility requirements for the competitive program. Optional eligibility requirements are: 1) A limit on the maximum amount of AHP subsidy available per member each year; or per member, per project, or per project unit in a single funding period. 2) A requirement that a household complete a homebuyer or homeowner counseling program provided by, or based on one provided by, an organization recognized as experienced in homebuyer or homeowner counseling, respectively. (12 CFR 1291.5(c)(15))
- 3) The Bank's method of awarding points for owner-occupied projects, based on a declining scale, taking into consideration percentages of units and targeted income levels. (12 CFR 1291.5(d)(5)(iii)(B)).
- 4) The Bank's First District priority, which may be one or more criteria selected from the list in 12 CFR 1291.5(d)(5)(vi).
- 5) The Bank's Second District priority, which may be one or more housing needs in the FHLBank's District selected by the FHLBank either from the list of First District priority criteria, or any other housing need in the district identified by the FHLBank. If the FHLBank chooses Second District Priority criteria from the list of criteria under the First District Priority, the Second District Priority criteria may not be the same as the First District priority criteria adopted by the FHLBank. (12 CFR 1291.5(d)(5)(vii)).
- 6) The Bank's definitions under 12 CFR 1291.1 for: "sponsor" (i.e., definition of "ownership interest" and "integrally involved"); and "retention period" for owner-occupied rehabilitation units currently occupied by the owner where there is no fixed closing date; and the FHLBank's definitions under the scoring criteria in 12 CFR 1291.5(d)(5) for "significant proportion" and "amount significantly below the fair market value" for donated or conveyed properties, "homeless households" and, if applicable, "rural" and "urban."
- 7) The FHLBank's requirements for funding revolving loan funds, if adopted by the FHLBank pursuant to 12 CFR 1291.5(c)(13), including any retention period, monitoring and recapture requirements for the revolving loan fund's subsequent lending of subsidy principal and interest repayments.

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- 8) The FHLBank's requirements for funding loan pools, if adopted by the FHLBank pursuant to 12 CFR 1291.5(c)(14), including time limits on the use of the AHP subsidy, which shall not exceed one year from the date of approval of the AHP application.

Homeownership Set-Aside Program:

- 1) The FHLBank's requirements and policy priorities for its Homeownership Set-Aside program(s), if adopted by the FHLBank, pursuant to 12 CFR 1291.6, as further described below.
- 2) The allocation criteria for providing the direct subsidies to members, pursuant to 12 CFR 1291.6(c)(1).
- 3) The required date of enrollment of households by members for purposes of participating in the Homeownership Set-Aside program, pursuant to 12 CFR 1291.6(c)(2)(i).
- 4) The maximum grant amount of AHP subsidy per household, which may not exceed \$15,000 per household, pursuant to 12 CFR 1291.6(c)(3).
- 5) Any additional eligibility criteria adopted by the FHLBank, such as requirements for matching funds, homebuyer or homeowner counseling, or criteria that give priority for the purchase or rehabilitation of housing in particular areas or as part of a disaster relief effort, pursuant to 12 CFR 1291.6(c)(2)(iii).
- 6) Any requirements for members and other lenders to provide financial or other concessions, as defined by the FHLBank, to households in connection with providing the AHP grant or financing to the household, pursuant to 12 CFR 1291.6(c)(6).
- 7) The amount of cash back that a member may provide to a household at closing on the mortgage loan, which may not exceed \$250 per household, pursuant to 12 CFR 1291.6(c)(9).

The FHLBank's Implementation Plan policies should be transparent and include sufficient information for members and project sponsors to prepare their applications and, if AHP funds are awarded, carry out their project development and monitoring responsibilities. Where the AHP regulation permits an FHLBank to exercise discretion in implementing certain regulatory requirements, the FHLBank must detail those discretionary policies in its Implementation Plan.

The FHLBank is required to consult with its Advisory Council before adopting its Implementation Plan or making amendments to the Plan. Although the Advisory Council does not approve the Implementation Plan, the Advisory Council must provide its recommendations on the Plan to the FHLBank's board of directors. After consulting with and receiving recommendations from its Advisory Council, the FHLBank's board of directors must approve the Implementation Plan and any amendments, but is not required to adopt the Advisory Council's recommendations in adopting the Plan.

The regulation requires that the FHLBank notify FHFA of any changes to the Implementation Plan within 30 days of board approval, and make the Implementation Plan available on the FHLBank's publicly accessible website within the same timeframe (12 CFR 1291.3(c), (d)). The FHLBank does not need to issue a new Implementation Plan for each funding round or each year, but must do so when it makes changes to its program requirements.

2) *Responsibilities of the FHLBank's Board of Directors (12 CFR Part 1291)*

The FHLBank's board of directors is responsible for overall policymaking regarding the FHLBank's AHP, and for ensuring the FHLBank's AHP complies with statutory and regulatory requirements. Specific responsibilities of the board of directors in the operation of the program that may not be delegated to FHLBank officers or other employees include:

- 1) Adopting the FHLBank's Implementation Plan and any amendments thereto, which include any optional District eligibility requirements, scoring criteria, set-aside program requirements if the FHLBank has set-aside programs, and monitoring policies (12 CFR 1291.3(a), 1291.5(h)(2));
- 2) Adopting a conflict of interest policy for FHLBank directors and employees (12 CFR 1291.10(c));
- 3) Adopting a conflict of interest policy for Advisory Council members (12 CFR 1291.10(c));
- 4) Appointing Advisory Council members (12 CFR 1291.4(f));
- 5) Meeting with the Advisory Council at least quarterly (12 CFR 1291.4(f));
- 6) Approving AHP applications to be funded and at least four alternate projects (12 CFR 1291.5(h)(2)); and
- 7) Approving project modifications involving increases in subsidy.

3) *Advisory Councils (12 CFR. 1291.4)*

The Advisory Council informs the FHLBank's board and management about the housing and community lending needs of the district and is a resource to the FHLBank regarding trends and practices in community development. The regulation provides that the Advisory Council is to provide advice on ways in which the FHLBank can better carry

out its housing finance and community lending mission, including but not limited to, advice on the low- and moderate-income housing and community lending programs and needs in the FHLBank's District, and on the use of AHP subsidies, FHLBank advances and other FHLBank credit products for these purposes. The Advisory Council plays an important role and can influence AHP policies and enhance program effectiveness. However, the AHP regulation does not provide the Advisory Council with approval authority for the policies or operations of the AHP.

The Advisory Council is responsible for submitting an annual report to FHFA containing its analysis of the FHLBank's AHP and other FHLBank programs and activities that support low- and moderate-income housing and community lending. Within 30 days after submitting the report to FHFA, the FHLBank must publish the report on its publicly available website.

Each FHLBank's board must appoint an Advisory Council of seven to fifteen persons who reside in the FHLBank's District. Advisory Council members must be drawn from a diverse range of community and not-for-profit organizations actively involved in providing or promoting low- and moderate-income housing, and community and not-for-profit organizations actively involved in providing or promoting community lending, in the FHLBank's District. Advisory Council members serve three year terms with a maximum of three full consecutive terms. An FHLBank may appoint a person to a one-year or two-year term only to achieve the objective of staggering terms among the members. The Advisory Council must elect a chair and vice chair and may elect additional officers it deems appropriate. The Advisory Council may adopt a charter that articulates expectations of individual members as well as the group.

In carrying out its responsibilities and making the recommendations described above, the Advisory Council must meet at least quarterly with the FHLBank's full board of directors or representatives of the board; further, the Advisory Council's advice must include recommendations on:

- 1) the amount of AHP subsidies to be allocated to the competitive application program and any homeownership set-aside programs established by the FHLBank;
- 2) the FHLBank's AHP Implementation Plan and any amendments to the Implementation Plan;
- 3) the FHLBank's scoring criteria, related definitions, and any additional optional District eligibility requirements for the competitive application program; and,
- 4) eligibility requirements and any priority criteria for any FHLBank homeownership set-aside programs.

4) *Competitive Application Program (12 CF.R. 1291.5)*

Under the regulation, each FHLBank awards AHP subsidies during one or more competitive funding rounds annually, as determined by the FHLBank. During these rounds, members submit applications for AHP funds on behalf of project sponsors. The FHLBank determines whether the proposed projects meet the AHP statutory and regulatory eligibility requirements. The FHLBank approves project applications and awards subsidies to applications that meet eligibility requirements and score competitively under the FHLBank's scoring guidelines. Scoring rank is awarded on how well the project meets the nine regulatory scoring criteria set forth in the FHLBank's AHP Implementation Plan.

The FHLBank awards AHP subsidies to the applications that receive the highest scores in the round in descending order, until the total amount of subsidy available for that round is exhausted. There is no other selection method allowed under the regulation.

The AHP regulation provides that any application that meets the eligibility requirements is eligible for funding regardless of its score if the FHLBank still has funding available in the round. Consequently, the regulation precludes an FHLBank from establishing a minimum score in order for an application to be eligible for funding and refusing to approve applications that do not meet that minimum score. Once the FHLBank has exhausted its available AHP subsidy for the round, the FHLBank must approve at least the next four highest scoring applications as alternates. If AHP subsidies are returned to the FHLBank's AHP fund through de-obligations, repayments or recapture, the FHLBank may elect to disburse the subsidies to these alternates within one year of approval of their applications.

Eligibility Requirements (12 CFR 1291.5(c))

Applications must meet certain statutory and regulatory eligibility requirements in order to be considered for a subsidy award. These eligibility requirements are:

- 1) **Income-targeted owner-occupied housing or rental housing with affordable rents.** The eligible uses of AHP subsidy are the purchase, construction or rehabilitation of owner-occupied housing by or for low- or moderate-income households, or the purchase, construction or rehabilitation of rental housing where at least 20 percent of the units will be occupied by and affordable for very low-income households. To meet the AHP rent affordability standard, the rent charged to a household may not exceed 30 percent of the income of a household of the maximum income and size expected, under the commitment made in the approved AHP application, to occupy the unit (see definition of "affordable" in 12 CFR 1291.1). There is no fixed affordability standard (*i.e.*, a requirement that mortgage payments not exceed a certain percentage of household income) for owner-occupied projects. However, unaffordable house payments bear the risk of default and subsequent non-

compliance; therefore, unit affordability should be considered under the project feasibility review in section 4(below).

Owner-occupied projects are defined to mean one or more owner-occupied units in a single-family or multifamily building, including condominiums and cooperatives. “Rental projects” are defined to include overnight and emergency shelters, transitional housing for homeless households, mutual housing¹, and single-room occupancy housing. Lease-purchase units are treated as rental units until sold to individual households. Manufactured housing is treated according to the use of the subsidy. If the AHP funds are used as down payment or closing cost assistance toward owner-occupied housing on rental pads, such use is consistent with the AHP regulation and is subject to the regulatory requirements applicable to owner-occupied housing. If the AHP funds are used for the acquisition, development or improvement of a rental pad underlying the manufactured housing unit and the pad is rented to the occupant of the unit, the use of AHP funds is subject to AHP requirements applicable to rental housing projects.

“Low- or moderate-income household” is defined as a household that has an income of 80 percent or less of AMI. “Very low-income household” is defined as a household that has an income of 50 percent or less of AMI. (12 CFR 1291.1) In determining household income eligibility, the FHLBanks may use median income standards published by the Department of Housing and Urban Development (HUD), which includes the HUD median income definition under the Native American Housing and Self-Determination Act; the Federal Financial Institutions Examination Council (FFIEC); the Mortgage Revenue Bond Program (26 U.S.C. 143(f)); the definition of area median income used by the U.S. Department of Agriculture; or, with prior approval from FHFA, the median income for an applicable definable geographic area, as published by a federal, state or local government entity. (12 CFR 1291.1) The FHLBank must identify, in its Implementation Plan, which median income standards particular project types must use to qualify households. Most rental projects use the HUD median income standard because other funding sources are often required to apply the HUD income data. Owner-occupied projects are likely to use either the HUD or the mortgage-revenue bond median income standards.

- 2) **Need for subsidy.** The project’s estimated sources of funds, including the requested AHP subsidy, must equal its estimated uses of funds, as reflected in the project’s development budget. The need for subsidy is the difference between the project’s sources of funds and uses of funds without the AHP subsidy, which is the maximum amount of AHP subsidy the project may receive. An FHLBank may allow a project’s source of funds to include estimates of the market value of in-kind donations and voluntary professional labor or services (excluding the value of sweat equity),

¹ A mutual housing association (MHA) is a private, nonprofit partnership organization that develops, owns and manages new and existing affordable housing in the community interest.

provided the estimated value is correspondingly included in the project's uses of funds. There are special requirements in the regulation for establishing the amount of the sources of funds for self-help owner-occupied projects in which the sponsor-provided discounted permanent financing is considered one of the sources of funds. (12 CFR 1291.5(c)(2))

- 3) **Project costs.** The project's costs, as reflected in the development budget, must be reasonable, in accordance with the FHLBank's project cost guidelines. (12 CFR 1291.5(c)(3)) This requirement is intended to prevent AHP subsidy from being diverted through artificially inflated costs. The FHLBank must take into consideration the geographic location of the project, development conditions, and other non-financial household or project characteristics in determining the reasonableness of project costs.

The FHLBanks should exercise judgment and flexibility in evaluating each project, especially those that are not being funded primarily through HUD programs or low-income housing tax credits. In such cases, an FHLBank does not have the benefit of these agencies providing an independent review of project costs. Each FHLBank should regularly review and revise, if applicable, its project cost guidelines. All decisions to grant exceptions to the guidelines during the application approval process must be justified and documented.

