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ALIGNING CAPITAL WITH JUSTICE
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2013 OPPORTUNITY FINANCE NETWORK
ANNUAL CONFERENCE
PHILADELPHIA, PA • OCT. 15-18, 2013

CDFIs and the FHLB System: What's Next?

October 16, 2013

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Roundtable Agenda

- ★ Welcome and Introductions
- ★ CDFIs and the FHLB System History
- ★ Successes & Challenges
 - ★ Discussion
- ★ Wrap-Up: Advocacy Agenda

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History

- ★ 2008: Housing and Economic Reform Act (HERA) opens membership for CDFIs
- ★ 2009: Proposed Membership Regulations
- ★ January 2010: Final Membership Regulations
- ★ September 2010: First CDFI Loan Fund Member
- ★ March 2011: First CDFI Loan Fund Borrowing

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Status at 9/30/2013

- ★ 17 nondepository CDFI Members Across 9 FHLBs
- ★ \$34 million in advances outstanding to 5 CDFIs at 6/30/13
 - Others have borrowed & repaid

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CDFI Members:

- Community Ventures Corporation
- Self-Help
- Concannon Development Fund
- FAHE
- Clearinghouse CDFI
- SPF
- Century Housing
- Neighborhood Finance Corporation
- Rio Grande Valley Multibank Corporat
- AAFC Community Development Fund
- Community Development Trust
- Gulf Coast Renaissance Fund
- LJF
- Ohio Capital Cooperation
- CEI
- Brazos Valley CDC
- Metro Communities

FHLB Districts:

- All Items (14)
- Dallas
- All Items (12)

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Successes & Challenges

★ You tell me! (And each other.)

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Goals of OFN Advocacy

- ★ Ensure that CDFIs can fully participate as FHLB members and access financial products
- ★ Increase CDFI Participation
 - Number of CDFI members
 - Number of CDFIs Borrowing
- ★ Expand CDFI Collateral Options
 - “Parity” with collateral presented by regulated institutions
 - “Community Financial Institution” amendment

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Advocating for Change

- ★ Process & Culture
 - Share lessons among FHLBs
 - Help FHLBs understand real risk
- ★ Regulatory
 - Explore “carrots and sticks” to foster increased CDFI membership and borrowing
 - Conduit for sharing lessons and successes
- ★ Legislative
 - Include CDFIs in collateral and borrowing opportunities available to “community financial institution” (small bank) FHLB members

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MEMO

To: Opportunity Finance Network Members

From: Cheryl Neas

Date: January 7, 2010

Re: Final Rule on CDFI Membership in the Federal Home Loan Bank System

In the last week of December 2009, the Federal Housing Finance Authority (FHFA) issued regulations governing CDFI membership in the Federal Home Loan Bank System (FHLBs). The final regulation includes an extensive preamble in which the FHFA responds to the comments it received in response to the proposed regulations released in May and provides additional guidance on the expectations it has for FHLBs implementing the regulations. This rule marks an important step in CDFI access to resources previously available only to regulated financial institutions and in implementation of a legislative provision that OFN secured as a result of its advocacy for CDFI-friendly provisions in the Housing and Economic Reform Act (HERA) in 2008. OFN, its Members, and partners also provided strong comments to the FHFA this summer.

As each of the twelve regional FHLBs makes its own membership decisions, the specific documentation and procedures for CDFI membership will vary from bank to bank. The FHFA states that it "is confident that CDFIs will bring added value to the Federal Home Loan Bank System consistent with the Banks' mission and without compromising their safety and soundness and it expects the Banks to be proactive in educating themselves about the CDFIs' lines of business and risk profiles."

The purpose of this memo is to provide Opportunity Finance Network Members with a general understanding of the provisions under which CDFIs may apply for membership in the FHLB system, and to help CDFIs decide whether FHLB membership is an appropriate opportunity for them. It outlines the membership requirements, explains what evidence CDFIs must provide to meet them, summarizes the membership process and stock purchase requirements, and provides brief background on the advances that are the main benefit for FHLB members.

Membership Requirements

CDFIs wanting to become members of the Federal Home Loan Bank System must meet seven criteria: be duly organized under the laws of any State, or of Tribal law; be certified by the CDFI Fund; make long-term home mortgage loans; be in financial condition such that advances may be safely made; have character of management consistent with sound and economical home financing; have a home financing policy consistent with sound and economical home financing; and have mortgage-related assets that reflect a commitment to housing finance. Each of these criteria, and the steps CDFIs must take to satisfy them, are explained in more detail below.

