

FEDERAL HOUSING FINANCE BOARD**12 CFR Parts 935, and 970****[No. 98-16]****RIN 3069-AA75****Community Investment Cash Advance Programs****AGENCY:** Federal Housing Finance Board.**ACTION:** Proposed rule.

SUMMARY: The Federal Housing Finance Board (Finance Board) is proposing a rule establishing a general framework under which the Federal Home Loan Banks (Bank) may establish community investment cash advance (CICA) programs in addition to their Affordable Housing Programs (AHP) and Community Investment Programs (CIP). The proposed rule does not require a Bank to establish CICA programs. It is intended to provide the Banks with an outline of what the Finance Board has determined will meet the statutory requirement that CICA programs support community investment.

The proposed rule is intended to establish one set of general standards governing all CICA programs, including the Banks' CIPs. The proposed rule, however, does not apply to a Bank's AHP, which is governed specifically by part 960 of the Finance Board's regulations. In addition to establishing a general outline for CICA programs, the proposed rule establishes standards for two specific CICA programs a Bank may establish: the Rural Development Advances (RDA) and the Urban Development Advances (UDA) programs. The proposed standards for the RDA and the UDA programs are intended to create a safe harbor for programs that the Finance Board would consider to meet the statutory requirement that CICA programs support community investment. A Bank will not be required to obtain prior Finance Board approval of CICA programs the Bank may create. However, all such programs will be subject to review through the examination process to determine whether they support what the Finance Board considers to be community investment financing.

DATES: Comments on this proposed rule must be received in writing on or before August 6, 1998.

ADDRESSES: Comments should be mailed to: Elaine L. Baker, Secretary to the Board, Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006. Comments will be available for public inspection at this address.

FOR FURTHER INFORMATION CONTACT:

Charles E. McLean, Deputy Director, Market Research, (202) 408-2537, Stanley Newman, Associate Director, Market Research, (202) 408-2812, or Diane E. Dorius, Associate Director, Program Development, (202) 408-2576, Office of Policy; or Brandon B. Straus, Senior Attorney-Advisor, (202) 408-2589, Office of General Counsel, Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006.

SUPPLEMENTARY INFORMATION:**I. Statutory and Regulatory Background**

The Banks currently have broad authority under section 10(a) of the Federal Home Loan Bank Act (Bank Act) and part 935 of the Finance Board's regulations to make advances in support of housing finance, including housing for very low-, low- and moderate-income families. See 12 U.S.C. 1430(a); 12 CFR part 935. Furthermore, in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Congress required the Banks to create two specific programs, the AHP and the CIP, to provide advances in support of unmet housing finance and economic development credit needs. See Pub. L. 101-73, section 721, 103 Stat. 183 (Aug. 9, 1989).

The AHP is a subsidy program through which the Banks support the finance of affordable owner-occupied and rental housing. See 12 U.S.C. 1430(j). The Finance Board first issued implementing regulations for the AHP in 1990. See 12 CFR Part 960.

The CIP is a program through which the Banks provide advances to members at cost to support the financing of housing benefiting families with incomes at or below 115 percent of the area median income and economic development activities benefiting families with incomes at or below 80 percent of the area median income. See 12 U.S.C. 1430(i)(2). The Finance Board previously has not promulgated regulations implementing the CIP.

Section 10(j)(10) of the Bank Act authorizes the Banks to establish CICA programs in addition to the CIP and the AHP to support "community investment." See *id.* section 1430(j)(10). The Finance Board has not previously promulgated regulations or other specific guidance on what kinds of Bank lending are permitted under this authority.

Since the establishment of the Banks' statutory authority to make advances for community investment under FIRREA, the Banks have provided relatively less long-term credit for economic development projects than for housing, and all of the Banks' economic

development lending has been done under their CIP authority, as opposed to their authority to establish other CICA programs. In the past eight years, the Banks have provided \$18.1 billion in CIP advances to finance 368,359 housing units. Only 25 percent of those units have been multifamily or rental units that often provide housing for lower-income families and are usually more difficult to finance than single-family owner-occupied housing. In addition, only \$751 million or 4 percent of CIP advances have financed economic development projects. Furthermore, CIP advances are not available to the Banks' nonmember borrowers. See *id.* section 1430(i)(1).

The Finance Board believes there is a need for long-term financing for economic development in urban and rural areas that is not being met by members using the CIP. The Banks can help to meet this need through the establishment of other CICA programs to provide long-term financing for economic development through both members and nonmember borrowers. Therefore, the Finance Board now is proposing to establish standards defining the kinds of housing and economic development activities that constitute "community investment" eligible to be financed by advances under section 10(j)(10) of the Bank Act. This proposed rule does not require a Bank to establish a CICA program; it is intended to provide the Banks with an outline of what the Finance Board has determined will meet the statutory requirement for "community investment" under section 10(j)(10). See *id.* However, all such programs will be subject to review through the examination process to determine whether they support what the Finance Board considers to be community investment financing, in compliance with the statutory requirement.

The Finance Board specifically requests comment on whether it should establish CICA standards, in whole or in part, in a form other than a regulation. Would establishing such standards in the form of a policy statement or guidelines be a more effective means of achieving the goal of promoting the Banks' support for community investment financing, and if so, why? The Finance Board is interested particularly in the comments of the potential users of CICA program advances, *i.e.*, members and nonmember borrowers, as well as the potential end users of CICA-financed credit products, such as developers of housing and commercial properties.

II. Analysis of Proposed Rule

A. Overview

The proposed rule adds a new Part 970 to the Finance Board's regulations. Part 970 establishes a framework for the Banks to create CICA programs to provide advances to members, nonmember borrowers, or both, who in turn use the advances to provide long-term financing for housing and economic development projects that benefit families with incomes at or below a targeted income level, as established by a Bank to address unmet community investment credit needs. Projects with unmet credit needs are those for which financing is not generally available, or is available at lower levels or under less attractive terms.