- 4) **Project feasibility.** The project must be developmentally feasible, meaning that it is likely to be completed and occupied. The FHLBank's assessment of project feasibility should be based on relevant factors contained in the FHLBank's project feasibility guidelines, including, but not be limited to, the development budget, market analysis, and project sponsor's experience in providing the requested assistance to households. In addition, rental projects must be operationally feasible, meaning that the project can operate in a financially sound manner, in accordance with the FHLBank's project feasibility guidelines, as projected in the operating *pro forma*. (12 CFR 1291.5(c)(4)) The FHLBank's Implementation Plan should include the FHLBank's project feasibility guidelines. Most FHLBanks base their project feasibility guidelines on those established by primary affordable housing funders, such as HUD and state housing finance agencies, which typically administer federal and state low-income housing tax credit (LIHTC) and mortgage-revenue bond programs. However, each FHLBank should regularly review and revise, as applicable, its project feasibility guidelines, and all decisions to grant exceptions to the guidelines during the application approval process must be justified and documented.
- 5) **Financing Costs.** The rate of interest, points, fees and any other charges for all loans made to the project in conjunction with the AHP subsidy must not exceed a

reasonable market rate of interest, points, fees, and other charges for loans of similar maturity, terms, and risk. (12 CFR 1291.5(c)(5))

- 6) **Timing of AHP subsidy use.** Some or the entire AHP subsidy must be likely to be drawn down by the project or used by the project to procure other financing commitments within 12 months from the date the application was approved for AHP funding. (12 CFR 1291.5(c)(6)) This requirement serves as a rough indication that the project is sufficiently advanced to proceed to development and ultimate completion. The failure of a sponsor with an approved application to begin drawing down the AHP subsidy or procuring other financing commitments within 12 months of application approval does not require deobligation or withdrawal of the project, but the FHLBank must evaluate the circumstances and likelihood that the project will go forward and must make a determination on whether to maintain its funding commitment to the project.
- 7) **Counseling costs.** AHP subsidies may be used to pay for counseling costs for a household only where the household is actually purchasing an AHP-assisted unit and the cost of the counseling has not been covered by another source of funding, including the member's own funds. (12 CFR 1291.5(c)(7))
- 8) **Refinancing.** The project may use AHP subsidies to refinance an existing single-family or multifamily mortgage loan, provided that the refinancing produces equity proceeds and such equity proceeds up to the amount of the AHP subsidy in the project shall be used only for the purchase, construction, or rehabilitation of housing units meeting the AHP eligibility requirements. (12 CFR 1291.5(c)(8))
- 9) **Retention.** Each AHP-assisted unit in an owner-occupied project must be subject to a five-year retention agreement, and each AHP-assisted rental project must be subject to a 15-year retention agreement. (12 CFR 1291.5(c)(9)) Although a rental or owner-occupied project may be subject to longer retention periods in accordance with other funding sources, AHP retention requirements may not extend beyond the respective regulatory AHP retention periods.
- 10) **Project sponsor qualifications.** The sponsor of a proposed project must be qualified and able to perform its responsibilities as it has committed in the AHP application. (12 CFR 1291.5(c)(10)) An FHLBank may take a variety of factors into consideration and may exclude a project based on an overall assessment of the sponsor's capacity. An FHLBank may have a policy of excluding sponsors from the competitive application program based on previous noncompliance with the program, including project noncompliance and repeated sponsor noncompliance with reporting requirements. An FHLBank may not exclude a project because a sponsor or project has received a previous AHP award.

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- 11) **Fair housing.** The proposed project must comply with applicable federal and state fair housing and housing accessibility laws and regulations, and must demonstrate how the project will be affirmatively marketed. (12 CFR 1291.5(c)(11)) Federal laws require all projects to comply with the federal Fair Housing Act and accessibility laws, and state or local laws may establish additional protected classes or accessibility standards. A project may have marketing materials that reach out to underserved groups; however, targeting a minority population to the exclusion of other populations may violate fair housing laws. Limited statutory exemptions from the Fair Housing Act permit tribal authorities to sponsor housing targeted solely to Native Americans and Native Alaskans, and permit HUD-approved planned housing on Native Hawaiian Homelands to be targeted solely to Native Hawaiians.
- 12) **Calculation of AHP interest-rate subsidy.** If AHP direct subsidy is used to write down the interest rate on a loan to a project, the amount of subsidy is the net present value (NPV) of the interest foregone by the lender, based on the lender's market rate, calculated as of the date the AHP application was submitted to the FHLBank, and subject to adjustment under 12 CFR 1291.5(g)(4) if interest rates subsequently change. If AHP subsidy is used for a subsidized advance to the member, the amount of subsidy is the NPV of the interest foregone by the FHLBank based on its cost of funds. The amount of subsidy determined at the time of application is subject to adjustment if interest rates have changed at the time of disbursement. (12 CFR 1291.5(c)(12))
- 13) **Lending and re-lending AHP direct subsidy by revolving loan funds.** Pursuant to written policies established by an FHLBank's board of directors, after consultation with its Advisory Council, an FHLBank, in its discretion, may permit revolving loan funds to apply under the competitive application program for AHP direct subsidy for the purpose of lending and relending that subsidy to eligible owner-occupied or rental projects. (12 CFR 1291.5(c)(13)) In order to use the AHP subsidy under these terms, the revolving loan fund must meet certain sponsor eligibility requirements. (12 CFR 1291.5(c)(10))
- 14) **Use of AHP subsidy in loan pools.** Pursuant to written policies established by an FHLBank's board of directors, after consultation with its Advisory Council, an FHLBank, in its discretion, may permit applications under its competitive application program for the use of AHP subsidies for the origination of first mortgages or rehabilitation loans with subsidized interest rates to AHP-eligible households through a purchase commitment by an entity that will purchase and pool the loans. (12 CFR 1291.5(c)(14)) The regulation sets forth specific sponsor qualification requirements for loan pool sponsors. (12 CFR 1291.5(c)(10))
- 15) **Optional District eligibility requirements.** An FHLBank has the option of requiring projects to meet one or more of the following additional eligibility

requirements: 1) a requirement that a household must complete a homebuyer or homeowner counseling program provided by, or based on one provided by, an organization recognized as experienced in homebuyer or homeowner counseling, respectively; and 2) a requirement that the amount of AHP subsidy requested for the project does not exceed limits established by the FHLBank as to the maximum amount of AHP subsidy available per member each year, or per member, per project or per unit in a single funding round. (12 CFR 1291.5(c)(15)) An FHLBank may not vary its per-member AHP subsidy limit according to the member's use of the FHLBank's credit products. In addition, an FHLBank may not prohibit applications for projects that are located outside of its District, and cannot use its authority to award points to in-District projects under the First District Priority in such a way as to effectively exclude out-of-District projects from AHP funding.

16) Prohibited uses of AHP subsidy -- processing, cancellation and prepayment fees.

A project may not use AHP subsidy to pay for cancellation fees and penalties imposed by an FHLBank on a member for a subsidized advance commitment that is cancelled. A project may not use AHP subsidy to pay for processing fees charged by members for providing AHP direct subsidies to a project. Members may charge the sponsor processing and cancellation fees, but neither the sponsor nor member may use AHP subsidies to pay for them. AHP subsidy may not be used to pay for the prepayment fees on subsidized advances unless: (1) the project is in financial distress that cannot be remedied through a project modification; (2) the prepayment of the subsidized advance is necessary to retain the project's affordability and income targeting commitments; (3) after prepayment, the project will continue to comply with the terms of the approved AHP application and the regulation for the duration of the original retention period; (4) any unused AHP subsidy is returned to the FHLBank and made available for other AHP projects; and (5) the amount of AHP subsidy used for the prepayment fee may not exceed the amount of the member's prepayment fee to the FHLBank. (12 CFR 1291.5(c)(16))

Project Selection: Scoring Requirements (12 CFR 1291.5(d))

An FHLBank must score the applications using nine general scoring criteria based on a 100-point scoring system as set forth in the AHP regulation (12 CFR 1291.5(d)(5)). The FHLBanks have some discretion in giving weight to the criteria as specified in the regulation; however, eight of the criteria must be allocated at least five points each, while the "Targeting" criterion must be allocated at least 20 points. An FHLBank has the discretion to assign the remaining 40 points among any or all of the nine scoring criteria. The scoring requirements permit the FHLBank to select priorities for its district, referred to as the First and Second District Priorities, which provide the FHLBank with additional discretion to address its District housing needs. An FHLBank must also designate each scoring criterion as either "fixed" or "variable." A variable point criterion is one where there are varying degrees to which an application can satisfy the criteria, with the number

of points that may be awarded to an application for meeting the criterion varying, depending on the extent to which the application satisfies the criterion, based on a fixed scale or on a scale relative to the other applications being scored. The Targeting and Subsidy-Per-Unit scoring criteria must be designated as variable-point criteria. A fixed-point criterion is one which cannot be satisfied in varying degrees and is either satisfied or not, with the total number of points allocated to the criterion awarded by the FHLBank to an application meeting the criterion.

The AHP regulation defines and limits the scoring criteria and, in some cases, requires specific definitions or standards for a criterion. These must be included in the FHLBank's Implementation Plan. The FHLBank has discretion in establishing certain other definitions or elements within the scoring criterion. The FHLBank must also include these in the Implementation Plan. The FHLBank's definitions, scoring criteria, and related standards of evaluation must be transparent to all prospective applicants.

The FHLBank's Advisory Council provides recommendations on the FHLBank's scoring criteria, including the number of points to be allocated for each scoring criterion, certain related definitions, the determination of the standards for varying the number of points for a variable-point criterion, and the selection of the FHLBank's First District Priority and Second District Priority, as discussed below. The Advisory Council may identify housing needs that are not included in the regulation, based on the Advisory Council members' knowledge and experience in affordable housing initiatives within the FHLBank's District as well as on any available studies of local housing conditions. The FHLBank may incorporate these identified housing needs into its scoring guidelines under the Second District Priority.

Scoring Criteria (12 CFR 1291.5(d)(5))

The nine scoring criteria required by the regulation to score an application submitted under the FHLBank's AHP competitive application program are:

- 1) **Use of donated or conveyed government-owned or other properties.** The financing of housing using a significant proportion of: (1) land or units donated or conveyed by the federal government; or (2) land or units donated or conveyed by any other party for an amount significantly below the fair market value. The FHLBank must define "significant proportion" and "amount significantly below the fair market value" in its Implementation Plan.
- 2) **Sponsorship by a not-for-profit organization or government entity.** Project sponsorship by a not-for-profit organization, a state or political subdivision of a state, a state housing agency, a local housing authority, a Native American Tribe, an Alaskan Native Village, or the government entity for Native Hawaiian Home Lands. An FHLBank may vary the number of points according to such factors as the

organization's activities, its geographic scope, or the extent of its ownership or involvement in the project.

- 3) **Targeting.** The extent to which the project provides housing for very low-income and low- or moderate-income households, as follows: Rental projects shall be awarded the maximum number of points available if 60 percent or more of the units in the project are reserved for occupancy by households with incomes of 50 percent or less of the AMI. The AHP regulation further specifies the manner of scoring treatment, based on a declining scale, for projects with units below this threshold. Owner-occupied projects shall be awarded points based on a declining scale as determined by the Bank in its Implementation Plan, taking into consideration percentages of units and targeted income levels. For purposes of the Targeting scoring criterion, rental and owner-occupied projects may be scored separately.
- 4) **Housing for homeless households.** The financing of rental or permanent owner-occupied housing, reserving at least 20 percent of the units for homeless households, or the creation of transitional housing for homeless households permitting residents a minimum of six months occupancy. Overnight shelters are not eligible for scoring points under this scoring criterion; however, they are eligible for AHP subsidy. The FHLBank is required to define "homeless households" in its Implementation Plan.
- 5) **Promotion of empowerment.** The provision of housing in combination with a program offering: employment; education; training; homebuyer, homeownership, or tenant counseling; daycare services; resident involvement in decision-making affecting the creation or operation of the project; or other services that assist residents to move toward better economic opportunities, such as welfare to work initiatives. Empowerment programs or services must be related to economic betterment, which means obtaining and maintaining employment or financial self-sufficiency by the household, and must be provided specifically to the project's residents. Proximity to a service, and the general availability of a service, such as county-provided education, are not eligible for points under this criterion. Recreational activities also are not eligible for points. Children's education and youth programs are eligible for points only when they serve as a substitute for daycare for children needing supervision, thereby enabling the children's parents or guardians to find or sustain employment. The FHLBank must list the specific types of programs or services that are eligible for points in its Implementation Plan.
- 6) **First District Priority:** Satisfaction of one of the following 12 regulatory criteria, or one of a number of such criteria, adopted by the FHLBank in its AHP Implementation Plan. If more than one criterion is adopted by the FHLBank under this scoring category, then the points awarded for each criterion are cumulative in determining a project's total score for the First District Priority, and the total points available for

meeting the criterion or criteria may not exceed the total points allocated to this scoring category.