- **Be duly organized** under the laws of any State, or of Tribal law. The final Rule makes a change to acknowledge that CDFIs organized under Tribal law are eligible for membership.
- **Be certified** by the CDFI Fund. If a CDFI's certification is more than three years old, the CDFI must provide a written statement attesting that there have been no material events that would adversely affect its strategic direction, mission, or business operations.
- **Make long-term home mortgage loans.** "Long-term" loans are defined as, "having a term to maturity of five years or greater." "Home mortgage loans" are loans that have a first lien on one-to-four family or multifamily property, in fee simple or under certain long-term leases; or combination business or farm property where at least 50 percent of the total appraised value is attributable to the



residential portion of the property. Definitions of these terms include manufactured housing (if State laws define manufactured housing as property), condominiums, and cooperative housing. “Home mortgage” and “home mortgage loan” are defined in the law creating the FHLB system, and the FHFA had minimal leeway to change these definitions.

There are, explicitly, no thresholds or minimum requirements for the number or type of such loans the CDFI must make. The preamble states that the FHFA “expects that in assessing a CDFI applicant’s compliance with this ‘makes long-term home mortgage loans’ requirement the Banks will view the extent to which the CDFI originates or purchases long-term home mortgage loans in light of their unique mission and community development orientation, and thus will deem such applicants to have satisfied this requirement if they in fact have originated or purchased home mortgage loans and can document that fact. Moreover, an applicant’s compliance with this provision need be assessed only at the time that a CDFI applies for membership.”

- **Be in financial condition such that advances may be safely made.** CDFIs must submit an audited financial statement from the most recent year, and, if available, more recent quarterly statements and financial statements for two years prior to the most recent audit. The presumptive standards for sound financial condition, calculated using information on the CDFI’s financial statements, are:
 - A ratio of net assets to total assets of **at least 20 percent**. Net and total assets include both restricted and unrestricted assets.
 - **Positive net income**. Net income is calculated as gross revenues less total expenses and is calculated on a rolling three-year average.
 - **Loan loss reserves** of at least 30 percent of loans and leases 90 days or more delinquent.
 - **Operating liquidity of at least 1.0** for the four most recent quarters and for one or both of the two preceding years.

A CDFI is presumed to be in sound financial condition if it meets these standards, but may also demonstrate that its financial condition is strong through other means. The CDFI may provide, and the FHLBank must consider, any other information to indicate that it is in sound financial condition. It may also “rebut” the presumptions of sound financial condition as described below. A FHLB may also require at its discretion additional information to determine a CDFI’s financial condition.

- Have **character of management** consistent with sound and economical home financing. A CDFI must provide a written certification adopted by its Board that the organization, its directors, or senior officers has not been the subject of criminal, civil, or administrative proceedings in the last three years; and there are no known potential criminal, civil, or administrative monetary liabilities, material pending liabilities, or unsatisfied judgments. CDFIs may rebut these presumptions as outlined below.
- Have a **home financing policy** consistent with sound and economical home financing. A CDFI must file a written justification of how and why its home financing policy is consistent with the Bank System’s housing finance mission.
- Have **mortgage-related assets** that reflect a commitment to housing finance. The amount and type of assets is at the discretion of the individual FHLB, but the FHFA states that, “the regulations do not require that a CDFI applicant’s assets be exclusively, or even predominantly, oriented to traditional housing finance. . .FHFA expects that the Banks will consider the assets of CDFI applicants in light of their unique products and mission. . .examples of [non-traditional housing finance] would include, but are not limited to, loans related to manufactured housing, pre-development or construction loans for real estate that will become or include residential property, or loans secured by subordinated liens on residential real estate.”



CDFIs are **exempt** from requirements of some FHLB members to have at least 10 percent of total assets in residential mortgage loans, and to undergo community support reviews.

Rebuttable Presumptions

Meeting the membership criteria outlined above is “presumptive compliance” with eligibility for membership. A CDFI applicant “that does not satisfy a presumptive standard, however, is not conclusively determined to have failed to satisfy the underlying requirement. Instead, the regulation effectively requires an applicant to go through a somewhat more rigorous process before a Bank can determine that the applicant in fact has satisfied the underlying membership requirement,” according to the preamble. CDFIs can undergo this more rigorous process at the time of application, or it can “rebut” the presumptive compliance. To rebut “presumptive noncompliance,” the CDFI must prepare a written justification that provides “substantial evidence acceptable to the Bank” that the CDFI is in sound financial condition.