B. Annual CICA Program Goals—Section 970.3

Each Bank should undertake a deliberate decision making process to determine how much community investment credit it intends to make available each year, through its CIP and other CICA programs, and the kinds of projects to which that credit should be directed. As discussed above, the current focus of the Banks' community investment lending efforts has been through volume lending under the CIP in support of home mortgage loans, to the relative exclusion of economic development financing. The Banks' concentration on funding large volumes of CIP-eligible home mortgage loans may have been encouraged by the CIP target system established in the past by the Finance Board, which was based on a Bank's average annual outstanding CIP advances. The Finance Board wishes to reverse this trend and to encourage the Banks to shift their focus from the overall volume of CIP advances to maximizing the impact of individual advances. Although the Bank Act does not expressly state that a Bank may establish limits on the amount of CIP advances it makes, the Finance Board believes that because the CIP is a no-profit program for the Banks, the supply of CIP advances is necessarily limited. Consequently, as discussed further below, the proposed rule makes clear each Bank's authority to determine the appropriate amount of CIP credit to make available on an annual basis. However, with the authority to limit the amount of available CIP credit comes the obligation to target how the opportunity cost associated with CIP advances is to be used most effectively in relation to the kinds of CIP projects the Bank funds.

As discussed above, the Banks provide CIP advances to members at

cost. *See id.* Therefore, where a Bank funds a member's mortgage lending with CIP advances, there is an opportunity cost to the Bank to the extent the Bank could have used regular advances to fund the transaction. CIP advances should be used to fund those loans and projects where the opportunity cost associated with the advance makes the most difference to the member or the project. The Banks have ample authority to make regular advances to support home mortgage lending currently being undertaken by members. To the extent that CIP capacity is made available by substituting regular advances funding, where appropriate, for home mortgage lending that is currently being funded under the CIP, a Bank can redirect the CIP to meeting unmet housing and economic development credit needs.

In order to implement these concepts, § 970.3 of the proposed rule provides that a Bank may establish an annual budget for the cumulative discount the Bank intends to make available under its CIP and other CICA programs (excluding AHP) the Bank may establish. The budget should be based upon the Bank's projected annual totals of CIP advances and other CICAs that the Bank intends to make, and the extent to which the Bank intends to provide a pricing discount, if any, for such other CICAs. A Bank also may include pricing discounts the Bank intends to offer for letters of credit in support of targeted economic development financing. In determining projected annual totals for CIP and other CICA program advances, a Bank should take into account its earnings. If a Bank establishes a budget for the cumulative discount available under its CICA programs, the Bank also should establish standards for allocating the discount among specific types of eligible housing finance and economic development activities. In the absence of such a budget, the Bank must fund requests from qualified members or nonmember borrowers for any advances that otherwise meet the requirements of the Bank's CIP or any other CICA Program the Bank may create.

A Bank's determination as to how much CIP credit to make available annually must be based upon the extent to which the Bank intends to make community investment credit available under other CICA programs. In the case of CIP advances, each Bank must establish a strategy for providing CIP advances to support financing for housing and economic development projects that is otherwise not generally available, or is available at lower levels or under less attractive terms. For

example, CIP advances could be directed to housing projects designed to improve the affordability of the housing through lower downpayments, longer term financing, and use of subsidies from other sources, or projects involving homebuyer counseling. A Bank's strategy may include the establishment of partnerships with government and private entities that provide funds to projects in conjunction with CIP advances and other CICAs in order to further reduce the cost of such financing. In developing its strategy, a Bank must consult with urban and rural economic development organizations in the Bank's District and the Bank's Advisory Council. The Finance Board requests comments on how information about a Bank's CIP and other CICA programs, including any projected annual totals for advances under such programs, could best be disseminated to Bank members and nonmember borrowers, as well as to other interested members of the public.

C. Definitions—Section 970.4

1. Definition of Benefit

Under each CICA program, a Bank may make advances to support housing and economic development projects that benefit families with incomes at or below a certain targeted income level. The proposed rule uses the same definition of the term "benefit" for all CICA programs. Section 970.4 of the proposed rule defines "benefit" based on whether the project is for economic development or for housing, and on the form of the housing, such as owner-occupied or rental. Specifically, an economic development project is deemed to benefit families with incomes at or below a targeted income level if:

- (1) The project is located in a neighborhood in which more than 50 percent of the families have incomes at or below the targeted income level;
- (2) the project is located in a rural Champion Community, or a rural Empowerment Zone or rural Enterprise Community, as designated by the Secretary of Agriculture (in the case of projects located in rural areas);
- (3) the project is located in an urban Champion Community, or an urban Empowerment Zone or urban Enterprise Community, as designated by the Secretary of HUD (in the case of projects located in urban areas);
- (4) the project is located in a federally declared disaster area;
- (5) the project involves property eligible for a federal Brownfield Tax Credit;
- (6) the project is located in an area affected by a federal military base closing or realignment;
- (7) the project is located in an area identified as a designated

community under the Community Adjustment and Investment Program, which is a joint program of the federal government and the North American Development Bank established in connection with the passage of the North American Free Trade Agreement (NAFTA) to promote economic opportunities in communities that have experienced job losses related to the implementation of the NAFTA; (8) the annual salaries for at least 75 percent of the permanent full-and part-time jobs, computed on a full-time equivalent basis, created or retained by the project, other than construction jobs, are at or below the targeted income level; (9) the project qualifies as a small business concern, as defined under the Small Business Act; or (10) more than 50 percent of the families who otherwise benefit from (other than through employment) or are provided services by the project have incomes at or below the targeted income level. The Finance Board specifically requests comment on whether measuring the salaries of jobs created by a project is an effective way to determine whether the project benefits families with incomes at or below a targeted level.