- a) **Special needs:** The financing of housing in which at least 20 percent of the units are reserved for occupancy by households with special needs, such as the elderly, mentally or physically disabled persons, persons recovering from physical abuse or alcohol or drug abuse, or persons with AIDS; or the financing of housing that is visitable by persons with physical disabilities who are not occupants of such housing. The FHLBank must include in its AHP Implementation Plan the types of special needs populations it intends to target, provided that the types chosen include or are similar to the examples listed in the criterion.
- b) **Community development:** The financing of housing that meets housing needs documented as part of a community revitalization or economic development strategy approved by a unit of a state or local government.
- c) **First-time homebuyers:** The financing of housing for first-time homebuyers. The FHLBank must define “first-time homebuyer” in its AHP Implementation Plan.
- d) **Member financial participation:** Member financial participation (excluding the pass-through of AHP subsidy) in the project, such as providing market rate or concessionary financing, fee waivers, or donations. The FHLBank must include in its Implementation Plan the type(s) of member financial participation for which it intends to allocate points, provided that the types chosen include or relate to the eligible member financial participation activities listed in this criterion. An application with financial participation by a member that is not the applicant for the project is eligible to receive points under this criterion.
- e) **Disaster areas and displaced households.** The financing of housing located in a federally declared disaster area, or for households displaced from a federally declared disaster area due to a disaster. The criterion is not limited to areas eligible for “individual assistance.” The FHLBank may vary the number of points according to the location of a disaster area or the type of disaster declaration. Projects in state-declared disaster areas are ineligible to receive points under this criterion.
- f) **Rural.** The financing of housing located in rural areas. The FHLBank must define “rural” in its Implementation Plan.
- g) **Urban.** The financing of urban infill or urban rehabilitation housing. The FHLBank must define “urban” in its Implementation Plan.
- h) **Economic diversity.** The financing of housing that is part of a strategy to end isolation of very-low-income households by providing economic diversity through mixed-income housing in low- or moderate-income neighborhoods, or providing very-low income or low- or moderate-income households with housing opportunities in neighborhoods or cities where the median income equals or exceeds the median income for the larger surrounding area, such as the city,

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- county, or Primary Metropolitan Statistical Area, in which the neighborhood or city is located.
- i) **Fair housing remedy.** The financing of housing as part of a court-ordered remedy under Title VI of the Civil Rights Act of 1964, the Fair Housing Act, or any other fair housing law, or as part of a settlement of such claims.
 - j) **Community involvement.** Demonstrated support for the project by local government, other than as a project sponsor, in the form of property tax deferment or abatement, zoning changes or variances, infrastructure improvements, fee waivers, or other similar forms of non-cash assistance, or demonstrated support for the project by community organizations or individuals, other than as a project sponsor, through the commitment by such entities or individuals of donated goods and services, or volunteer labor. The FHLBank must include in its Implementation Plan the types of noncash assistance for which it awards points, provided that the types chosen include or relate to the types of noncash assistance listed in the criterion. Donated goods and services and volunteer labor by nongovernmental organizations and individuals must be substantive and not *de minimis*. Cash or other debt or equity funding by such nongovernmental organizations or individuals are not eligible for points.
 - k) **Lender consortia.** The involvement of financing by a consortium of at least two financial institutions. The consortium does not have to include the member applicant for the project or any other FHLBank member.
 - l) **In-district projects.** The financing of housing located in the FHLBank's District. The FHLBank may not use this criterion in such a way as to effectively exclude out-of-District projects from the competition.
- 7) **Second District Priority:** The satisfaction of one or more housing needs in the FHLBank's District, as defined by the FHLBank in its Implementation Plan. This scoring priority category provides additional flexibility for an FHLBank to respond to identified housing needs in its District. The Second District Priority may represent any criteria listed under the First District Priority scoring category in the regulation that were not selected by the FHLBank under the First District Priority, or may meet other housing needs in the FHLBank's District identified by the FHLBank that are not listed as eligible criteria under the First District Priority scoring category in the regulation.
- 8) **AHP subsidy per unit:** The extent to which a project proposes to use the least amount of AHP subsidy per AHP-targeted unit. For purposes of this scoring criterion, applications for owner-occupied projects and rental projects may be scored separately. An FHLBank may use a fixed scale that does not change from round to round under this scoring criterion.
- 9) **Community Stability:** The promotion of community stability, such as by rehabilitating vacant or abandoned properties, being an integral part of a

neighborhood stabilization plan approved by a unit of state or local government, and not displacing low- or moderate-income households, or if such displacement will occur, assuring that such households will be assisted to minimize the impact of such displacement. The FHLBank must include in its AHP Implementation Plan the types of activities or project characteristics that are eligible to receive points under this criterion

Modifications of Approved Projects (12 CFR 1291.5(f))

If, prior to or after final disbursement of funds to a project from all funding sources, there is or will be a change in the project that would change the score that the project application received in the funding period in which it was originally scored and approved, the FHLBank may, in its discretion, approve a modification to the terms of the approved application subject to the following:

- (1) The project, incorporating any such changes, would continue to meet applicable minimum eligibility requirements under 12 CFR 1291.5(c). These requirements include, but are not limited to, the need for the AHP subsidy, and, the operational and developmental feasibility of the project. A modified project must be likely to be completed and occupied, based on relevant factors contained in the Bank's project feasibility guidelines, including, but not limited to, the development budget, market analysis, and project sponsor's experience in providing the requested assistance to households. A rental project must be able to operate in a financially sound manner, in accordance with the Bank's project feasibility guidelines, as projected in the project's operating *pro forma*.
- (2) The application after the modification continues to score high enough to have been approved in the funding period in which it was originally scored and approved by the Bank; and
- (3) There is good cause for the modification, and the analysis and justification for the modification are documented by the Bank in writing.
- (4) Any modification involving an increase in AHP subsidies must be approved or disapproved by the board of directors and cannot be delegated to Bank officers or other Bank employees.

Procedure for Funding (12 CFR 1291.5(g))

The FHLBank is required to establish and implement policies, including time limits, for determining whether progress is being made towards draw-down and use of AHP

subsidies by approved projects, and whether to cancel AHP application approvals for lack of such progress. The FHLBank is also required to establish and implement policies for determining, prior to initial disbursement of AHP subsidies for approved projects, and prior to each subsequent disbursement if the need for AHP subsidy has changed, that the project meets the regulatory eligibility requirements and all obligations committed to in the approved AHP application. Thus, prior to any disbursement of AHP subsidy, the FHLBank must determine that the project continues to meet eligibility requirements, including a review to determine whether there has been a change in any of the project's characteristics that affect its need for subsidy. If the need for subsidy has decreased from the amount approved, then the FHLBank must reduce the project's total award. If the need for subsidy has increased, then the FHLBank has the discretion to fund the additional amount, assuming the FHLBank has sufficient uncommitted funds and the project is feasible.

Each FHLBank has its own policy for disbursing AHP funds to a project. Some FHLBanks disburse AHP subsidies in the early stages of project development for such uses as land acquisition or development. Other FHLBanks disburse funds when the project is farther along in the development phase. Some FHLBanks only disburse the subsidy as reimbursement to the sponsor after project expenses have been incurred either prior to, or in some cases after, project completion.

Each approach has policy advantages and disadvantages that an FHLBank will need to consider. Early stage funding is often difficult to secure from other funders and may enable a sponsor to complete projects more efficiently. Earlier funding can also benefit affordable housing by leveraging funding from other sources. Funding a project during the later stages of development helps ensure that the AHP subsidy is going to projects that are in compliance at completion, thereby minimizing the likelihood of subsidy recapture. When used as late-stage funding, the AHP may serve as an important source of gap-financing to increase the number or depth of income targeted units. However, late stage funding, especially after a project has been completed, may result in a sponsor incurring additional carrying costs or delayed cash flows.

Both disbursement approaches have their merit. However, whether an AHP project receives early or later stage funding, the Bank's risk management practices should be appropriate to the risk for that project. For example, early stage funding, especially for predevelopment, requires a diligent feasibility review before funds are disbursed to assure that a project is likely to be completed and occupied, and, that the subsidy will be used in compliance with the commitments in the AHP application. However, late stage funding, especially after a project has been completed, may result in a sponsor incurring additional carrying costs or delayed cash flows, thus resulting in a more expensive project. And, late stage funding might require a review by the FHLBank to assure that the AHP project continues to demonstrate a need for the AHP subsidy. In both early-, or late-stage

funding, expedient release of the subsidy is essential to keeping down project costs and increasing the likelihood for project stability and compliance.

5) *AHP Homeownership Set-Aside Program (12 CFR 1291.6)*

The homeownership set-aside programs allow an individual household to access AHP direct subsidies directly from FHLBank members to purchase or rehabilitate their homes, as opposed to through a successful sponsor-initiated competitive application. The homeownership set-aside program provides direct subsidy to a household for down payment, closing costs, homeownership counseling, and/or rehabilitation assistance in conjunction with the purchase or rehabilitation of an owner-occupied unit.

An FHLBank may establish one or more homeownership set-aside programs by allocating up to the greater of \$4.5 million or 35 percent of its annual statutorily required AHP contribution to such programs. At least one-third of the FHLBank's annual homeowner set-aside amount must be allocated (i.e., reserved) for first-time homebuyers, but it does not have to be actually committed or disbursed to first-time homebuyers. The entire amount of the annual allocation is not required to be drawn down each year, for example, in a year when there is insufficient demand. However, a pattern in which a substantial amount of the set-aside allocation remains undisbursed over several years could indicate an inefficient use of the AHP subsidy.

An FHLBank may reserve an allotment of funds for each member, or may commit funds to a member for individual households on a first-come, first-served basis as they enroll households in the program. Generally, a member provides homeownership set-aside grants to eligible households on a first-come, first-served basis. Each FHLBank sets its own maximum grant amount of up to \$15,000 per household.

The following eligibility criteria must be met in order to be eligible for the set-aside grants:

- a) The household must have an income of no more than 80 percent of AMI;
- b) The AHP subsidy must be secured by a five-year retention agreement as specified in the AHP regulation. (See 12 CFR 1291.6(c)(5), 1291.9(a)(7));
- c) If the applicant is a first-time homebuyer it must complete a homebuyer or homeowner counseling program; and
- d) The household must meet any other eligibility criteria established by the FHLBank in its AHP Implementation Plan, such as a requirement that the household participate in a matched savings program, obtain homeownership counseling if not a first-time homebuyer, obtain the mortgage from the member, or comply with a limitation on the location of the property in-District, on Native American lands or in disaster areas.

Members may work with sponsors of owner-occupied housing to identify eligible households that the sponsor may refer to the member for assistance under the set-aside program. However, set-aside funds must be made available to borrowers whether or not they are participating in a sponsored program.

The FHLBank may permit members to use one or more sources of information to establish AMI in order to determine whether a household is at or below 80 percent of AMI, in keeping with the FHLBank's definition of AMI in its AHP Implementation Plan.

The date of enrollment of the household by the member, which the FHLBank must also define in its Implementation Plan, determines when household income eligibility is established. Generally, this is when the member accepts the household for participation in the program and, in the case of a matched savings program, when the period for any savings requirement starts. Typically, the member reserves set-aside funds for the household either from its allocation from the FHLBank or by notifying the FHLBank. A member may enroll a household at any time, but the FHLBank may not reserve funds for an individual household more than two years prior to the FHLBank's time limit established in its Implementation Plan for the draw-down and use of the AHP funds by the household. The reservation of the AHP subsidies must be made from the set-aside allocation of the year in which the FHLBank makes the reservation.

The FHLBank may require that the participating member provide the permanent mortgage for the home purchased with the set-aside subsidy. The FHLBank may also require that members or other lenders that provide financing to assisted households provide financial or other concessions in connection with such financing. If so, the FHLBank must identify in its Implementation Plan the types of financial or other concessions that will meet the requirements. The AHP regulation requires that the interest rate, points, fees, and any other charges by the member or by any other lender providing the mortgage to the household in conjunction with the AHP subsidy must not exceed a reasonable market interest rate, points, fees, and other charges for a loan of similar maturity, terms, and risk. All loans financed by set-aside funds must be consistent with the Interagency Guidance on Non-Traditional Mortgage Products and any successor guidance, and related state laws.

The AHP set-aside can be used in conjunction with matched savings programs. For example, a household may need only \$3,000 in AHP subsidy for the lender's required down payment, but through a savings match has qualified for \$4,000 in AHP subsidy. The additional \$1,000 in AHP subsidy may be credited to reduce the principal of the household's mortgage loan or credited toward the household's monthly mortgage payments.

To ensure that AHP subsidies are used for purposes of down payment and closing cost assistance (and counseling payments as applicable), a household cannot receive cash back

at closing in excess of \$250, as determined by the FHLBank in its Implementation Plan. Any additional subsidy available at closing beyond what is needed at closing for closing costs and the approved mortgage amount must be applied as a credit to reduce the principal of the loan or provided to the lender to be credited toward the household's monthly mortgage payments.

The \$250 cash-back limit does not apply to reimbursement of closing costs paid by the household or to third parties, typically escrows, for rehabilitation work to be completed after closing. However, the AHP subsidy cannot be used to reimburse the household for money, such as earnest money, which is credited to the household's down payment. Closing documentation must show that any excess AHP subsidy of more than \$250 was provided to the lender and used to reduce the loan principal or loan payments.

6) *Monitoring (12 CFR 1291.7)*

For both the competitive application program and the homeownership set-aside program, an FHLBank must establish monitoring policies and procedures to ensure that projects are making satisfactory progress towards completion and occupancy, and are in compliance with the commitments in the approved AHP application, FHLBank policies, and the AHP regulatory requirements. The regulation sets forth requirements for the FHLBanks' monitoring programs, and requires that the FHLBanks' monitoring policies and procedures address initial monitoring of owner-occupied and rental projects and long-term monitoring of rental projects under the competitive application program, and monitoring of owner-occupied units under the homeownership set-aside program.

Essential to the FHLBank's monitoring is establishment of a thorough and reliable management information system (MIS). The MIS must be capable of tracking required project information under the competitive application program and household information under the homeownership set-aside program, and producing useful and relevant reports. FHLBank management and staff must be able to readily access current and accurate individual and aggregate information on: (1) the status, including follow-up actions, of project funding, project completion, project monitoring and project compliance; (2) problem projects, sponsors, owners and members; and (3) AHP subsidy cash flows including commitments, disbursements, repayments, recaptures and de-obligations.

