



## Federal Housing Finance Board

January 21, 1998

via: Facsimile / Mail

### MEMORANDUM

TO: Federal Home Loan Bank Presidents

FROM: Bruce A. Morrison *FAM*  
Chairman Federal Housing Finance Board

SUBJECT: Legal Opinion Regarding the Status of State and Local Mortgage Revenue Bonds  
and of SBA Pool Certificates Under the Financial Management Policy

As you know, I have encouraged the Federal Home Loan Banks (FHLBanks) to expand mission-related assets on their balance sheets. Pilot programs have been one vehicle used to explore new products which provide "value-added" assets that are profitable for the FHLBanks and that assist in the expansion of credit opportunity for housing and community development. Another area of activity has been the FHLBanks' use of their statutory investment authority to focus on "value-added" contributions to improve pricing and liquidity for investment vehicles that fund housing and community investment projects. The 1996 amendments to the FHLBank System Financial Management Policy (FMP), which included the addition of Aa/AA-rated housing finance agency (HFA) bonds to the list of approved FHLBank investments, were a step in that direction. However, the "listed investments" approach of the FMP often necessitates interpretations regarding which authorized mortgage-related investments must be included in the "three times capital" limitation on the purchase of MBSs, CMOs, REMICs and eligible asset-backed securities that is set forth in section 11(C)(2). This issue has arisen recently with respect to certificates representing an undivided interest in pools of loans guaranteed by the Small Business Administration (SBA Pool Certificates).

At my request, the Finance Board's Office of General Counsel (OGC), in consultation with the Office of Policy (OP), has prepared a memorandum (attached hereto) addressing this interpretive question as it relates to both HFA bonds and SBA Pool Certificates. OGC's memorandum concludes that, because HFA obligations eligible for FHLBank investment under section II(B)(11) of the FMP are mission-related, "value-added" investments, they are not subject to the restrictions set forth in section 11(C)(2) that apply to standard MBSs. In contrast, because FHLBank purchases of variable rate mortgage-backed SBA Pool Certificates add little or no value to the highly liquid market that exists for these instruments, such Pool Certificates are subject to the section 71(C)(2) limitation.

I am forwarding this OGC memorandum to you in order to elucidate the legal and policy reasoning behind these determinations and to provide you and your staffs with an analytical framework that may be applied when evaluating investments similar to those addressed in the OGC memorandum. I would be the first to concede that the case-by-case analysis required under the FMP is less than ideal. For that reason, it is my intention to push for an expeditious replacement of the FMP with a more generic and flexible financial management regulation that deals separately with the three sources of limitation on FHLBank assets: statutory authority; risk control and management; and mission advancement. With your input and support, both more flexibility and more mission-consistency for the System's balance sheet can be achieved in 1998 and beyond. Enactment of legislation along the lines of H.R 10, as improved by the Hagel bill, can only enhance the ease of achieving this goal.

Attachment

**cc:** **FHLB Chairpersons**  
**FHLB Vice-Chairpersons**



## Federal Housing Finance Board

January 5, 1998

### MEMORANDUM

TO: Bruce A. Morrison  
Chairman

FROM: Deborah F. Silberman *dtb*  
Acting General Counsel

SUBJECT: Status of State and Local Mortgage Revenue Bonds and of SBA Pool Certificates  
Under the Financial Management Policy

Several of the Federal Home Loan Banks (FHLBanks) recently have raised questions about the status under the FHLBank System Financial Management Policy (FMP) of both Aa/AA-rated mortgage revenue bonds issued by state housing finance agencies (HFAs) and certificates representing an undivided interest in variable-rate mortgage-backed pools guaranteed by the Small Business Administration (SBA Pool Certificates). As a result, you have requested my opinion as to whether these instruments are authorized as FHLBank investments under the FMP and whether they must be counted in determining a FHLBank's compliance with the limitation on the purchase of MBSs, CMOs, REMICs and eligible asset-backed securities set forth in section 11(C)(2).

### Analysis

Sections 11(g), 11(h) and 16(a) of the Federal Home Loan Bank Act (Bank Act), 12 U.S.C. §§ 1430(g), 1430(h), .1436(a), authorize the FHLBanks to invest their surplus and reserves in certain categories of investments, subject to any regulations or other limitations that may be imposed by the Federal Housing Finance Board (Finance Board). Section 934.1 of the regulations of the Finance Board provides, *inter alia*, that FHLBanks may acquire such statutorily-authorized investments only ‘With prior approval of the [Finance] Board . . . or in conformity with: (1) [a]uthorizations of the [Finance] Board or (2) stated [Finance] Board policy.’ 12 C.F.R. § 934.1(a) (1997). In conjunction with this regulation, section II(B) of the FMP serves primarily as “stated [Finance] Board policy” regarding statutorily-authorized investments that FHLBanks may make without seeking specific authorization from the Finance Board. All investments enumerated under section II(B) are eligible for FHLBank investment only to the extent that they are specifically authorized by the Bank Act or are “such securities as fiduciary and trust funds may be invested in under the laws of the state in which the [FHL]Bank is located,” 12 U.S.C. § 1431(h), 1436(a). See FMP § II(B) (preamble).