A housing project is deemed to benefit families with incomes at or below a targeted income level if the project involves: (1) Owner-occupied units, each of which is purchased or owned by a family with an income at or below the targeted income level; (2) multi-unit, owner-occupied housing in which more than 50 percent of the units are owned or purchased by families with incomes at or below the targeted income level; (3) multifamily rental housing where more than 50 percent of the units in the project will be occupied by, or the rents will be affordable to, families with incomes at or below the targeted income level; or (4) manufactured housing parks where either substantially all of the resident families have incomes at or below the targeted income level, or the project is located in a neighborhood where more than 50 percent of the families have incomes at or below the targeted income level.

2. Forms of Financing

Section 10(i)(1) of the Bank Act requires the Banks to establish a CIP to provide funding for members, who in turn, provide loans to finance CIP-eligible activities. *See id.* section 1430(i)(1). Most of the Banks have implemented this statutory requirement by providing advances to members to fund the origination of loans financing CIP-eligible activities. The proposed rule adopts a more expansive reading of

the meaning of the statutory language authorizing CIP advances to be used by members to "provide loans." *See id.* Specifically, the proposed rule authorizes CIP advances and other CICA advances to be used not only to fund CICA-eligible loan originations but also to purchase mortgage revenue bonds (MRB) and mortgage-backed securities (MBS) where all of the loans financed by such bonds and all of the loans backing such securities are CICA-eligible loans. *See* proposed § 970.3 (definition of "providing financing"). The proposed rule also authorizes CICA advances to be used by members to create or maintain a secondary market for loans, where all such loans are CICA-eligible loans. The Finance Board believes that these are additional means of providing loans for the financing of CICA-eligible activities, in accordance with the intent of the statute, because they create liquidity in the market for CICA-eligible loans.

3. Income Limits

The Bank Act does not specifically require the income limits for the CIP or other CICA programs to be based on median income data published by the Department of Housing and Urban Development (HUD). A "low-or moderate-income household" is defined in the Bank Act as a household with an income of 80 percent or less of the area median income. *See* 12 U.S.C. 1430(j)(13)(B). A "low-or moderate-income neighborhood" is defined as a neighborhood in which 51 percent or more of the households are low-or moderate-income households. *See id.* section 1430(j)(13)(C).

For purposes of the Banks' AHPs, the Finance Board permits each Bank to choose among several median income standards for owner-occupied and rental projects. *See* 12 CFR 960.1. In the case of owner-occupied projects, "area median income" may be defined as: (1) The median income for the area, as published annually by HUD; (2) the applicable median family income, as determined under the mortgage revenue bond program set forth in 26 U.S.C. 143(f) and published by a State agency or instrumentality; (3) the median income for the area, as published by the United States Department of Agriculture; or (4) the median income for any definable geographic area, as published by a federal, state, or local government entity for purposes of that entity's housing programs, that has been approved by the Board of Directors of the Finance Board for use under the AHP. *See id.* In the case of rental projects, "area median income" may be defined as: (1) the median income for

the area, as published annually by HUD; or (2) the median income for any definable geographic area, as published by a federal, state, or local government entity for purposes of that entity's housing programs, that has been approved by the Board of Directors of the Finance Board for use under the AHP. *See id.* In order to provide uniformity between the AHP and other CICA programs, the proposed rule permits a Bank, for purposes of its CICA programs, to choose among the median income standards identified in the AHP regulation. The Finance Board specifically requests comments on defining income limits for CICA programs based upon median income data other than that published annually by HUD.

D. Provisions Governing the CIP—Section 970.5

As discussed above, the Finance Board has not previously issued a regulation governing the CIP. The Banks currently operate their CIPs under the applicable statutory provisions in section 10(i) of the Bank Act. *See* 12 U.S.C. 1430(i). The Finance Board has provided some interpretations of section 10(i) in instances where there is ambiguity in the statutory provisions, and in the absence of Finance Board interpretations, the Banks have made their own interpretations for purposes of program implementation. This process of experimentation among the Banks in the context of the CIP, closely monitored by the Finance Board, was useful in the beginning of the program. It also has resulted in inconsistencies among the Banks in the implementation of the program, and left many questions unanswered. Consequently, the proposed rule is intended to establish one set of standards governing all CICA programs, taking into account the specific statutory requirements governing the CIP, previous interpretations, and other questions of which the staff is aware.

1. Housing Projects

Section 10(i)(2)(A) and (B) of the Bank Act authorize the Banks to finance: (1) Home purchases by families whose income does not exceed 115 percent of median income for the area, and (2) the purchase or rehabilitation of housing for occupancy by families whose income does not exceed 115 percent of median income for the area. *See id.* sections 1430(i)(2)(A), (B). Section 970.5(b) of the proposed rule implements this provision by defining the following housing activities that qualify for CIP financing: (1) the purchase or construction of owner-occupied housing

units; (2) the purchase or rehabilitation of rental housing; (3) the purchase or rehabilitation of manufactured housing parks; and (4) the purchase or rehabilitation of housing for the homeless.

While manufactured housing parks have aspects of both owner-occupied and rental housing projects, they do not fit clearly within the categories for single-family or rental housing projects described under the CIP provisions of the Bank Act. Furthermore, ensuring that the population of occupants in a manufactured housing park meets the relevant income eligibility requirements for the CIP is more difficult than in the context of financing other kinds of housing. For instance, most occupants of manufactured housing located in such parks own their homes but rent the space on which their homes are located. Verification of income is not a usual practice in the course of renting space to the owner of a manufactured home. Therefore, it is difficult to verify that the resident families in a manufactured housing park are income-eligible.

Nonetheless, the Finance Board believes that the financing of manufactured housing parks should be permitted under the CIP and other CICA programs. Consequently, under § 970.4 of the proposed rule, a manufactured housing park is deemed to benefit families with targeted incomes if either: (1) substantially all of the resident families have incomes at or below the targeted income level, or (2) the project is located in a neighborhood where more than 50 percent of the families have incomes at or below the targeted income level. The latter criterion is intended as a proxy for the requirement that each resident family is income-eligible.