Competitive Application Program

Initial Monitoring

The FHLBank must establish initial monitoring policies and procedures, set forth in its Implementation Plan, for owner-occupied and rental projects, with the monitoring occurring prior to, and within a reasonable period of time after, project completion, which

shall include documentation requirements for members and project sponsors and owners as further specified in the regulation. The FHLBank is required to conduct such initial monitoring of all owner-occupied and rental projects. (12 CFR 1291.7(a)(1)) The FHLBank may not use a sampling plan to select the projects for initial monitoring, but may use a reasonable risk-based sampling plan to review back-up project documentation when such projects undergo initial monitoring. Initial monitoring is critical to determine whether a project complies with all of the commitments made in the approved AHP application, FHLBank policies, and the AHP regulatory requirements. An FHLBank only monitors rental projects for compliance with an application's income targeting and affordability commitments during the long-term monitoring period, and owner-occupied projects are not subject to long-term monitoring, therefore, the initial monitoring evaluation is essential to determining project compliance. Initial monitoring for rental projects establishes a baseline for the FHLBank to assess the project's characteristics and risk of potential noncompliance. Initial monitoring enables the FHLBank to anticipate issues so it can work with its members, project sponsors, and owners to increase the likelihood of compliance.

Long-Term Monitoring of Rental Projects

In the case of completed rental projects under its competitive application program, the FHLBank must establish long-term monitoring policies and procedures, set forth in its Implementation Plan, with the monitoring commencing in the second year after project completion. The purpose of this monitoring is to determine whether the project meets the income targeting and rent commitments made in the approved AHP application for the duration of the 15-year retention period. (12 CFR 1291.7(a)(4)) The regulation requires that all rental project owners submit an annual certification to the FHLBank, for the duration of the 15 years, stating that the project continues to meet the income targeting and rent commitments. The FHLBank may vary the frequency and scope of monitoring according to various risk factors, such as the amount of AHP subsidy in the project, type of project, size of project, experience of the sponsor, monitoring of the project by other governmental funding sources, or project characteristics such as location or population served. The FHLBank may use a reasonable, risk-based sampling plan to select the rental projects to be monitored, and to review the project owner certifications, back-up, and any other project documentation. The sampling plan and its basis must be in writing.

The AHP regulation specifies that for completed AHP-assisted rental projects that have been allocated Low Income Housing Tax Credits (LIHTC), an FHLBank may, in its discretion, for AHP long-term monitoring purposes, rely on the monitoring by the state tax credit monitoring entity of the income targeting and rent requirements applicable under the LIHTC program, and the FHLBank need not obtain and review reports from such agency or otherwise monitor the project's long-term AHP compliance. (12 CFR 1291.7(a)(2)) The FHLBank is not required to conduct any long-term monitoring of the AHP subsidy used in these projects unless and until the project no longer participates in

the LIHTC program as a result of uncured LIHTC program noncompliance. In order for a FHLBank to know that a project is no longer a tax-credit project, the FHLBank may require in its monitoring agreement that the project owner notify the FHLBank if the tax-credit monitoring entity issues a Form 8823 notifying the Internal Revenue Service (IRS) that the project is no longer in tax-credit compliance and has ceased participation in the LIHTC program.

The AHP regulation also provides that for completed AHP-assisted rental projects that received funds other than LIHTCs from other governmental entities, an FHLBank may, in its discretion, rely on the long-term monitoring by the governmental entities of the income targeting and rent requirements applicable under their programs, provided that the FHLBank can show that: (1) the compliance profiles regarding income targeting, rent and retention period requirements of the AHP and the other programs are substantively equivalent; (2) the entity has demonstrated and continues to demonstrate its ability to monitor the project; (3) the entity agrees to provide reports to the FHLBank on the project's incomes and rents for the full 15-year AHP retention period; and (4) the FHLBank reviews the reports from the monitoring entity to confirm that they comply with the FHLBank's monitoring policies. (12 CFR 1291.7(a)(3))

Homeownership Set-Aside Program

The FHLBank must establish monitoring policies and procedures, set forth in its Implementation Plan, for its homeownership set-aside programs to determine that program requirements have been met, including that households are subject to five-year retention agreements, and that households receiving the subsidy are eligible. The FHLBank's policies must include requirements for FHLBank review of member certifications prior to subsidy disbursement that the subsidy will be provided in compliance with all applicable eligibility requirements, and FHLBank review of back-up documentation regarding household incomes maintained by the member. The FHLBank must review all member certifications, but it may use a reasonable sampling plan to select the households to be monitored and to review the back-up and any other documentation received by the FHLBank. (12 CFR 1291.7(b)) In its sampling plan, the FHLBank should include a review of the relevant documents that establish compliance with household income, set-aside eligibility requirements, and documents such as a HUD-1, which provides evidence that a loan has closed and costs are reasonable.

7) Remedial Actions for Noncompliance (12 CFR 1291.8)

If any member, project sponsor, project owner or FHLBank, through its actions or omissions, causes the AHP subsidy to not be used in compliance with the commitments in the approved AHP application and the AHP regulatory requirements, then such party or parties must repay the amount of misused subsidy to the FHLBank's AHP fund for use by other eligible AHP projects. If the project sponsor or owner is liable for repayment of

the AHP subsidy, the FHLBank may recover the subsidy directly from such sponsor or owner, or may require that the member be responsible for recovering the subsidy from such sponsor or owner and repaying it to the FHLBank. Recovery of the misused AHP subsidy is not required if: (1) the member, project sponsor or project owner cures the noncompliance within a reasonable period of time; (2) the circumstances of the noncompliance are eliminated through a project modification; or (3) the member is unable to collect the subsidy after making reasonable efforts to collect it.

An FHLBank may settle a claim for AHP subsidies for less than the full amount due, but may be required by FHFA to reimburse its AHP fund for the shortfall, unless: (1) the FHLBank has sufficient documentation showing that the settlement amount is reasonably justified based on the facts and circumstances of the noncompliance; or (2) the FHLBank obtains a determination from FHFA that the settlement amount is reasonably justified based on the facts and circumstances of the noncompliance. An FHLBank is required to reimburse its AHP fund for any AHP subsidies misused as a result of the actions or omissions of the FHLBank itself.

There is no provision for recapture from an AHP-assisted household if the household did not comply with the eligibility requirements under either the competitive program or the homeownership set-aside program. The regulation provides that a project sponsor, project owner or member is the party responsible for ensuring that the household is eligible for AHP assistance, and thus is liable for repayment if the household is ineligible. Consequently, the project sponsor, project owner, member or FHLBank may recover AHP subsidy from a household only for the sale or refinancing of an owner-occupied unit under the circumstances discussed in the Agreements section below.

In both the competitive application program and homeownership set-aside program, if an AHP-assisted owner-occupant household repays AHP subsidy to the member or project sponsor as a result of a sale by the household of the unit prior to the end of the retention period, and, the purchaser is not a low- or moderate-income household, the FHLBank may allow the member or project sponsor to reuse that repayment by making the subsidy available for another AHP-eligible household to purchase or rehabilitate an owner-occupied unit in the same project in accordance with the terms of the approved AHP application. The FHLBank's Implementation Plan must specify the requirements for reuse of repaid AHP subsidies according to the FHLBank's policy. (12 CFR 1291.8(f)(2))

8) *Agreements (12 CFR 1291.9)*

The regulation requires an FHLBank to have in place with each member receiving AHP subsidy an agreement or agreements containing specific provisions set forth in the regulation, including monitoring, retention period and AHP subsidy repayment requirements.

The AHP retention period for AHP-assisted owner-occupied units and rental projects is five years and 15 years, respectively. In the event an AHP-assisted rental project is sold or refinanced during the 15-year retention period, the entire amount of the AHP subsidy must be repaid to the FHLBank, unless the project continues to be subject to the AHP retention agreement requirements for the remainder of the retention period, or the households in the rental project are relocated, as further specified in the regulation.

If an AHP-assisted household sells or refinances an owner-occupied unit prior to the end of the five-year retention period, the household must repay a pro rata share of the AHP subsidy from any net gain realized upon the sale or refinancing, reduced pro-rata for every year the household owned the unit, unless:

- (a) The unit is sold to a low- or moderate-income household;
- (b) The AHP retention agreement requirements remain in place for the remainder of the retention period in the case of a refinancing; or
- (c) The unit was assisted with a permanent mortgage loan funded by an AHP subsidized advance.

If a household must repay a portion of AHP subsidy upon sale or refinancing, then the household does so only from any net gain from the sale or refinancing. The household does not pay back any portion of the AHP subsidy that is more than the amount of the net gain from the sale or refinancing.

All agreements for the use of AHP subsidy are between the FHLBank and the member. In the case of competitive application program projects, the agreements are between the FHLBank, the member and the project sponsor or owner, as applicable. The FHLBank may have direct agreements with the sponsor or owner under the competitive application program for monitoring, recapture, or other provisions as the FHLBank may determine. Households that purchase owner-occupied units with AHP set-aside assistance are subject to the same five-year retention requirements as owner-occupied units purchased under the competitive application program.

If a member or project sponsor lends AHP direct subsidy to a project, any repayments of principal and payments of interest received by the member or project sponsor must be paid forthwith to the FHLBank, unless the direct subsidy is being both lent and relented by a revolving loan fund pursuant to 12 CFR 1291.5(c)(13), if the FHLBank has authorized such use. (12 CFR 1291.9(a)(9)) Liability for repayment of principal and payment of interest ends when the applicable AHP retention period ends. For example, lending of AHP direct subsidy is common in federal LIHTC-assisted rental projects in which the sponsor lends the AHP direct subsidy to the tax-credit partnership. If the partnership repays the subsidy to the sponsor after the project's 15-year retention period ends, then the sponsor is not required to repay that amount to the member or the FHLBank.

9) *Temporary Suspension of AHP Contributions (12 CFR 1291.11)*

An FHLBank may request approval from FHFA to temporarily suspend its required annual AHP contribution if such contribution would contribute to the financial instability of the FHLBank, as further defined in the regulation.

10) *Affordable Housing Reserve Fund (12 CFR 1291.12)*

If an FHLBank does not use or commit all of its required annual statutory AHP contribution in that year, the FHLBank must deposit 90 percent of the unused or uncommitted amount in an Affordable Housing Reserve Fund established and administered by FHFA. The remaining 10 percent retained by the FHLBank should be fully used or committed by the FHLBank during the following year, with any remaining portion deposited in the Fund. To date, no such Fund has been established by FHFA.

The regulation provides that approval of AHP applications sufficient to exhaust the FHLBank's annual required AHP contribution shall constitute use or commitment of funds. Amounts remaining unused or uncommitted at year-end are deemed to be used or committed if, in combination with deobligated or recaptured AHP funds, they are insufficient to fund: (1) the next highest scoring AHP application in the FHLBank's final funding period of the year for its competitive application program; (2) pending applications under the FHLBank's homeownership set-aside program; and (3) project modifications approved by the FHLBank. Such insufficient amounts shall be carried over for use or commitment in the following year in the FHLBank's competitive application or homeownership set-aside programs.

Regulatory and Supervisory References

In addition to Section 10(j) of the Bank Act and 12 CFR Part 1291 of FHFA's rules and regulations, primary governing authorities, No-Action Letters, and Regulatory Interpretations and other regulatory policies relevant to the FHLBanks' AHP are found in the FOIA Reading Room of the FHFA's public website at www.fhfa.gov. The FHLBanks should ensure that the application of such authorities to an FHLBank has been considered by the Bank directors, officers and management with support from the Bank's legal counsel.

Examination Guidance

The objectives of the AHP examination are to determine whether an FHLBank's governance and operations achieve an effective administration of the AHP that: (1) results in AHP projects that provide housing that benefits very low-income and low- and moderate-income households; (2) ensures the integrity of the AHP by providing comprehensive and equitable methods for awarding and disbursing funds and monitoring

and evaluating outcomes; (3) fosters the compliance of members and projects in providing housing meeting the program objectives; (4) results in the AHP subsidy being disbursed and used in a manner consistent with the AHP statute and regulation, AHP policies and reflecting good practices; (5) responds in a timely and appropriate manner to problem projects or members; and (6) achieves results that are generally consistent with the FHLBank's established priorities and are responsive to District housing needs. Examination work will also assess whether the FHLBank's board of directors has sufficient knowledge of program operations and the effectiveness of the FHLBank's portfolio of AHP projects in meeting the program goals.

The scope of the examination will be developed prior to each FHLBank examination. The examiners' work program will identify the methodology to be used, such as project sampling plans and documents to be reviewed. Using the examination work program as the framework, the AHP examiner may establish an examination scope that focuses on particular program activities and attributes. Not all areas of the AHP examination need to be addressed in a single examination cycle. Rather, the examination should focus on areas that might need particular attention or entail heightened risk. The scope of the examination may include additional inquiries in response to changing conditions, policy concerns, or emerging areas of risk.

In evaluating the responsiveness and effective operations of the FHLBank's program, AHP examiners may review such documents as: AHP Advisory Council reports; AHP Implementation Plans; the FHLBank's internal AHP procedures; the FHLBank's monitoring reports; Community Lending Plans; minutes and materials from meetings of the FHLBank's board of directors, the FHLBank's Board Housing Committee, and management committee; the FHLBank's strategic plan; and any other relevant information. Further, quantitative indicators, such as the AHP Database, and other supplementary sources of information may be used to identify and evaluate program objectives, trends, and potential risks.

Corporate Governance

The evaluation of the corporate governance may address any of the following:

- 1) Whether the FHLBank's directors and management exercise their due diligence responsibilities to the AHP consistent with the fundamental intent of the program.
- 2) The quality of strategic planning for the AHP, adequacy of budget allocations, capacity and expertise of personnel, and the board's and executive management's involvement in significant AHP decisions.
- 3) Whether the FHLBank works with members of the Advisory Council, the FHLBank's members and, as appropriate, potential applicants to identify housing needs and establish priorities and objectives for the AHP.

