



Federal Housing Finance Board

August 21, 1996

MEMORANDUM

TO: Gary B. Townsend
Deputy Director Office of Supervision

THROUGH: Deborah F. Silberman
Acting General Counsel

FROM: Brandon B. Straus
Attorney-Advisor

SUBJECT: Use Of Community Investment Program (CIP) Advances To Purchase Housing Bonds And Mortgage-Racked Securities

I. BACKGROUND

In a memorandum of August 14, 1996, you requested a legal analysis of whether a Federal Home Loan Bank (FHLBank) member may use the proceeds of a CIP advance to purchase bonds issued by state housing finance agencies (SHFA bonds) or mortgage-backed securities (MBS) representing interests in pools of loans that would be eligible to be funded directly with CIP advances.'

II. ANALYSIS

The statutory requirements governing the CIP are set forth in subsection 10(i) of the Federal Home Loan Bank Act (Bank Act), which provides, in part:

Each Bank shall establish a program to provide funding for members to undertake community-oriented mortgage lending. . .

12 U.S.C. § 1430(i)(1). Section 10(i)(2) of the Bank Act provides:

1. See Memorandum from Gary B. Townsend, Deputy Director, OS, to Deborah F. Silberman, Acting General Counsel (Aug. 14, 1996). This issue arose in connection with the 1996 examination of the FHLBank of Seattle. The FHLBank of Seattle's CIP Advance Guidelines and its Advances Manual permit members to use CIP advances for the above-described purposes.

For purposes of this subsection, the term “community-oriented mortgage lending” means providing loans:

(A) to finance home purchases by families whose income does not exceed 115 percent of median income for the area.

(B) to finance purchase or rehabilitation of housing for occupancy by families whose income does not exceed 115 percent of median income for the area,

(C) to finance commercial and economic development activities that benefit low- and moderate-income families or activities that are located in low- and moderate-income neighborhoods, and

(D) to finance projects that further a combination of the purposes described in subparagraphs (A) through (C).

Id. § 1430(i).² Thus, at issue is whether purchasing SHFA bonds or MBS qualifies as “providing loans to finance” the activities listed in subsection 10(i)(2).³

The phrase “providing loans” appears to refer to direct lending by members. This reading of the statute is supported by the legislative history of the Bank Act. The Conference Report accompanying the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)⁴ which added the CIP provisions to the Bank Act, states:

The conferees wish to make clear that among the purposes specified in this provision, the loans should be used for the purpose of providing mortgage financing for qualified projects that would not necessarily meet the customary secondary market standards or for which there is no secondary market. Such financing might involve loans having longer terms than are customary for the secondary market. . . . The conferees expect the HUD secretary to work with the several secondary market entities to expand existing, or create new, secondary market approaches to provide liquidity for these otherwise non-conforming loans The Conferees expect that the Banks will not limit their advance activities to a few projects simply to satisfy the requirements of this section but instead will use their advances on as many projects as is practicable without spreading them too thinly.

H.R. Conf. Rep. 222, 101st Cong., 1st Sess. 430 (Aug. 4, 1989) (FIRREA Conference Report).

The Federal Housing Finance Board (Finance Board) has not issued regulations, policies, or other guidance implementing the statutory provisions quoted above.

³ See id. § 1430(i)(2). For purposes of this analysis, it is assumed that in cases where a member used the proceeds of a CIP advance to purchase SHFA bonds or MBS the FHLBank could document that the proceeds of a particular SHFA bond issuance were used to finance CIP-eligible activities and that a particular MBS was backed by pools of W-eligible loans.

⁴ Pub. L. No. 101-73, § 721, 103 Stat. 183, (Aug. 9, 1989).

The above-quoted excerpt from the FIRREA Conference Report suggests that Congress intended members to use CIP advances specifically for the Origination of mortgage loans for which there was no secondary mortgage market with the focus being on the financing of individual projects. See *id.*

An argument could be made that purchasing investments such as SHFA bonds or MBS may be deemed to be “providing loans” for purposes of section 10(i)(2), because such investment activity increases the credit available for the origination of CIP eligible loans by providing liquidity to the secondary market for such loans although the Conference Report language cited above would suggest that that was not the role intended for the CIP advances themselves.

Such an interpretation of “providing loans” arguably also would be consistent with the Finance Board’s interpretation of the phrase “makes . . . home mortgage loans” in section 4 of the Bank Act. & 12 U.S.C. § 1424(a)(1)(C). Under section 4, one of the prerequisites for FHLBank membership is that an institution “makes such home mortgage loans as, in the judgment of the Board are long-term loans” *Id.* Under the Finance Board’s membership regulation, an institution is deemed to meet this requirement if it purchases mortgage pass-through securities representing an undivided ownership interest in long-term home mortgage loans. See 12 C.F.R. §§ 933.11(i)(2); 933.4(a)(3). For purposes of membership eligibility, the Finance Board considers the purchase of such MBS backed by qualifying loans to be equivalent to making loans, because the MBS represent an ownership interest in the underlying loans. See 58 Fed. Reg. 43525 (Aug. 17, 1993) (preamble to 1993 amendments to the membership regulation). Similarly, the Finance Board could deem the purchase of MBS backed by CF-eligible loans to be the equivalent of making such loans, for purposes of section 10(i)(2) of the Bank Act.

In contrast, the Finance Board has determined that the purchase of mortgage debt securities does not meet the “makes . . . home mortgage loans” requirement because such securities do not represent an ownership interest in the underlying pool of mortgage loans. See *id.* at 43526. Therefore, the above discussed analogy to the interpretation of section 4 of the Bank Act would not apply to the purchase of SHFA bonds, which are mortgage debt securities.

CONCLUSION

The language of section 10(i)(2) of the Bank Act, when read in light of the legislative history of that section, suggests that Congress intended members to use CIP advances to finance direct mortgage lending to eligible projects. See 12 U.S.C. § 1430(i)(2). However, neither the statutory language nor the legislative history would preclude a more expansive reading of section 10(i)(2) to permit members to use CIP advances to invest in MBS and SHFA bonds, in addition to direct lending. Moreover, at least with regard to MBS that represent an undivided ownership interest in the underlying mortgage loans, there is precedent for such a reading of the statute in the context of the Finance Board’s interpretation of the statutory membership eligibility requirements. See *id.* § 1424(a)(1)(C). 12 C.F.R. §§ 933.11(i)(2); 933.4(a)(3).