2. Economic Development Projects

Section 10(i)(2)(C) of the Bank Act authorizes CIP funding to be used 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. See *id.* § 1430(i)(2)(C). The proposed rule implements this provision by defining the kinds of economic development activities that qualify for CIP financing.

Section 970.4 of the proposed rule defines "economic development projects" as: (1) commercial, manufacturing, social service, and public facility projects and activities; and (2) the construction or rehabilitation of public or private infrastructure, such as roads, utilities, and sewers. In order to be CIP-eligible, a loan must finance an economic development project that benefits

families with incomes at or below 80 percent of the area median income. As discussed above, an economic development project is deemed to benefit such families if it meets the definition of "benefit" under § 970.4 of the proposed rule.

3. Use of CIP Advances for Refinancing

Section 970.5(d) clarifies that a member may use CIP advances to provide refinancing for owner-occupied and rental housing projects provided that the proceeds of any equity taken out of such projects are used to rehabilitate the projects or to preserve affordability for current residents. Where refinancing is done to preserve affordability for current residents, there is no requirement that continued affordability be monitored subsequent to the refinancing. The proposed rule also provides that CIP advances may be used to refinance economic development projects. For economic development projects, there is no limitation on the use of the proceeds of any equity taken out of the project.

4. Pricing of CIP Advances

Section 10(i)(1) of the Bank Act provides that CIP advances shall be priced at the cost of Bank consolidated obligations of comparable maturities, taking into account reasonable administrative costs. See *id.* section 1430(i)(1). The statute does not define reasonable administrative costs. Section 935.7 of the Finance Board's regulation on Bank Advances codifies the statutory pricing requirement for CIP advances without material change. See 12 CFR 935.7.

A survey of the Banks' CIP policies in 1996 indicated that the Banks have adopted a variety of CIP pricing policies under § 935.7 of the Advances regulation. See *id.* Four Banks priced CIP advances at their cost of funds, and two Banks priced CIP advances at five basis points over their cost of funds. Two banks priced CIP advances 12 to 35 basis points below the price of regular Bank advances, depending upon the maturity of the advance. It is estimated that, on average, CIP advances are priced approximately 25 basis points below the price of regular Bank advances.

The proposed rule amends the language of existing § 935.7 of the Advances regulation by clarifying that in pricing CIP advances, a Bank may take into account only those administrative costs necessary for the operation of its CIP, not administrative costs attributable to other Bank operations. Furthermore, the price of CIP advances shall be lower than the price of advances of similar amounts,

maturities and terms made pursuant to section 10(a) of the Bank Act. See 12 U.S.C. 1430(a). The proposed rule moves the CIP pricing provision from existing § 935.7 of the Advances regulation to new § 970.5 of the CICA regulation.

According to the 1996 survey of the Banks' CIP policies, four Banks varied CIP pricing based on the kinds of projects being financed and the income levels of the households benefiting from the project, for instance, projects that benefit families with incomes at or below 80 percent of the area median income. One Bank provided lower pricing for members that have been assigned a rating of outstanding under the Community Reinvestment Act. See *id.* sections 2901 *et seq.* The Finance Board requests comment on whether the regulation should contain a list of factors such as these that could be the basis for deeper CIP discounts by the Banks.

5. Pricing Pass-through

The statutory provisions governing the CIP do not require members that obtain CIP advances to pass on the benefit of the pricing differential between CIP advances and regular Bank advances to the owners or occupants of CIP-financed housing or businesses. The 1996 survey of the Banks' CIP pricing policies indicated that two Banks specifically required such a pass-through and four Banks encouraged a pass-through. Section 970.5(g) of the proposed rule provides that a Bank may, in its discretion, require members receiving CIP advances to pass through the benefit of the pricing differential of the CIP advance to the member's borrower.

E. Provisions Governing Other CICA Programs Established By A Bank—Section 970.6 and Section 970.7

1. RDA and UDA Programs—Section 970.6

As discussed above, the RDA and UDA programs are CICA programs a Bank may establish to provide financing for economic development projects in rural or urban areas, respectively. Section 970.6(a) of the proposed rule authorizes each Bank to establish an RDA program to provide advances to its members, nonmember borrowers, or both to finance economic development projects in rural areas that benefit families with incomes at or below 115 percent of the area median income. Section 970.6(b) of the proposed rule authorizes a Bank to establish a UDA program to provide advances to its

members, nonmember borrowers, or both to finance economic development projects in urban areas that benefit families with incomes at or below 100 percent of the area median income. As discussed above, the proposed standards for the RDA and the UDA are intended to create safe harbor programs that the Finance Board considers to meet the statutory requirement that CICA programs support "community investment." See *id.* section 1430(j)(10).

The RDA is intended to benefit a population that is not targeted under the CIP, which has an income eligibility standard of 80 percent of area median income for economic development projects. See *id.* section 1430(i)(2)(C). The UDA program, which is intended to benefit families with incomes at or below 100 percent of the area median income, also is intended to reach a population not targeted by the CIP. Due to generally higher median incomes in urban areas, this standard, although numerically lower than the income eligibility standard for the RDA program, reaches families with higher incomes.

In cases where a UDA or an RDA project has a housing component, only the economic development portion of the project must be designed to benefit families with targeted income levels.

The proposed rule permits the Banks to price RDAs and UDAs either as regular advances or at rates below the price of regular advances of similar amounts, maturities and terms. Permitting the Banks to price UDAs and RDAs as regular advances may provide them with a financial incentive to make such advances. The Banks have the option to provide reduced pricing for RDAs and UDAs in order to provide members and nonmember borrowers with a financial incentive to undertake the kinds of financing described in the RDA and UDA programs.