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- 4) The FHLBank's process of identifying its communities' housing needs, establishing AHP priorities, developing strategies, and monitoring outcomes.
 - 5) Whether the FHLBank's board and the Advisory Council are meeting Bank Act and AHP regulatory requirements.
 - 6) Whether the board and the Advisory Council appropriately handle potential or actual conflicts of interest.
 - 7) The quality of the internal audit as it applies to assessing AHP compliance, and the FHLBank's responsiveness to audit findings.
 - 8) Policies, procedures and controls that promote sound and effective operations, fair and impartial program administration, regulatory compliance, and effective risk management practices, and protect the AHP from reputation risk.
 - 9) The adequacy of the FHLBank's AHP management information system in accurately reporting essential program functions and characteristics, including but not limited to, FHFA's reporting requirements.

The FHLBank's board of directors is ultimately responsible for the effective operation of the AHP. An FHLBank's board of directors may charter a housing or comparable committee of the board to oversee housing and community investment issues. Some boards delegate many of their AHP-related functions to the housing committee. The housing committee must report its proceedings to the full board. The board of directors is responsible for ensuring that sufficient resources are allocated to the AHP, which include qualified and effective management and a reliable and secure MIS. The Advisory Council members serve in an advisory capacity to the board of directors and management, providing information and insight into the affordable housing and community lending needs, activities and trends within the FHLBank's district.

The internal audit of the AHP should follow the objectives for internal audits contained in the FHFA examination module for Internal and External Audit, consistent with AHP regulations, FHFA supervisory guidance and examination standards. Additionally, examiners should evaluate work completed by the enterprise risk management function and determine if potential risks to the FHLBank have been appropriately identified and whether adequate controls are in place to mitigate potential risks.

Program Operations

The FHLBank's CIO, under the supervision of the FHLBank President, is responsible for the overall management of the AHP. In addition to maintaining contact with community organizations in the affordable housing area, the CIO is responsible for ensuring the AHP is managed in accordance with FHFA regulations and FHLBank policy.

Management must implement policies and procedures to operate the AHP and establish a sound internal control environment and ensure that examination and internal audit findings are addressed in a timely manner. Effective program operations require a reliable management information system that allows staff and management to track the monitoring and compliance of AHP-assisted projects so that management can promptly address any problems with members, projects, sponsors and owners. Effective program operations also require a reliable system to track and reconcile AHP cash flows and to reconcile these AHP accounts with the FHLBank's general ledger. At any time, an FHLBank must know the status of its flow of AHP funding from the amount of required contributions through commitments, disbursements, deobligations, repayments, and recaptures. Such reconciliations ensure that the FHLBank knows that AHP funds are being fully committed and used for intended purposes from year to year. In total, sound program operations are necessary to mitigate the operational risk associated with managing the AHP.

Examiners will assess the effectiveness of program operations by reviewing the FHLBank's policies and procedures, and testing the procedures used for the competitive application program and set-aside program, initial monitoring, long-term monitoring, and problem project resolution, leading to a conclusion as to how well the operations of the program contribute to the AHP goals.

Examiners will assess: (1) whether FHLBank staff comply with the policies, procedures, and controls for the competitive and homeownership set-aside applications, subsidy disbursements, monitoring, deobligations, recaptures and repayments; and (2) whether communications among staff, management, and the board of directors are appropriate to communicate progress in meeting goals and ensuring AHP operations function appropriately.

Examination Procedures

In its review, the examiner should evaluate the quality of overall management and operational risk management and draw conclusions about the effectiveness of the FHLBank's AHP as described at the beginning of the Examination Guidance section of this module. Examiners will assess the FHLBank's operation of the AHP generally, and both the competitive and homeownership set-aside programs specifically. Examiners must complete the workprogram contained in the "Workprogram and Guidance" section below. At any time during the examination, an examiner may determine that additional testing or review is warranted and modify the scope of the examination with the concurrence of the lead examiner and supervisory examiner. The Examiner-in-Charge (EIC) will factor the AHP examiners' conclusions about the AHP into the component ratings for Management and Operational Risk in accordance with FHFA's examination rating system (CAMELSO).

Workprogram and Guidance

The workprogram includes guidance for examination of the competitive application program and the homeownership set-aside program, which can assist the examiner in evaluating the various areas of the AHP that an individual examiner may be reviewing within each of these programs. This guidance is illustrative and not exclusive. The workprogram should be used as a framework; however, not all factors or questions need to be addressed during each examination cycle so the examiner may focus on areas most in need of attention. The examiner may identify and carry out other actions that garner similar information that support the objectives of the workprogram. Thus, the workprograms below, while drawn from the principles in this examination module, may vary in their scope.

<h3>1. Scope of Examination Work Performed</h3>
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Review and assess the adequacy of the FHLBank's responsiveness to examination findings from the previous AHP examination and the FHLBank's internal audits of the program. The examination should:

- 1) Review examination findings from the previous year's AHP examination, FHLBank management's responses to these, and notes from quarterly follow-up teleconferences between examiners and FHLBank staff.
- 2) Assess whether the FHLBank's reporting and management processes adequately ensure timely corrective action.

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- 3) Determine whether the FHLBank has taken appropriate and effective action to address deficiencies noted during the previous examination (e.g., review revised FHLBank policies and procedures, communicate with FHLBank staff to discuss corrective actions taken, and conduct transaction testing to confirm that corrective actions were taken and are effective to correct the deficiencies noted in the previous examination).
 - 4) Update the examination findings tracker prepared in connection with the previous examination to reflect subsequent corrective actions taken by the FHLBank. Notify the EIC of the FHLBank of any corrective actions or modifications and send the EIC the updated findings tracker.
 - 5) Review all audits completed for the AHP since the previous examination. Determine if the board and management have been responsive to findings from these audits.

Summarize the work performed in the examination of the FHLBank's AHP. To the extent there were modifications to the originally planned examination scope based on concerns identified during the examination, document those changes and the reasons for such changes.

2. Description of Risk

The primary objective of assessing the FHLBank's oversight of the AHP is to ensure the directors and management exercise due diligence and fulfill their responsibilities to the AHP. FHLBank decisions must be documented, adequately supported, and consistent with the best interests of the program. The board and senior management should assure periodic evaluation of the AHP program to assess its effectiveness in addressing the FHLBank's priorities and policy objectives.

In assessing the effectiveness of the AHP oversight and engagement by the board of directors and executive management, the examiner should generally review all actions of the board, board housing committee and subcommittees, and management committees, and the Advisory Council charter (or equivalent document) and relevant bylaw provisions, as applicable. In addition, the examiner should review the meeting minutes for all of these groups, supplemental meeting materials, and any reports issued since the last AHP examination. Examiners should conduct a review for adequacy of significant AHP-related documents, such as conflict of interest policies, strategic plans, and internal audit plans and assess the FHLBank's adherence to the specified terms in these documents.

The examiner's review of the above-referenced actions and documents shall:

- 1) Assess the structure of and interactions between and among the board, its committees and subcommittees, and the Advisory Council, as well as the working relationships between and among these groups and the FHLBank's affordable housing and community investment staff.
- 2) Assess whether AHP reports are completed on a timely basis and presented to the appropriate members of the management team and the board of directors.
- 3) Include a review of meeting frequency, attendance, duration, and subject matter coverage. At a minimum, the following matters should be routinely considered by the examiner:
 - a) Board and management involvement in significant developments regarding the AHP, the Bank's AHP project portfolio, or individual AHP projects;
 - b) Oversight reports – Project Watch List (or an equivalent monitoring mechanism), project extension approvals, monitoring delinquencies (including delays and reasons for the delay), subsidy disbursements, settlements, recaptures, deobligations and repayments;
 - c) Any Implementation Plan revisions;
 - d) Information on current competitive scoring rounds sufficient to enable the board to make informed decisions regarding the approval or denial of applications for AHP subsidy (e.g., project descriptions, policy exceptions, ineligible projects, and summary statistics);
 - e) Pending regulatory changes and their possible impact;
 - f) Proposed FHLBank policy changes;
 - g) Member, project sponsor, or project owner debarments and suspensions; and
 - h) Reports of suspected or actual fraud arising in connection with the AHP.
- 4) Address the following:
 - a) Does there appear to be sufficient expertise in each group involved in the AHP to carry out that group's responsibilities?
 - b) Do the board or board representatives and the Advisory Council meet at least quarterly?
 - c) How has the board and the FHLBank's affordable housing and community investment staff responded to the Advisory Council's input and is this input reflected in the FHLBank's AHP Implementation Plan or other policies? If not, why not?
 - d) Are delegations of authority made by the board to relevant board committees and the FHLBank's affordable housing and community investment staff appropriate? (For example, does the Board delegate too much or too little authority?)

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- e) Do the board, board committee(s) and Advisory Council receive sufficient information from the FHLBank's affordable housing and community investment staff to adequately fulfill their respective roles?
 - f) Are the duties carried out by the Advisory Council consistent with 12 CFR 1291.4 of FHFA's regulations, and is the information that the Advisory Council receives sufficient to make informed recommendations while assuring that the right to confidentiality of members and project sponsors and owners is not transgressed?
 - g) Do the FHLBank's senior managers provide adequate oversight and attention to the Community Investment Office and the CIO?

Advisory Council

Based on the examiner's discussions with management and review of the minutes of Advisory Council meetings held since the previous AHP examination, determine whether the Advisory Council is effective in advising the FHLBank on housing needs in the district, and how the FHLBank can use the AHP to help meet such housing needs. The examiner should consider:

- 1) Advisory Council meeting attendance and efforts to address poor attendance if applicable.
- 2) Whether Advisory Council membership represents community and not-for-profit organizations actively involved in affordable housing or community lending and includes persons drawn from a diverse range of organizations so that representatives of no one group constitute an undue proportion of the Advisory Council membership, giving consideration to the size of the FHLBank's district and the diversity of low- and moderate-income housing and community lending needs and activities within the district.
- 3) Whether the Advisory Council is engaged, and effectively represents and communicates community affordable housing needs and challenges to the FHLBank; and, whether it offers constructive recommendations on housing policy and AHP objectives, and strategic planning (with respect to AHP) to the FHLBank.
- 4) Advisory Council input, analysis and recommendations for the FHLBank's AHP policies are contained in the Implementation Plan, taking into consideration that the regulation does not require that the FHLBank adopt the Advisory Council's recommendations.
- 5) Whether Advisory Council members are in good standing (e.g., do not have AHP projects that are severely troubled or unresponsive to FHLBank requests) with regard to their own AHP projects and whether they recuse themselves in the event of a conflict of interest.

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- 6) The Advisory Council exercises its due diligence responsibility by participating in the preparation and approval of the Advisory Council's report to FHFA on the FHLBank's low- and moderate income housing and community lending activities, as required by the Bank Act.

3. Risk Management

Risk Identification

- 1) Consider the comprehensiveness and reliability of the FHLBank's enterprise risk management assessment of potential risks with respect to the AHP.
- 2) Determine if potential risks have been appropriately identified and whether internal controls have been established to mitigate these risks.

Organizational Structure

Assess the effectiveness of the FHLBank's AHP organizational structure and reporting lines. Obtain, analyze and discuss as appropriate with FHLBank management:

- 1) The FHLBank's organization chart and AHP position within the overall organizational structure of the FHLBank. The organization chart should clearly depict lines of authority and accountability as well as channels of communication.
- 2) The board of directors' oversight of the AHP. How has the board delegated the responsibilities? Are delegations appropriate?
- 3) The individuals or FHLBank units responsible for managing and discharging the FHLBank's AHP duties and responsibilities and the achievement of the program objectives.
- 4) A comprehensive listing of AHP staff and a full description of AHP staff expertise.

Policies and Procedures

The FHLBank's policies provide the framework for a sound AHP. As such, policies should communicate the goals of the FHLBank's AHP and clearly define the roles of individuals involved in administering the program.

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The FHLBank's procedures should outline specific actions that are taken in administering the AHP and serve as the basis for establishing sound practices for the FHLBank's oversight of the program.

Competitive Application Program Policies and Procedures

The FHLBank's policies and procedures must accurately incorporate and reflect FHFA regulations and guidance. In assessing the competitive application program, consider the following:

- 1) Determine that the FHLBank has a process for ensuring that its policies and procedures governing the AHP comply with FHFA regulations and guidance, including:
 - a) A process for reviewing FHFA regulatory amendments, Regulatory Interpretations and supervisory guidance, such as Advisory Bulletins and No-Action Letters, with management and staff and with other relevant FHLBank departments, such as the legal, credit or accounting departments; and
 - b) Implements and accurately interprets and applies FHFA regulatory amendments, Regulatory Interpretations, supervisory guidance and examination findings.
- 2) Assess the adequacy of the Implementation Plan (IP) in describing the FHLBank's expectations for the AHP and complying with the applicable requirements of 12 CFR Part 1291 and FHFA guidance.
 - a) Review the AHP Implementation Plan² and note any sections for further discussion with FHLBank management. In particular, note whether:
 - i) The AHP Implementation Plan sets out the requirements for the program administration, which comply with the AHP regulation and FHFA guidance and enable the FHLBank to carry out program activities in a timely manner and adequately manage program risks.
 - ii) The AHP Implementation Plan addresses the following matters required in 12 CFR Part 1291 of FHFA's regulations:
 - The applicable median income standard or standards;
 - Definitions of terms as required under the regulation.
 - Requirements for the competitive application program, including eligibility requirements and scoring criteria;
 - Requirements for the homeownership set-aside programs, if applicable;
 - Requirements for funding revolving loan funds, if applicable;
 - Requirements for funding loans originated for mortgage loan pools, if applicable;

² Each FHLBank should maintain the most current version of its Implementation Plan on its website. It is this version that examiners should review in connection with an examination.

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- Monitoring requirements for the competitive application program and any homeownership set-aside programs;
 - Requirements, including time limits, for re-use of repaid AHP direct subsidy, if applicable; and
 - Retention agreement requirements for projects and households under the competitive application program and any FHLBank homeownership set-aside programs.
- 3) In evaluating the soundness of policies and procedures, review key policies on project eligibility, costs and feasibility, scoring, approval, monitoring and problem project resolution, and consider whether such policies are carried out.