## I. HFA Obligations

Section II(B)( 11) of the FMP authorizes FHLBanks to invest in:

Marketable direct obligations of state or local government units or agencies, rated at least Aa by Moody's or AA by Standard & Poor's, where the purchase of such obligations by a FHLBank provides to the issuer the customized terms, necessary liquidity, or favorable pricing required to generate needed funding for housing or community development.

FMP § II(B)(11). This section was added to the FMP as one of a series of amendments adopted by the Board of Directors of the Finance Board at its July 3,1996 meeting, see Finance Board Res. No. 96-45. (July 3,1996), and was intended to encourage the FHLBanks to invest in mission-related obligations of state and local agencies where FHLBank involvement would have a measurable impact on the availability of funds for housing and community development.<sup>3</sup>

Because the agencies referred to in section II(B)(11) are likely to be in the business of providing funds for housing, many of the obligations they issue will be backed by mortgages and have prepayment risk characteristics similar to MBSs, which normally must have a Aaa/AAA rating to qualify for FHLBank investment under the FMP. See FMP § II(B)(9). However, despite any similarities they may have to MBSs, direct obligations of state or local agencies that meet the "measurable impact" requirement of section II(B)( 11) need to achieve only a Aa/AA-rating to be considered authorized for FHLBank investment without prior Finance Board approval. See FMP § II(B)(11). Factors that should be considered in determining whether a particular HFA obligation meets this requirement include whether there is a ready market for the obligation absent FHLBank involvement and whether FHLBank involvement provides the HFA with some benefit such as favorable pricing, liquidity, or customized terms necessary to generate needed funding for housing or community investment.

While the risk characteristics of obligations of state and local HFAs are similar in many respects to those of MBSs, such obligations need not be counted in calculating a FHLBank's compliance with section II(C)(2) of the FMP, which provides that "[a] [FHL]Bank may enter 'into agreements to purchase MBS, CMOs, REMICs, and eligible asset-backed securities so long as such purchases will not cause the aggregate book value of such securities held by the [FHL]Bank to exceed 300 percent of the [FHL]Bank's capital.'" FMP § II(C)(2). Section 11(C)(2) is intended to limit FHLBank investment in standard MBSs, CMOs, REMICs and asset-backed securities that, while "mission-related" in a technical sense, do not have a measurable impact on the availability of housing and community development and, therefore, are not "value-added." In contrast, section II(B)( 11) is intended to encourage FHLBanks to invest in mission-related instruments that result in a financial benefit to the issuer—that is, customized terms, necessary liquidity, or favorable pricing—that would likely not be obtainable without FHLBank involvement. To the extent that HFA investments are priced below standard MBSs,

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3 The impetus behind the addition of section II(B)(11) to the FMP was the Finance Board's January 1996 approval of the FHLBank of New York's request to purchase bonds issued by the New York City Housing Development Corporation (NYCHDC) to Finance the Queens West Development Project. See Res. No. 96-14 (Jan, 23,1996).

the FHLBanks might not pursue these investments if they were required to include them in calculating their compliance with the limitation on standard MBS investments set forth in section II(C)(2).

## II. SBA Pool Certificates

FHLBanks may also invest in SBA Pool Certificates pursuant to section II(B)(G) of the FMP, which permits FHLBanks to invest in “marketable obligations issued or guaranteed by the United States.” FMP § II(B)(G). While SBA Pool Certificates, which represent undivided interests in pools of the guaranteed portions of SBA-guaranteed loans, see 13 C.F.R. § 120.612, are assembled and issued by private parties, the SBA guarantees to registered holders of the Certificates all principal and interest payments. See *id.* § 120.620(a). As stated in the regulations of the SBA, “SBA’s guarantee of the Pool Certificate is backed by the full faith and credit of the United States.” See *id.* § 120.620(b). Accordingly, the SBA Pool Certificates constitute “[m]arketable obligations . . . guaranteed by the United States” and are investments authorized under section 11(B)(6) of the FMP.<sup>2</sup>

When SBA Pool Certificates are backed by mortgage loans on commercial property, Finance Board staff will consider them to be within the purview of section II(C)(2). Discussions with SBA staff indicate that the market for variable rate mortgage-backed Pool Certificates is liquid and that the FHLBank’s investment in these Certificates has little or no impact on the market.<sup>3</sup> As such, and unlike the “value-added” HFA obligations discussed above, there is no mission-related or other basis upon which to exempt variable rate mortgage-backed SBA Pool Certificates from the limitations of section 11(C)(2) that apply to MBSs and other asset-backed securities.

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<sup>2</sup> A FHLBank need not conclude that the Pool Certificates are permissible investments for fiduciary and trust funds under the law in which the FHLBank is located because obligations of the United States are specifically authorized as **FHLBank investments by section 11(h) of the Bank Act.** 12 U.S.C. § 1431(h).

<sup>3</sup> According to SBA staff the vast majority of mortgage-backed SBA Pool Certificates are variable rate. Apparently, the market for fixed-rate Pool Certificates is less liquid than that for the variable rate instruments. However, no determination has been made regarding the status of fixed-rate mortgage-backed SBA Pool Certificates under section II(C)(2), or regarding SBA Pool Certificates backed by assets other than commercial mortgages.