2. Other CICA Programs—Section 970.7

Section 970.7 of the proposed rule establishes minimum requirements for CICA programs a Bank may wish to establish that do not conform to the requirements of the RDA and UDA programs. A Bank may establish such other CICA programs to provide advances to finance community investment for economic development and housing. Projects that involve a combination of economic development and housing must meet the appropriate targeting standards for the economic development and housing components of such projects, respectively.

a. Economic Development Projects. Under proposed § 970.7(b), a Bank may establish a CICA program to provide

financing for economic development projects benefiting families with incomes at or below a level established by the Bank to address unmet economic development credit needs.

b. Housing projects. Under proposed § 970.7(c), a Bank may establish a CICA program to provide financing for housing projects involving the acquisition, construction, rehabilitation, or refinancing of owner-occupied and rental housing, as well as manufactured housing parks and housing for the homeless. In the case of refinancing, the refinancing must be necessary to preserve affordability for the current residents of a rental housing project or the current owners of owner-occupied housing.

As in the case of economic development projects, the Bank must establish an income eligibility level at or below a level targeted to address unmet housing credit needs. Proposed § 970.7(c)(2) makes clear that the financing of predevelopment costs for eligible housing also is permitted.

c. Pricing of other CICA program advances. As under the provisions governing the RDA and UDA programs, § 970.7(f) of the proposed rule permits the Banks to price other CICA advances either as regular advances or below regular advances.

d. Prior Finance Board approval not required. As discussed above, a Bank is not required to obtain prior Finance Board approval of a CICA program it establishes under § 970.7. However, such programs will be subject to review through the examination process to determine whether they support what the Finance Board considers to be community investment financing, in compliance with the Bank Act.

F. Limits on Access to CICA Advances—Section 970.8

Section 7(j) of the Bank Act provides that the board of directors of each Bank shall administer the affairs of the Bank fairly and impartially and without discrimination in favor of or against any member borrower. See 12 U.S.C. 1427(j). Section 970.8 of the proposed rule is intended to make clear that any limitations established by a Bank upon members' or nonmember borrowers' access to CIP or other CICA advances must comply with the statutory nondiscrimination requirement in section 7(j) of the Bank Act.

G. Conforming Amendments to the Finance Board's Advances Regulation

The proposed rule makes conforming amendments to the Advances regulation in order to make clear that a Bank may make long-term advances for the

purpose of financing lending and investment activities that meet the requirements of a CICA Program, including economic development activities. Specifically, the proposed rule amends the existing definition of "residential housing finance assets" in § 935.1 of the Advances regulation to include loans or investments financed by CICA Program advances. The proposed rule also revises several existing provisions of the Advances regulation on the use of long-term advances under the CIP in order to make clear that these provisions apply to all CICA Programs, not just the CIP. See *id.* §§ 935.13, 935.14. In addition, the proposed rule replaces the existing definition of "Community Investment Program" with a new definition of "Community Investment Cash Advance Program," which, as discussed above, includes the CIP.

III. Regulatory Flexibility Act

The proposed rule applies only to the Banks, which do not come within the meaning of "small entities," as defined in the Regulatory Flexibility Act (RFA). See 5 U.S.C. 601(6). Therefore, in accordance with section 605(b) of the RFA, see *id.* section 605(b), the Finance Board hereby certifies that this proposed rule, if promulgated as a final rule, will not have a significant economic impact on a substantial number of small entities.

List of Subjects

12 CFR Part 935

Credit, Federal home loan banks, Reporting and recordkeeping requirements.

12 CFR Part 970

Credit, Federal home loan banks, Housing.

Accordingly, chapter IX, title 12, Code of Federal Regulations, is hereby proposed to be amended, as set forth below:

Subchapter B—Federal Home Loan Bank System

PART 935—ADVANCES

1. The authority citation for Part 935 continues to read as follows:

Authority: 12 U.S.C. 1422a(a)(3), 1422b(a)(1) 1426, 1429, 1430; 1430b, and 1431.

2. Section 935.1 is amended by adding in alphabetical order the following definition of "Community Investment Cash Advance Program", by removing the definition of "Community Investment Program", and in the definition of "Residential housing

finance assets'' by republishing the introductory text and in paragraph (4), to read as follows:

§ 935.1 Definitions.

* * * * *

Community Investment Cash Advance Program or *CICA Program* has the same meaning as in part 970 of this chapter.

* * * * *

Residential housing finance assets means any of the following:

* * * * *

(4) Loans or investments financed by advances made pursuant to a CICA program;

* * * * *

§ 935.7 [Removed and reserved]

3. Section 935.7 is removed and reserved.

4. Section 935.13 is amended by revising paragraph (a)(5) to read as follows:

§ 935.13 Restrictions on advances to members that are not qualified thrift lenders.

(a) * * *

(5) The requirements of paragraph (a)(2) of this section shall not apply to applications from non-savings association members for CICA Program advances.

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5. Section 935.14 is amended by revising paragraph (b)(2) to read as follows:

§ 935.14 Limitations on long-term advances.

* * * * *

(b) * * *

(2) Applications for CICA Program advances are exempt from the requirements of paragraph (b)(1) of this section.

6. Subchapter F, consisting of part 970, is added to chapter IX to read as follows:

Subchapter F—Community Investment

PART 970—Community Investment Cash Advance Programs

Sec.

970.1 Scope.

970.2 Purpose.

970.3 Annual CICA Program goals.

970.4 Definitions.

960.5 Community Investment Program.

970.6 Rural and Urban Development Advances Programs.

970.7 Other Community Investment Cash Advance programs.

970.8 Limits on access to CICA Program advances.

970.9 Reporting.

Authority: 12 U.S.C. 1422b(a)(1) and 1430.

§ 970.1 Scope.