Competitive Scoring Process

The examiner should review a sample of applications and assess the adequacy of the FHLBank's execution of the most recent competitive funding round for sufficient rigor, fairness to applicants, and compliance with the AHP regulation and FHFA guidance.

1) Availability of Funds

- a) Review the FHLBank's methodology for establishing the amount of funds available for allocation to each round and to any set-aside programs. Assess the strength of the controls to ensure consistency in accounting and reporting on:
 - i) Amount of Funding. Consider the following:
 - Consistency with statutory and regulatory requirements, including assurances that 10 percent of the prior year's earnings are allocated to the AHP fund;
 - Identification of funds de-obligated, recaptured, and repaid or replenished by the FHLBank;
 - Funds advanced from future funding rounds (acceleration); and
 - Any FHLBank voluntary contributions to the AHP
 - ii) Number of funding rounds and allocation of funding between rounds.
- b) If the FHLBank accelerated funds for AHP from future earnings:
 - i) Did the FHLBank's board approve the acceleration? What was the reason for the acceleration?
 - ii) How does the FHLBank plan to credit the amount accelerated over future years, as required in the AHP regulation? What is the possible impact on the FHLBank and the AHP?

2) Competitive Funding Round Communication and Technical Assistance

- a) Assess methods employed by the FHLBank to communicate the competitive program funding round opening and closing dates and the reach of the FHLBank's technical assistance to members and sponsors intending to apply for AHP funds. Consider:
 - i) Communication tools used by the FHLBank (e.g., seminars, news releases, webinars, FHLBank AHP and community investment newsletter issues, FHLBank public website announcements, emails and direct mailings);
 - ii) Frequency and distribution of communications;
 - iii) Content of the announcement, including information regarding application deadlines, changes, acceptable means of application submission (electronic, paper copy), and availability of training and technical assistance; and
 - iv) The methods the FHLBank uses to provide technical assistance (e.g., phone, email or in-person) and/or its policies concerning the type and amount of technical assistance. Is there evidence that the FHLBank's methods favor some members of sponsors over others?
- b) What methods does the FHLBank employ to evaluate the reach of its competitive funding round communications and technical assistance?
- c) Has the FHLBank made changes to its communication and technical assistance strategies to address any identified deficiencies?

3) Application Submission Process

- a) Assess the mode(s) of transmission for a member to submit an application.
 - i) Determine how the FHLBank receives AHP applications (e.g., electronic and/or hard copy)
 - ii) If the FHLBank permits more than one method of delivery, do the different modes of transmission trigger different analysis and scoring by the FHLBank of the applications received under each mode?
- b) Assess the FHLBank's practices with respect to the closing of the application acceptance period.
 - i) Does the FHLBank maintain a firm application deadline? Were any applications accepted after the established deadline?
 - ii) Does the FHLBank allow subsequent submission of missing, corrected and/or improved supporting documentation? If it does, does this provide an unfair advantage to the applicant?

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- iii) Is there any evidence that the FHLBank favors acceptance of applications from some members or sponsors over others?

Select several project applications from the most recently completed scoring round for review. Document analysis of how the projects were selected for the scoring round review:

1) Scoring Methodology

- a) Evaluate the FHLBank's scoring guidelines and practices and confirm that the project applications were correctly scored. Consider:
- i) Whether the FHLBank's scoring guidelines and procedures conform to the Implementation Plan; and
 - ii) Whether the FHLBank has established and implemented adequate controls over the scoring process (e.g., requiring more than one employee to score the applications, testing of automated scoring)

2) Preferential Treatment

- a) Assess whether applications submitted from certain members or sponsors might be receiving preferential treatment at any stage of the application process. Evidence of preferential treatment may include, but is not limited to: a disproportionately high approval rate for certain applicants; exceptions to the project cost guidelines for certain applicants; and FHLBank scoring criteria or scoring methods showing particular patterns or situations favoring certain applicants. Preferential treatment could also become evident at a later stage of the project. The following are examples of conditions that could lead to preferential treatment: a significant financial relationship between the FHLBank and the applicant (i.e., high advances activity); membership on the board; membership on the FHLBank's Advisory Council; and the political or strategic importance of the applicant to the FHLBank (e.g., a politician, or an influential community leader). The fact that such relationships exist is not definitive grounds to conclude preferential treatment; rather, it calls for further investigation to rule it out.

3) Eligibility Requirements

- a) Evaluate the FHLBank's policies and procedures and its application acceptance process to ensure that the FHLBank accepts applications for AHP subsidy under its competitive program only from institutions that are FHLBank members at the time their applications are submitted to the FHLBank. (12 CFR 1291.5(b)(2))

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- b) Confirm the FHLBank's policies and procedures and review applications to ensure that competitive program applications satisfy the minimum eligibility requirements set forth in 12 CFR 1291.5(c). Consider the following:

Income-Targeted, Owner-Occupied Housing or Rental Housing with Affordable Rents

AHP subsidy is required to be used exclusively for the: (1) purchase, construction or rehabilitation of an owner-occupied project for low- or moderate-income-households; or (2) purchase, construction or rehabilitation of a rental project where at least 20 percent of the units will be occupied by and affordable for very low-income households.

- a) *Household Income.* Are the application's household income targets consistent with the AHP regulatory requirements?
- b) *Need for Subsidy.* A project's estimated sources of funds, including the requested AHP subsidy, must equal its estimated uses of funds, as reflected in the project's development budget and sources and uses statements. The maximum amount of AHP subsidy the project is permitted to receive is the difference by which the uses exceed the sources, other than the requested AHP subsidy. If a project's sources of funds include estimates of the market value of in-kind donations and voluntary professional labor or services (excluding the value of sweat equity), are such estimated values also required to be included in the project's uses of funds? In the case of a homeownership project for which the sponsor extends permanent discounted financing to the homebuyer (e.g., self-help owner-occupied projects such as Habitat for Humanity projects), is the sponsor's stated cash contribution required to include the present value of any payments the sponsor is to receive from the buyer (including any cash down payment from the buyer), plus the present value of any purchase note the sponsor holds on the unit, as determined in accordance with 12 CFR 1291.5(c)(2)(ii).
- c) *Project Costs.* Taking into account the geographic location of the project, development conditions, and other non-financial household or project characteristics, has the FHLBank adequately evaluated that a project's costs, as reflected in the project's development budget, are reasonable, in accordance with the FHLBank's project cost guidelines? Does the FHLBank regularly review its project cost guidelines for continuing reasonableness, and document any decisions it makes to allow exceptions to the guidelines during and after the application process?
- d) *Project Feasibility.* (See section on Project Feasibility Analysis, below.)
- e) *Financing Costs.* The rate of interest, points, fees and any other charges for all loans that are made for the project in conjunction with the AHP subsidy shall not exceed a

reasonable market rate of interest, points, fees and other charges for loans of similar maturity, terms and risk. Does the FHLBank review financing costs for loans made in conjunction with the AHP subsidy in accordance with this requirement?

- f) *Timing of AHP Subsidy Use.* The FHLBank requires evidence provided by the project sponsor or reasonable inference based on project characteristics that some or all of the AHP subsidy is likely to be drawn down by the project or used by the project to procure other funding commitments within 12 months of the date of application approval for that project.
- g) *Counseling Costs.* The FHLBank limits the use of AHP subsidies for counseling costs to instances in which a household actually purchases an AHP-assisted unit and such counseling costs are not covered by the member or other funding source.
- h) *Refinancing Mortgage Loans.* The FHLBank limits the use of AHP subsidies for refinancing of mortgage loans under the competitive program to projects where the refinancing produces equity proceeds up to the amount of the AHP subsidy in the project and such proceeds are only used for the purchase, construction, or rehabilitation of eligible household units.
- i) *Retention Agreements.* The FHLBank requires each AHP-assisted housing unit in an owner-occupied project to be subject to a five-year retention agreement consistent with 12 CFR 1291.9(a)(7), and each AHP-assisted rental project to be subject to (or be committed to be subject to) a 15-year retention agreement consistent with 12 CFR 1291.9(a)(8).
- j) *Project Sponsor Qualifications.* Evaluate the policies and practices the FHLBank employs to assess a sponsor's ability to successfully carry out the project as described in the submitted application.
- k) *Fair Housing.* Projects as proposed will comply with applicable federal and state fair housing and housing accessibility laws (e.g., Fair Housing Act, Rehabilitation Act of 1973, Americans with Disabilities Act of 1990, and the Architectural Barriers Act of 1969), and must demonstrate how the project will be affirmatively marketed.

Calculation of AHP Subsidy (See 12 CFR 1291.5(c)(12))

- a) *AHP Direct Subsidy.* Where the FHLBank is providing AHP direct subsidy to write down the interest rate on a loan to a project, the FHLBank calculates the amount of subsidy as the net present value of interest foregone by the lender, based on the lender's market rate as of the date the application for subsidy is submitted to the FHLBank.

- b) *AHP Subsidized Advance.* Where the FHLBank is providing an AHP subsidized advance to a member, the FHLBank calculates the amount of subsidy as the net present value of the interest foregone by the FHLBank based on its cost of funds, determined as of the earlier of the date of disbursement of the subsidized advance or the date prior to disbursement on which the FHLBank first manages the funding to support the subsidized advance through its asset/liability management system, or otherwise.
 - c) *Optional District Eligibility Requirements.* Has the FHLBank established any optional District eligibility requirements? If so, are they consistent with the requirements set forth in 12 CFR 1291.5(c)(15)?
 - d) *AHP Subsidy Limits.* The FHLBank may establish limits on the maximum amount of AHP subsidy available per member per year, or per member, per project, or per project unit in a single funding round.
 - e) *Homebuyer or Homeowner Counseling Requirement.* The FHLBank may require that a household complete a homebuyer or homeowner counseling program for owner-occupied projects, where such program is provided by, or based on one provided by, an organization recognized as experienced in homebuyer or homeowner counseling.
 - f) *Prohibited Uses of AHP Subsidy.* The FHLBank may not permit members or sponsors to use AHP subsidies to pay for certain prepayment fees, cancellation fees or processing fees prohibited under 12 CFR 1291.5(c)(16), except as specifically provided thereunder.
- 4) Project Feasibility Considerations (12 CFR 1291.5(c)(4))
- a) Identify the FHLBank's process for developing and changing its project feasibility guidelines (e.g., market analysis, Advisory Council recommendations, consideration of feasibility guidelines established by HUD, state housing finance agencies and other primary affordable housing funders). Are the FHLBank's project feasibility guidelines reasonable? Are they consistently applied by the FHLBank?
 - b) Do the FHLBank's policies and practices in assessing application eligibility and scoring criteria documentation ensure that developmentally and operationally feasible projects are considered for an award, notwithstanding technical omissions that are, or can be offset by, information contained elsewhere in the project application, or would be readily available from the member or project sponsor?

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- c) Review FHLBank analysts' evaluations of project feasibility. Are evaluations consistent with the project feasibility guidelines? Are any exceptions to the project feasibility guidelines adequately analyzed, supported and documented?
 - d) Does the FHLBank have quality controls in place for project feasibility analyses to ensure sufficient rigor and consistency in the staff feasibility analysis?
 - e) Does the project development team have the requisite experience in developing the project and delivering the types of services they propose (e.g., development of affordable housing projects that did not use AHP subsidy, successful completion and monitoring of any previous AHP-subsidized projects, successful provision of empowerment services or securing of reputable empowerment service providers, as applicable, and securing of reputable contractors)?
 - f) Has the FHLBank conducted or obtained sufficient market analyses to support demand for the proposed project?
- 5) Project Costs:
- a) How is the acquisition price of a project property set, particularly when a property is acquired from a related party or the member applicant (e.g., appraisal, tax assessment)? Is the price consistent with the regulatory requirements of 12 CFR 1291.5(c)(3)(ii)?
 - b) Where project property is to be rehabilitated, does the estimated cost of rehabilitation appear reasonable based on objective standards relative to the scope of work to be performed?
 - c) Where project sponsors or owners have projected unusually high or low operating expenses based on the FHLBank's cost guidelines, has the FHLBank obtained adequate explanations for these and are the operating expenses reasonable?
 - d) How are related party transactions and interests (e.g., in acquisition, management, construction and development) identified and analyzed to assure costs and charges are competitive, and how are any potential conflicts of interest managed.
- 6) Need for Subsidy:
- a) Determine whether the FHLBank requires separate sources and uses statements for housing and non-housing items as well as an aggregated statement. Do the sources of funds, including the requested AHP subsidy, equal the uses of funds? Were there any inconsistencies within the project application with respect to the sources and uses of funds that FHLBank staff did not reconcile?