To rebut presumptive noncompliance with the “Character of Management” provisions, a CDFI must provide a written analysis “acceptable to the Bank” that the liabilities, lawsuits, or judgments will not likely have a “deleterious” effect on the CDFI’s operations, will not cause it to fall below its capital requirements.

Membership Process

A CDFI can apply for membership only in the FHLB serving the state in which the CDFI’s principal office is located.

To apply, a CDFI provides the FHLB with an application including evidence that it satisfies all the requirements for membership. FHLBs will likely design an application specific to CDFIs; most have separate applications for the other various categories of eligible members (federally-insured depositories, insurance companies, de novo banks).

After a prospective member submits its application and the FHLB deems it “complete,” by notifying the applicant in writing, the FHLB must act on it within 60 calendar days. The “clock” may stop and start again if, during its review, the FHLB determines that it needs additional information.

Appeals process

An institution denied membership may appeal that decision to the FHFA. The applicant must appeal in writing within 90 days and provide facts, analysis, and explanation to support its position. The FHLB will provide the FHFA with the applicant’s complete membership file. The FHFA will resolve the appeal within 90 days.

Stock Purchase

Within 60 days after an FHLB approves an institution’s membership, the member must make a minimum initial stock purchase in the FHLB. The minimum is calculated according to each FHLB’s capital plan, and so varies by FHLB. For example, one bank’s is the greater of 0.06 percent of its total assets (based on the most recent quarter-end) or \$1,000.00; another’s is 0.2 percent of a Member’s total assets as of December 31 of the preceding calendar year with a minimum of \$1,000 and a maximum of \$1,000,000; some tie the required capital purchase to housing-related assets.

Members securing advances from the FHLB or using its other financial products must make additional stock purchases, generally calculated as a percentage of the outstanding advances or asset purchases.



Potential for CARS™ Ratings

Though OFN, many of its Members, and several of the FHLBs endorsed the use of CARS™ ratings in comments on the proposed Rule, the final Rule does not explicitly state that FHLBs make use of CARS™ ratings in membership decisions. However, the Rule and preamble make clear that CDFIs may provide and FHLBs may request additional information on the CDFI's financial condition. It is possible that one or more FHLBs will opt to include CARS™ in their CDFI application process, or for individual CDFIs to submit their ratings and/or CARS™ analyses when applying for membership. Submission of a CARS™ rating and analysis may be useful under certain circumstances for a CDFI that does not meet the presumptive criteria for sound financial condition. If a CDFI is required by a FHLB or independently chooses to submit a CARS™ Ratings Report as part of its application for membership, the CDFI would have to pay a fee to CARS™. CARS™ then would provide the Ratings Report to the FHLB.

Advances

The primary benefit of membership in the FHLB system is access to liquidity and the capital markets. The FHLBs offer advances to their members through access to the debt markets several times a day. The size of the FHLBank System allows for advances to be structured in various ways, allowing each member to find a funding strategy that is tailored to their needs. The FHLBanks issue discount notes in maturities ranging from one day to one year, and bonds with maturities of six months to 30 years. The majority of issues are between one and five years. Issue size can range from millions to over several billion dollars. FHLBank debt is sold through a broad, international network of about 100 underwriters. There are few restrictions on the use of FHLB advances so long as they are adequately collateralized.

To access advances, members must purchase additional stock as outlined in **Stock Purchase** above. They must also collateralize the advances with secured assets related to housing. OFN was unsuccessful in arguing for a change in the proposed Rule that would have made a broader range of CDFI assets eligible collateral for FHLB advances.

For More Information

For additional information about the Federal Home Loan Bank System, including the states served by each FHLB, see <http://www.fhlbanks.com/>. That page includes links to each FHLB's site, where you can find more information about the Bank's membership process, products, and capital plan.

For the Final Rule and preamble, see http://www.fhfa.gov/webfiles/15339/75FR678_Jan_5_2010.pdf

For questions about this document or OFN's work on this issue, contact Cheryl Neas at cneas@opportunityfinance.net or 215.320.4309.