Sections 10(i) and (j) of the Act require the Banks to establish an Affordable Housing Program (AHP) and a Community Investment Program (CIP). (See 12 U.S.C. 1430(j), (i)). Section 10(j)(10) of the Act authorizes the Banks to establish community investment cash advance (CICA) programs in addition to the AHP and the CIP. (See 12 U.S.C. 1430(j)(10)). This part establishes requirements for a Bank's CIP and for other CICA programs established by a Bank. The requirements of this part do not apply to a Bank's AHP, which is governed specifically by part 960 of this chapter.

§ 970.2 Purpose.

The purpose of this part is to identify targeted community investment activities the Banks may support through the establishment of CICA programs under section 10(j)(10) of the Act. (12 U.S.C. 1430(j)(10)). Advances made under a CICA program are to be used in support of financing for housing and economic development activities that benefit income-targeted families. This part establishes the general framework under which a Bank may create CICA programs in support of community investment financing. This part establishes regulations for advances made under a Bank's statutorily mandated CIP. This part also sets forth standards governing other CICA programs a Bank may establish, including two specific CICA programs a Bank may establish: Rural Development Advances (RDA) and Urban Development Advances (UDA) programs.

§ 970.3 Annual CICA Program goals.

A Bank may establish an annual budget for the cumulative discount the Bank intends to make available under its CIP and other CICA programs (excluding AHP) the Bank may establish. The budget should be based upon the Bank's projected annual totals of CIP advances and other CICA programs that the Bank intends to make, and the extent to which the Bank intends to provide a pricing discount, if any, for such other CICA programs. A Bank also may include pricing discounts the Bank intends to offer for letters of credit in support of targeted economic development financing. In determining projected annual totals for CIP and other CICA program advances, a Bank should take into account its earnings. If a Bank establishes a budget for the cumulative discount available under its CICA programs, the Bank also should establish standards for allocating the discount among specific types of

eligible housing finance and economic development activities. In the absence of such a budget, the Bank must fund must fund requests from qualified members or nonmember borrowers for any advances that otherwise meet the requirements of the Bank's CIP or any other CICA Program the Bank may create. Each Bank shall establish a strategy for providing CIP advances to support financing for housing and economic development projects that is otherwise not generally available, or is available at lower levels or under less attractive terms. A Bank's strategy may include the establishment of partnerships with government and private entities that provide funds to projects in conjunction with CIP and other CICA advances in order to further reduce the cost of such financing. In developing its strategy, a Bank must consult with urban and rural economic development organizations in the Bank's District and with the Bank's Advisory Council.

§ 970.4 Definitions.

As used in this part:

Act means the Federal Home Loan Bank Act, as amended (12 U.S.C. 1421 *et seq.*).

Advance means a loan to a member from a Bank that is:

- (1) Provided pursuant to a written agreement;
- (2) Supported by a note or other written evidence of the borrower's obligation; and
- (3) Fully secured by collateral in accordance with the Act and part 935 of this chapter.

AHP means the Affordable Housing Program, the CICA Program mandated by section 10(j) of the Act (12 U.S.C. 1430(j)) and part 960 of this chapter.

Bank means a Federal Home Loan Bank established under the authority of the Act.

Benefit. (1) *Economic development projects.* An economic development project is deemed to *benefit* families with incomes at or below a targeted income level if:

- (i) The project is located in a neighborhood in which more than 50 percent of the families have incomes at or below the targeted income level;
- (ii) The project is located in a rural Champion Community, or a rural Empowerment Zone or rural Enterprise Community, as designated by the Secretary of Agriculture (in the case of projects located in rural areas);
- (iii) The project is located in an urban Champion Community, or an urban Empowerment Zone or urban Enterprise Community, as designated by the

Secretary of HUD (in the case of projects located in urban areas);

(iv) The project is located in a federally declared disaster area;

(v) The project involves property eligible for a federal Brownfield Tax Credit;

(vi) The project is located in an area affected by a federal military base closing or realignment;

(vii) The project is located in an area identified as a designated community under the Community Adjustment and Investment Program;

(viii) The annual salaries for at least 75 percent of the permanent full-and part-time jobs, computed on a full-time equivalent basis, created or retained by the project, other than construction jobs, are at or below the targeted income level;

(ix) The project qualifies as a small business; or

(x) More than 50 percent of the families who otherwise benefit from (other than through employment) or are provided services by the project have incomes at or below the targeted income level.

(2) *Housing projects.* A housing project is deemed to *benefit* families with incomes at or below a targeted income level if the project involves:

(i) Owner-occupied units, each of which is purchased or owned by a family with an income at or below the targeted income level;

(ii) Multi-unit, owner-occupied housing in which more than 50 percent of the units are owned or purchased by families with incomes at or below the targeted income level;

(iii) Rental housing where more than 50 percent of the units in the project are occupied by, or the rents are affordable to, families with incomes at or below the targeted income level; or

(iv) Manufactured housing parks where:

(A) Substantially all of the resident families have incomes at or below the targeted income level; or

(B) The project is located in a neighborhood where more than 50 percent of the families have incomes at or below the targeted income level.

Board of Directors means the Board of Directors of the Finance Board.

Champion Community means a community which developed a strategic plan and applied for designation by either the Secretary of HUD or the Secretary of Agriculture as an Empowerment Zone or Enterprise Community, but was designated a Champion Community.

CICA or Community Investment Cash Advance means an advance made pursuant to a CICA program.

CICA Program or Community Investment Cash Advance program means:

(1) A Bank's AHP;

(2) A Bank's CIP;

(3) A Bank's RDA program;

(4) A Bank's UDA program; and

(5) Any other cash advance program established by a Bank that meets the requirements of § 970.6.

CIP means a Bank's Community Investment Program, the CICA Program mandated by section 10(i) of the Act (12 U.S.C. 1430(i)).

Community investment means housing finance and economic development projects that benefit families with incomes at or below a targeted income level.

Economic development projects means:

(1) Commercial, manufacturing, social service, and public facility projects and activities; and

(2) The construction or rehabilitation of public or private infrastructure, such as roads, utilities, and sewers.