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- b) Does FHLBank staff adequately analyze project cash flow projections for reasonableness in projects that are not financed with debt? (Too much cash flow may be indicative of a lack of demonstrated need for AHP subsidy.)
 - c) Where projects are financed with subsidized advances, or direct subsidies to write down the interest rate on a loan, is the amount of subsidy awarded to such projects calculated correctly?
- 7) Ineligible and Withdrawn Projects:
- a) Evaluate projects found to be ineligible by the FHLBank or withdrawn by the member from scoring consideration. Consider:
 - i) Trends in volume (e.g., project types, sponsors, members, locations or in-District versus out-of-District projects);
 - ii) High percentages of ineligible and withdrawn projects compared to the number of applications received; and
 - iii) High numbers of ineligible and withdrawn projects submitted by a specific sponsor that is used as an unofficial suspension or debarment mechanism; and trends in an analyst's approval or rejection rate.
- 8) Project Awards and Alternates
- a) Verify that the FHLBank has approved applications in descending order starting with the highest scoring application until the total funding amount for that funding period has been allocated (except for any amount insufficient to fund the next highest scoring application) in accordance with 12 CFR 1291.5(e)(1).
 - b) Verify that all awarded projects are approved by the board with appropriate recusal by directors who have financial interests in, or are directors, officers or employees of organizations involved in, pending AHP applications recommended by FHLBank staff for approval.
 - c) Does the FHLBank approve at least the next four highest scoring applications as alternates as required by 12 CFR 1291.5(e)(2)? Does the FHLBank ever fund alternates? If so, has the FHLBank funded these within one year of approval and in order of their scores?
 - d) Review information packages prepared for senior management review and board of directors and/or board housing committee approval of competitive round applications (board package) and minutes of the board and board housing committee meetings at which the applications were considered and approved. Determine whether senior management had sufficient information before it to

recommend, and the board housing committee and/or board had sufficient information to approve or ratify, the competitive round applications. Do the board packages contain the following information:

- i) Disclosure of any interests in the applications by board members, Advisory Council members, or FHLBank management and staff (determine if there is a conflict of interest or appearance of one);
- ii) List of proposed and alternate projects with information as to the AHP subsidy amount requests, project type, project name, member name, sponsor name, project location, scores, and any other relevant information;
- iii) List of ineligible projects with information as to the AHP subsidy amount requested, project type, project name, member name, sponsor name, project location, and any other relevant information;
- iv) List of applications for which exceptions to the FHLBank's project cost guidelines were granted and the bases for the exceptions; and
- v) Aggregate round statistics (e.g., numbers of applications received and approved, project types, numbers of in-District and out-of-District applications, and geographic dispersion within the district).

9) Post Award Procedures

a) Award Notification and Agreements with Members, Project Sponsors or Owners

- i) Assess the FHLBank's method for informing members, project sponsors or owners of competitive round awards and rejections (e.g., letters to members, project sponsors or owners, and press releases and website announcements for the public-at-large) and evaluate whether these methods provide adequate and timely notice to recipients based on their respective needs for the information.
- ii) Identify the FHLBank's methods for making members, sponsors and owners aware of the requirements of 12 CFR 1291.9 for entering into agreements for the use of AHP subsidy, project monitoring, subsidy recaptures, subsidy repayments, and other applicable matters with members and/or project sponsors or owners and assess their effectiveness.

b) Advisory Council Role

- i) Review the information provided to the Advisory Councils to verify that the Advisory Councils received only summary information regarding AHP applications from prior rounds, as permitted under 12 CFR 1291.4(d)(2). The Advisory Councils are not permitted under the regulation to review specific AHP applications or receive information concerning those specific applications.

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- ii) Review minutes of Advisory Council meetings to evaluate whether the Advisory Council or any of its members were inappropriately involved in recommending specific AHP applications for approval.

Disbursement of AHP Subsidy

In evaluating the FHLBank's policies and procedures set forth in its Implementation Plan for disbursement of AHP subsidies, determine that:

- 1) The FHLBank's actions in disbursing the subsidies are consistent with the policies and procedures.
- 2) The FHLBank obtains sufficient information at each subsidy disbursement to support its funding decision, including that the project continues to meet the regulatory eligibility requirements, FHLBank AHP policies, and all obligations committed to in the approved AHP application.

Such information shall include the current sources-and-uses-of-funds statement and the operating *pro forma* statement (if applicable) showing that the project continues to need the AHP subsidy.

- 3) The FHLBank disburses the subsidies within a reasonable timeframe, pursuant to the time limits set forth in its Implementation Plan.

Initial Monitoring

Evaluate the FHLBank's policies and procedures set forth in its Implementation Plan for initial monitoring of owner-occupied and rental projects to verify that the FHLBank has established policies and procedures for verifying that the requirements in 12 CFR 1291.7(a)(1) are met, including reports for determining whether projects fulfilled their scoring commitments for which they were awarded points.

Verify that the FHLBank's policies and procedures include requirements for: (1) FHLBank review of back-up project documentation on household incomes and rents maintained by the project sponsor or owner; and (2) maintenance and FHLBank review of other project documentation in the FHLBank's discretion. The FHLBank may not use a sampling plan to select the projects to be initially monitored, but may use a reasonable risk-based sampling plan to review the back-up project documentation.

In evaluating the FHLBank's implementation of its initial monitoring policies and procedures, review a sample of projects for which the FHLBank recently completed its initial monitoring to determine whether the FHLBank:

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- 1) Reviewed the project's final sources-and-uses-of-funds statement and operating *pro forma*, compared them with interim statements received with funding requests, obtained reasonable explanations of any significant changes, and determined the project's need for the AHP subsidy;
 - 2) Determined that the project's final costs were reasonable, in accordance with the FHLBank's project cost guidelines, and the file shows evidence of reasonable explanations for any significant changes from statements made in the original application and/or interim cost statements, and reasonable explanations for any exceptions made by the FHLBank to the project cost guidelines; and
 - 3) Confirmed that the FHLBank verified that the project sponsor or owner met the commitments made in the approved AHP application and the AHP regulation, including the household income targeting, rents and scoring commitments. Evaluated how the FHLBank determined whether each scoring criterion was fulfilled. Confirmed that the FHLBank also reviewed, pursuant to its risk-based sampling plan, the back-up project documentation on household incomes and rents and any other documentation in the FHLBank's discretion. If the FHLBank determined that the project was not in compliance with the commitments in its approved AHP application or the AHP regulation, confirm whether the FHLBank:
 - a) Developed a plan for the project sponsor or owner to cure the noncompliance within a reasonable time period and the noncompliance was cured;
 - b) Modified the project, so that the project, as modified: (1) continues to meet the regulatory eligibility requirements; (2) continues to score highly enough to have been approved in the round in which it was originally approved; and (3) evidences good cause for the modification, with the FHLBank's good cause analysis and justification documented in writing; or
 - c) Recaptured the amount of subsidy not used in compliance with the AHP application commitments or the regulation within a reasonable time.
 - 4) Confirmed that each AHP-assisted unit of an owner-occupied project and each rental project is subject to an AHP retention agreement pursuant to the requirements of 12 CFR 1291.9(a)(7) or (a)(8), respectively.

Long-Term Monitoring

- 1) Evaluate the FHLBank's policies and procedures established in its Implementation Plan for long-term monitoring of rental projects under 12 CFR 1291.7(a)(4) to verify that the FHLBank has established a risk-based, long-term monitoring program based on risks (e.g., amount of AHP subsidy, project type, size or location, sponsor experience, or monitoring of the project by other governmental entities) which the FHLBank has identified for its program; and

- 2) Verify that the FHLBank's policies and procedures established in its Implementation Plan for long-term monitoring of rental projects under 12 CFR 1291.7(a)(4) include requirements for: (i) FHLBank review of annual project owner certifications on household incomes and rents; (ii) FHLBank review of back-up project documentation on household incomes and rents maintained by the project owner; and (iii) maintenance and FHLBank review of other project documentation in the FHLBank's discretion.
- 3) Determine whether the FHLBank's Implementation Plan indicates that the FHLBank has chosen to rely, for purposes of long-term AHP monitoring under its competitive application program, on the monitoring by state low-income housing tax credit allocating entities of AHP-assisted rental projects that have been allocated low-income housing tax credits, as permitted under 12 CFR 1291.7(a)(2).
- 4) Determine whether the FHLBank's Implementation Plan indicates that the FHLBank has chosen to rely, for purposes of long-term AHP monitoring under its competitive application program, on the monitoring by other federal, state, or local government entities of AHP-assisted rental projects that have received funds from such entities, as permitted under 12 CFR 1291.7(a)(3).
- 5) If so, determine whether the FHLBank has satisfied the requirements in 12 CFR 1291.7(a)(3)(i)-(iv) for reliance on such other monitoring entity. Review the FHLBank's procedures for receiving and reviewing reports from the monitoring entities, and review a sample of the reports.
- 6) In evaluating the FHLBank's implementation of its long-term monitoring policies and procedures, review a sample of projects for which the FHLBank recently completed its long-term monitoring. Determine, based on this review, whether the FHLBank reviewed the project owner certifications and back-up project documentation on households incomes and rents and any other documentation in the FHLBank's discretion, and the FHLBank verified that the project sponsor or owner met, or is meeting, the household income targeting and rent commitments made in the approved AHP application. If not, determine whether the FHLBank:
 - a) Developed a plan for the project sponsor or owner to cure the noncompliance within a reasonable time period and the noncompliance was cured;
 - b) Modified the project, so that the project, as modified: (1) continues to meet the regulatory eligibility requirements; (2) continues to score highly enough to have been approved in the round in which it was originally approved; and (3) evidences good cause for the modification, with the FHLBank's good cause analysis and justification documented in writing; or

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- c) Recaptured the amount of subsidy not used in compliance with the AHP application commitments or the regulation within a reasonable time.

Problem Project Management

Objective: Assess the adequacy of the FHLBank's performance in identifying, managing, and resolving projects that have encountered financing or other problems that are delaying the projects' progress and completion. Identify problem projects for possible review from FHLBank reports (e.g., watch list, stalled projects report, extensions report, recaptures and deobligations report and modifications report) and evaluate the reasonableness of the frequency and distribution of these reports. A larger than usual number of project modifications may reflect inadequate initial review by the FHLBank of project applications, including project sponsor capacity.

- 1) Evaluate the FHLBank's policy for debarment and/or suspension of members, project sponsors and owners, and assess the FHLBank's implementation of the policy, i.e., has the FHLBank actually debarred or suspended any such entities and what were the bases for such actions?
- 2) Evaluate the FHLBank's project modification policies to determine if they accurately reflect the regulatory requirements for modifying approved projects, and assess the FHLBank's implementation of the policies, i.e., review a sample of actual modifications to verify that the FHLBank correctly followed the modification requirements, including preparing a written good cause justification for the modifications.
- 3) Project Extensions
 - a) Assess the reasonableness of the FHLBank's policy in its Implementation Plan for approving project extensions. Review the Project Extension list. Are there limits on the number of extensions a project may receive and the length of the extensions?
 - i) Evaluate reporting of extensions to the board; and
 - ii) Review a sample of project files in which extensions were made to assess the reasonableness of decisions to grant the extensions (e.g., extensions are tied to project milestones?).

Recaptures and Settlements

- a) Review all AHP subsidy claim settlements effected since the previous AHP examination.

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- i) Assess the reasonableness of decisions by the FHLBank to settle claims for AHP subsidies that it has against a member, project sponsor, or project owner for less than the full amount due, based on the facts and circumstances of the noncompliance (including the degree of culpability of the non-complying parties and the extent of the FHLBank’s recovery efforts), the FHLBank’s written documentation of such bases, and the consistency of the FHLBank’s settlement decisions with its settlement policies. Do the settlements show a pattern by volume, dollar amount or other characteristics that is of concern? If yes, has the FHLBank addressed the concern?
 - ii) Assess the adequacy of reporting of settlements to the board.
- b) Review all recaptures³ effected by the FHLBank since the previous AHP examination.
- i) Where misused subsidy was not recaptured, evaluate whether the FHLBank and member undertook reasonable collection efforts to recapture the subsidy but were unable to collect it.
 - ii) Assess the reasonableness of decisions by the FHLBank to recapture AHP subsidy not used in compliance with the approved AHP application or the regulation, including the amount of subsidy recaptured, the FHLBank’s written documentation of the bases for recapture, and the consistency of the FHLBank’s recapture decisions with its recapture policies. Do the recaptures show a pattern by volume, dollar amount or other characteristics that is of concern? If yes, has the FHLBank addressed the concern?
 - iii) Assess the adequacy of reporting of recaptures to the board.
- c) Review all deobligations effected by the FHLBank since the previous examination.
- i) Assess the reasonableness of deobligation decisions reached by the FHLBank, the FHLBank’s written documentation of such bases, and the consistency of the FHLBank’s deobligation decisions with its policies. Do the deobligations show a pattern by volume, dollar amount or other characteristic that is of concern? If yes, has the FHLBank addressed the concern?
 - ii) Assess the adequacy of reporting of deobligations to the Board.

³ The term “recapture” refers to the required recovery pursuant to 12 CFR 1291.8 of the FHFA’s regulations by an FHLBank from a member, project sponsor, or project owner of AHP subsidies not used in compliance with approved AHP subsidy application commitments and 12 CFR Part 1291’s requirements, where such misuse is the result of actions or omissions by the member, project sponsor, or project owner. Recapture should be distinguished from the term “repayment” which refers to a repayment by an owner of an AHP-assisted owner-occupied unit or rental project of AHP subsidy to an FHLBank, member, or project sponsor in accordance with a retention agreement entered into by these parties pursuant to 12 CFR 1291.9, under circumstances set forth in the retention agreement and the regulation.

Internal/External Audit

- 1) Review all reports issued by the FHLBank's internal audit function since the previous AHP examination setting forth the results of its audit(s) of the AHP. Assess the reports and supporting work papers to determine whether reasonable reliance can be placed upon them in conducting the review of the AHP.⁴
- 2) Review the FHLBank's audit program for the AHP to assess its adequacy, including, without limitation, audit frequency, scope and depth (i.e., whether the audit consisted solely of staff interviews and policy reviews or also included transaction testing).

Information Technology

Determine whether the MIS is adequate to assist in the FHLBank's management of applications and projects under the AHP competitive application program and the homeownership set-aside programs.

- 1) Evaluate whether the MIS produces the kinds of reports or data compilations that provide relevant information for management to make judgments and decisions about the overall operation and compliance of the AHP and about any individual application or approved project, by reviewing, for example:
 - a) The FHLBank's method for keeping track of individual project documentation requirements, monitoring activities, performance and compliance status, funding, and exceptions to FHLBank policies or guidelines;
 - b) The FHLBank's documentation of non-data information about projects, such as phone conversations or oral requests for project documentation;
 - c) The FHLBank's periodic reconciliation of data, including funding flows and project status; and
 - d) The information provided to executive management and the CIO on a regular basis, including watch lists or similar status reports on problem projects.
- 2) Determine, based on the AHP general ledger and other financial source documents, whether the FHLBank accurately reported elements in the Call Report System for the AHP competitive application program and the AHP homeownership set-aside program.