Family means one or more persons living in the same dwelling unit.

Finance Board means the agency established as the Federal Housing Finance Board.

HUD means the Department of Housing and Urban Development.

Median income for the area. (1) *Owner-occupied housing projects and economic development projects.* For purposes of owner-occupied housing projects and economic development projects, *median income for the area* means one or more of the following, as determined by the Bank:

(i) The median income for the area, as published annually by HUD;

(ii) The applicable median family income, as determined under 26 U.S.C. 143(f) (Mortgage Revenue Bonds) and published by a State agency or instrumentality;

(iii) The median income for the area, as published by the United States Department of Agriculture; or

(iv) The median income for any definable geographic area, as published by a federal, state, or local government entity for purposes of that entity's housing programs, and approved by the Board of Directors, at the request of a Bank, for use under the Bank's CICA programs.

(2) *Rental housing projects.* For purposes of rental projects, median income for the area means:

(i) The median income for the area, as published annually by HUD; or

(ii) The median income for any definable geographic area, as published by a federal, state, or local government entity for purposes of that entity's

housing programs, and approved by the Board of Directors, at the request of a Bank, for use under the Bank's CICA programs.

(3) *Procedure for approval.* Requests for approval of median income standards shall receive prompt consideration by the Board of Directors.

Member means an institution that has been approved for membership in a Bank and has purchased capital stock in the Bank in accordance with §§ 933.20 and 933.24 of this chapter.

Neighborhood means:

(1) A census tract or block numbering area;

(2) A unit of local government with a population of 25,000 or less;

(3) A rural county;

(4) A trust or restricted Indian land, Native Hawaiian Home Land, or Alaskan Native Village; or

(5) A geographic location designated in comprehensive plans, ordinance, or other local documents as a neighborhood, village, or similar geographic designation that is within the boundary of but does not encompass the entire area of a unit of general local government.

Nonmember borrower means an entity certified as a nonmember mortgagee pursuant to § 935.22(b) of this chapter.

Provide financing means:

(1) Originating loans;

(2) Purchasing mortgage revenue bonds or mortgage-backed securities, where all of the loans financed by such bonds and all of the loans backing such securities meet the eligibility requirements of the program under which the member or nonmember borrower receives an advance; and

(3) Creating or maintaining a secondary market for loans, where all such loans are mortgage loans meeting the eligibility requirements of the program under which the member or nonmember borrower receives an advance.

RDA or Rural Development Advance means an advance made pursuant to an RDA program.

RDA program or Rural Development Advance program means a program established by a Bank meeting the requirements of § 970.6(a).

Rural area means:

(1) A unit of general local government or an unincorporated place outside a Metropolitan Statistical Area (MSA), as defined by the U.S. Bureau of the Census, that has a population of less than 30,000; or

(2) A trust or restricted Indian land, Native Hawaiian Home Land, or Alaskan Native Village.

Small business means a "small business concern," as that term is

defined by section 3(a) of the Small Business Act (15 U.S.C. 632(a)) and implemented by the Small Business Administration under 13 CFR part 121, or any successor provisions.

UDA or Urban Development Advance means an advance made pursuant to a UDA program.

UDA program or Urban Development Advance program means a program established by a Bank meeting the requirements of § 970.6(b).

Urban area means a unit of general local government or an unincorporated place that is:

- (1) Within an MSA; or
- (2) Outside an MSA and has a population of more than 30,000.

§ 970.5 Community Investment Program.

(a) *In general.* Each Bank shall establish a CIP to make advances to its members to provide financing, as defined in § 970.4, for eligible community investment projects. (Nonmember borrowers are not eligible to receive CIP advances.)

(b) *Housing projects.* A Bank may provide CIP advances to finance the following kinds of housing projects, provided that such projects benefit families with incomes at or below 115 percent of the median income for the area of a family of four:

- (1) The purchase or construction of owner-occupied housing units;
- (2) The purchase or rehabilitation of rental housing;
- (3) The purchase or rehabilitation of manufactured housing parks; and
- (4) The purchase or rehabilitation of housing for the homeless.

(c) *Economic development projects.* A Bank may provide CIP advances to finance economic development projects that benefit families with incomes at or below 80 percent of the median income for the area of a family of four.

(d) *Refinancing.* A Bank may provide CIP advances to refinance:

- (1) Economic development projects described in paragraph (c) of this section; and
- (2) Owner-occupied and multifamily housing and manufactured housing parks described in paragraphs (b)(1) through (b)(4) of this section, provided that the equity proceeds of the refinancing are used to rehabilitate the projects or to preserve affordability for current residents.

(e) *Mixed-use projects.* If a project involves a combination of eligible housing finance and economic development activities, the economic development and housing components of the project must benefit families at the appropriate income levels.

(f) *Pricing of CIP advances—(1) In general.* Each Bank shall price its CIP

advances as provided in § 935.6 of this chapter, provided that the cost of such advances shall not exceed, and may be lower than, the Bank's cost of issuing consolidated obligations of comparable maturity, taking into account reasonable administrative costs. In pricing CIP advances, a Bank may take into account only those administrative costs necessary for the operation of its CIP.

(2) *Pricing differential.* The price of CIP advances shall be lower than the price of advances of similar amounts, maturities and terms made pursuant to section 10(a) of the Act.

(g) *Pricing pass-through.* A Bank may require members receiving CIP advances to pass through the benefit of the pricing differential of the CIP advance to the member's borrower.

§ 970.6 Rural and Urban Development Advances Programs.

(a) *RDA program.* Each Bank may establish an RDA program to provide advances to its members, nonmember borrowers, or both to provide financing, as defined in § 970.4, for economic development projects in rural areas that benefit families with incomes at or below 115 percent of the median income for the area of a family of four.