⁴ Examiners may rely upon the work performed by the FHLBank's internal auditors when it is reasonable to do so. The degree of reliance that an examiner may reasonably place on this work is based upon his or her judgment of the competence and independence of the auditors involved, the scope of the audits and the amount of testing performed, the timeframe during which the audits were performed, and the overall adequacy of the FHLBank's system of internal controls. Examiners should consider these factors in determining the level of testing to be conducted during their review.

Compliance

In order to ensure that the FHLBank's AHP operations are sound and achieve the goals of an effective AHP, the FHLBank's policies and procedures must accurately incorporate and reflect FHFA regulations and guidance.

- 1) Determine that the FHLBank has a process for ensuring that its policies and procedures governing the AHP comply with FHFA regulations and guidance, including:
 - a) A process for reviewing FHFA regulatory amendments, Regulatory Interpretations, AHP examination findings, and supervisory guidance, such as Advisory Bulletins and No-Action Letters, with FHLBank management and staff and with other relevant FHLBank departments, such as the legal, credit or accounting departments; and
 - b) Legal and management oversight to ensure that the AHP department implements the AHP regulation and any amendments, Regulatory Interpretations, supervisory guidance and examination findings promptly and correctly.
- 2) Assess compliance with the FHLBank's conflict of interest policy, by:
 - a) Reviewing the FHLBank's conflict of interest policy for compliance with the AHP regulation.
 - b) Reviewing minutes of board, board housing committee, and Advisory Council meetings, and the FHLBank's conflicts of interest disclosure form, to evaluate disclosures and any recusals, and determine whether there is evidence that a director, Advisory Council member, or employee did not comply with the conflict of interest policy.
 - c) Reviewing applications of submitted and approved projects from the most recent scoring round in which directors, Advisory Council members, or employees have an interest, to determine whether such applications have a disproportionately high approval rate or were granted substantive exceptions to FHLBank policies and guidelines, or otherwise suggest preferential treatment.
 - d) For the competitive application program, evaluate, by discussing with management and reviewing the board housing committee, board and Advisory Council minutes, but not limited to these discussions, whether any directors or Advisory Council members attempted to exert influence on the scoring process in order to unduly favor the interests of their own or other organizations and, if so, how the situation was addressed by the FHLBank.

- e) For the homeownership set-aside program, evaluate, by discussing with management and reviewing the board housing committee, board and Advisory Council minutes, but not limited to these discussions, whether any directors or Advisory Council members attempted to exert influence on the approval process under the homeownership set-aside programs in order to unduly favor the interests of their own or other organizations and, if so, how the situation was addressed.

Homeownership Set-Aside Program

AHP Implementation Plan Checklist

The FHLBank's AHP Implementation Plan must include the FHLBank's requirements for its homeownership set-aside program(s), including the following:

- 1) The allocation criteria for providing AHP subsidy to members.
- 2) The required date of enrollment of the household by the member for purposes of participating in the homeownership set-aside program.
- 3) Any eligibility criteria for matching funds, counseling for non-first-time homebuyers, or priority criteria for the purchase or rehabilitation of housing in particular areas or as part of a disaster relief effort.
- 4) The maximum AHP grant amount per household, which may not exceed \$15,000.
- 5) The amount of cash back that a member may provide to a household at closing on the mortgage loan, which may not exceed \$250.
- 6) The policies for reservation of set-aside subsidies for households enrolled in the homeownership set-aside program.
- 7) Any requirements for member or other lender financial or other concessions to households receiving AHP homeownership set-aside assistance.
- 8) The monitoring requirements under the homeownership set-aside program.

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- 9) The retention agreement requirements for households receiving set-aside subsidy.

Implementation of AHP Homeownership Set-Aside Program

- 1) Are the FHLBank's guidelines, documents, communications and agreements with members adequate so that members understand their responsibilities, and the interests of AHP-assisted households are protected?
- 2) Does the FHLBank follow a fair and impartial process of disbursing funds to its members?
- 3) Are the AHP set-aside funds being used by members in a timely manner?
- 4) Does the FHLBank have a large amount of undisbursed set-aside funds? Does it have time limits and/or policies to recall undisbursed funds from the member? How does it communicate this information to its members?
- 5) Does the FHLBank follow AHP regulatory requirements if an AHP-assisted household sells its home prior to the end of the five-year retention period?
- 6) Does the FHLBank have an adequate sampling plan or other review procedures for HUD-1s?
- 7) How does the FHLBank address non-compliant uses of set-aside funds?
- 8) Is the use of set-aside funds consistent with the FHLBank's policies and the AHP regulation?
- 9) In the case of loans that do not meet the AHP regulation's financing costs requirement, does the FHLBank take timely corrective action?
- 10) How does the FHLBank protect the set-aside against waste, fraud, abuse, or misuse? Are the FHLBank's practices adequate to protect the program?
- 11) Does the FHLBank enforce the retention and repayment requirements in the set-aside program? Are the FHLBank's practices consistent with the regulation? Is the FHLBank compliant with the AHP regulatory provisions on non-recapture in the event of foreclosure or deed-in-lieu?
- 12) Are the FHLBank's set-aside management and information systems adequate?
- 13) Is the FHLBank adequately monitoring its set-aside program to assure that: members are using the AHP consistent with the AHP regulation and the FHLBank's set-aside program policies; members follow the FHLBank's enrollment procedures; households are income-eligible; financing and closing costs are reasonable; and that any cash backs are consistent with the AHP regulation requirements?

4. Testing

Examiners should consult with colleagues in the model risk area in identifying a representative sample for purposes of testing.

- 1) Assess the adequacy of the FHLBank's review and approval of owner-occupied rehabilitation (rehab) projects under the competitive program and any rehab-specific set-aside programs.
- 2) Assess whether the FHLBank reports accurate information to FHFA for the AHP database of the competitive application program. In doing so, test a sample of applications submitted during the most recent funding round(s), to determine that the FHLBank accurately reported various elements in the AHP database.
- 3) Evaluate the FHLBank's monitoring reporting forms to determine if sufficient information is requested and evaluated to allow the FHLBank to make informed determinations about project status. Does the FHLBank receive and review in a timely manner periodic reports on projects' progress towards completion and occupancy by eligible households?
- 4) Sample a selection of annual project owner certifications of rents and household incomes to determine whether the certifications match the project's rent and household income targeting commitments made in its approved AHP application.
- 5) Sample a selection of completed rental projects to confirm whether long-term monitoring is carried out in compliance with the AHP regulation and FHLBank monitoring policy.
- 6) Review a sample of subsidy disbursements to determine compliance with the AHP regulation and FHLBank policies and procedures.
- 7) Score a sample of applications to confirm that their assigned scores are replicable under the FHLBank's scoring criteria set forth in its Implementation Plan. Scrutinize the FHLBank's application of the scoring criteria to confirm consistency in the application of scoring criteria among applications.
- 8) Review the FHLBank's policies, procedures and practices in the event of member merger or receivership that occurred after the submission of the application. See 12 CFR 1291.5(g).

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- 9) Review project applications to assess the FHLBank's compliance with its policies and procedures governing post-submission application changes. Based on the FHLBank's policies, procedures, and actual practices, is the FHLBank reasonable and equitable in its actions?
 - 10) Assess compliance with the FHLBank's project feasibility guidelines, as discussed in the Risk Management section of the Examination Guidance section of this module.
 - 11) Confirm through testing that the regulatory requirements of the competitive application program are carried out in program operations as well as in stated policies. Examples of areas for testing include, but are not limited to:
 - a) Project modifications. This review includes the rescoring of modified projects to determine that the projects continue to meet the regulatory eligibility requirements, continue to score high enough to have been approved in the funding round in which they were originally approved, and there is good cause for the modifications. Verify that minutes show that the board of directors approved or denied any modifications that involved subsidy increases;
 - b) Initial monitoring. This review is to assure that a FHLBank conducts initial monitoring for all completed projects, including Low Income Housing Tax Credit projects, within the time frames specified by the FHLBank's policies, and, that the FHLBank selects samples of project units or documentation for monitoring where permitted under the regulation; and
 - c) Retention agreements, to ensure that they have been put into place and meet the AHP regulatory requirements.
 - 12) Test a sample of applications for compliance with the FHLBank's policies governing the application submission process for the competitive application program.
 - 13) Test a sample of approved applications for compliance with 12 CFR 1291.5(e). Are applications approved in descending order starting with the highest scoring application?
 - 14) Test a sample of applications to determine any involvement of Advisory Council members in the competitive scoring process.
 - 15) Test a sample of approved applications for adequacy of the initial monitoring of the projects.
 - 16) Test a sample of subsidy settlements, recaptures, deobligations, and repayments to determine if decisions were consistent with the regulation and FHLBank policies.

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- 17) Test a sample of applications for compliance with optional district eligibility requirements for subsidy limits and homebuyer or homeowner counseling, if adopted by the FHLBank pursuant to 12 CFR 1291.5(c)(15).
 - 18) Test a sample of applications to determine compliance with the FHLBank's policies and procedures governing the competitive scoring process.
 - 19) Test a sample of projects on the FHLBank's "Watch List" to:
 - a) Assess the adequacy of the FHLBank's policy for placing projects on and removing projects from the Watch List.
 - b) Determine if the Watch List is capturing all projects that should be listed (e.g., cross-check against other departmental reports and Data Reporting Manual (DRM) reports, including reports on aged, incomplete projects). Review the active portfolio for aged projects, multiple modifications and project extensions.
 - c) Discuss all Watch List projects with appropriate staff and/or management. Is the FHLBank prompt and rigorous in resolving problem projects? Where discussion leaves questions as to the appropriateness of actions underway to resolve issues, review the project file.
 - d) Evaluate patterns of projects on the Watch List (e.g., common sponsor, project type, or geographic location). Is management aware of these patterns and have actions been taken to address issues that resulted in problems?
 - e) Evaluate reporting of Watch List projects to the board and senior management.

5. Conclusions

- 1) Summarize conclusions for all examination work performed, including work performed by other FHFA staff as it relates to the FHLBank's AHP. Prepare a memorandum describing any risks to the FHLBank and the impacts on the FHLBank's AHP resulting from any weaknesses or violations identified. The memorandum should clearly describe the basis of conclusions reached and summarize the analysis completed. Within the memorandum, discuss the types of risk the FHLBank is exposed to, the level of risk exposure, the direction of risk (stable, decreasing, increasing), and the quality of risk management practices (strong, adequate, weak). A memorandum must be prepared irrespective of whether the examiner's assessment is positive or negative.
- 2) Evaluate the adequacy of the FHLBank's responses to previous AHP examination findings and concerns.

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- 3) Based on the examination work performed, prepare findings memoranda communicating any concerns identified during the examination. Findings should identify the most significant risks to the FHLBank and the potential effects on the FHLBank and its AHP resulting from the concerns identified. The findings memoranda should describe a remediation plan, if appropriate, specifying the appropriate corrective actions to address examination concerns and establish a reasonable deadline for the FHLBank to remediate the findings. Communicate preliminary findings to the EIC, other interested examiners, FHFA's Office of General Counsel, and senior FHFA staff, as appropriate. Discuss findings with FHLBank personnel to ensure the findings and analysis are free of factual errors.

 - 4) Develop a list of follow-up items to evaluate during the next annual AHP examination. In addition to the findings developed in the steps above, include concerns noted during the examination that do not rise to the level of a finding. Potential concerns include issues the FHLBank is in the process of addressing but that require follow-up work to ensure actions are completed appropriately. In addition, potential concerns should include anticipated changes to the FHLBank's practices or anticipated external changes that could affect the FHLBank's future practices with respect to administration of its AHP.

Work Program

1. Scope of AHP Examination Work Performed

Work papers must document the examination activities undertaken to evaluate potential risks to and other adverse impacts on the FHLBank's Affordable Housing Program.

2. Description of Risk and Impacts

- Identify areas of concern in the Board of Directors and Senior Management oversight of the FHLBank's Affordable Housing Program
- Evaluate changes within the FHLBank or industry affecting risks to or otherwise affecting the FHLBank's AHP
- Evaluate the FHLBank's practices for identifying potential risks to and other adverse impacts on its AHP and conclude on their adequacy

3. Risk Management

- Assess and conclude on the adequacy of the FHLBank's process for identifying potential risks to and other adverse impacts on its AHP
- Assess and conclude on the overall adequacy of internal controls, including an evaluation of:
 - The FHLBank's organizational structure
 - The FHLBank's policy and procedure development for the AHP
 - Reporting by management to the board with respect to the AHP
- Assess and conclude on the internal and external audit of risks to and other adverse impacts on the AHP
- Assess and conclude on the adequacy of information technology and controls related to the AHP
- Assess and conclude on the adequacy of the FHLBank's efforts to ensure:
 - Compliance with AHP laws, regulations and other supervisory guidance
 - Compliance with the FHLBank's AHP policies and procedures

4. Testing

- Complete testing, as appropriate, to assess adherence to AHP examination standards

5. Conclusions

- Summarize conclusions for all AHP examination work performed
 - Identify the degree of risk to or other adverse impacts on the FHLBank's AHP
 - Include an assessment of the adequacy of the FHLBank's monitoring of risk to and other adverse impacts on the AHP and establishment of internal controls to mitigate such risk and adverse impacts
- Conclude on the FHLBank's responsiveness to the AHP examination findings from previous examinations

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- Develop examination findings as appropriate
 - Identify areas requiring follow-up AHP examination activities or FHFA monitoring