(b) *UDA program.* Each Bank may establish a UDA program to provide advances to its members, nonmember borrowers, or both to provide financing, as defined in § 970.4, for economic development projects in urban areas that benefit families with incomes at or below 100 percent of the median income for the area of a family of four.

(c) *Mixed-use projects.* If an economic development project financed by a UDA or an RDA involves the financing of housing, only the economic development portion of the project must be designed to benefit families with targeted income levels.

(d) *Pricing of UDAs and RDAs—(1) Advances to members.* A Bank shall price UDAs and RDAs to members as provided in § 935.6 of this chapter, and may price such advances at rates below the price of advances of similar amounts, maturities and terms made pursuant to section 10(a) of the Act. (12 U.S.C. 1430(a)).

(2) *Advances to nonmember borrowers.* A Bank shall price UDAs and RDAs to nonmember borrowers as provided in § 935.24 of this chapter and may price such advances at rates below the price of advances of similar amounts, maturities and terms made pursuant to section 10b of the Act. (12 U.S.C. 1430b).

§ 970.7 Other Community Investment Cash Advance programs.

(a) *In general.* Each Bank may establish CICA programs in addition to those described in §§ 970.5 and 970.6, to provide advances to its members, nonmember borrowers, or both to finance community investment.

(b) *Economic development projects.* A Bank may make a CICA to a member or nonmember borrower to provide financing, as defined in § 970.4, for economic development projects that benefit families with incomes at or below a targeted income level, as established by the Bank to address unmet economic development credit needs. Projects with unmet economic development credit needs are those economic development projects for which financing is not generally available, or is available at lower levels or under less attractive terms.

(c) *Housing projects.* A Bank may make a CICA to a member or nonmember borrower to provide financing, as defined in § 970.4, for the following kinds of housing projects, provided such projects benefit families with incomes at or below a targeted income level, as established by the Bank to address unmet housing credit needs. Projects with unmet housing credit needs are those housing projects for which financing is not generally available, or is available at lower levels or under less attractive terms:

- (1) The acquisition, construction, rehabilitation, or refinancing of:
 - (i) Owner-occupied housing units;
 - (ii) Multi-unit, owner-occupied housing;
 - (iii) Rental housing;
 - (iv) Manufactured housing parks; and
 - (v) Housing for the homeless; or
- (2) The financing of predevelopment costs for housing described in paragraph (c)(1) of this section.

(d) *Limit on refinancing.* Where a member or nonmember borrower uses a CICA for the purpose of refinancing housing, the refinancing must be necessary to preserve affordability for the current residents of a multifamily rental housing project or the current owners of owner-occupied housing.

(e) *Mixed-use projects.* If a project involves a combination of eligible housing finance and economic development activities, the economic development and housing components of the project must benefit families at the appropriate targeted income levels.

(f) *Pricing of other CICA program advances.—(1) Advances to members.* A Bank shall price advances to members made under a CICA program established pursuant to this section as provided in § 935.6 of this chapter, and may price

such advances at rates below the price of advances of similar amounts, maturities, and terms made pursuant to section 10(a) of the Act. (12 U.S.C. 1430(a)).

(2) *Advances to nonmember borrowers.* A Bank shall price advances to nonmember borrowers made under a CICA program established pursuant to this section as provided in § 935.24 of this chapter, and may price such advances at rates below the price of advances of similar amounts, maturities, and terms made pursuant to section 10b of the Act. (12 U.S.C. 1430b).

§ 970.8 Limits on access to CICA program advances.

Any limit established by a Bank upon members' or nonmember borrowers' access to CICA advances shall not discriminate in favor of or against any member.

§ 970.9 Reporting.

(a) *CICA policies.* Each Bank shall submit to the Finance Board annually a copy of the policies governing the Bank's CICA programs.

(b) *Quarterly reports.* Each Bank shall report quarterly to the Finance Board on the Bank's use of CICA's.

Dated: April 22, 1998.

By the Board of Directors of the Federal Housing Finance Board.

Bruce A. Morrison,
Chairman.

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FEDERAL HOUSING FINANCE BOARD

12 CFR Part 938

[No. 98-17]

RIN 3069-AA61

Federal Home Loan Bank Standby Letters of Credit

AGENCY: Federal Housing Finance Board.

ACTION: Proposed Rule.

SUMMARY: The Federal Housing Finance Board is proposing to codify its existing policies on Federal Home Loan Bank (FHLBank) standby letters of credit into the form of a regulation and to amend these policies to allow for broader use of these products by FHLBank members and eligible nonmember mortgagees. The proposed rule also would eliminate some of the restrictions currently imposed on issuance of standby letters of credit by FHLBanks that limit the usefulness of these products to members and eligible nonmember mortgagees.

DATES: Comments are due on or before August 6, 1998.

ADDRESSES: Mail comments to Elaine L. Baker, Executive Secretary, Federal Housing Finance Board, 1777 F Street, N.W., Washington D.C. 20006. Comments will be available for inspection at this address.

FOR FURTHER INFORMATION CONTACT:

Diane E. Dorius, Associate Director, Program Development, Office of Policy, (202) 408-2576; or Eric M. Raudenbush, Attorney-Advisor, Office of General Counsel, (202) 408-2932, Federal Housing Finance Board, 1777 F Street, N.W., Washington, D.C. 20006.

SUPPLEMENTARY INFORMATION:

I. Background

The FHLBanks have been permitted to engage in standby letter of credit (LOC) transactions since 1983, when the predecessor agency to the Federal Housing Finance Board (Finance Board), the former Federal Home Loan Bank Board (FHLBB), first adopted its Policy Guidelines for Issuance of FHLBank Standby Letters of Credit (FHLBB Guidelines). Underlying this policy was a 1983 FHLBB legal opinion which concluded that FHLBank issuance of standby LOCs on behalf of members is permissible under the FHLBanks' authority to make secured advances, set forth in section 10 of the Bank Act, 12 U.S.C. 1430, because a FHLBank standby LOC is the functional equivalent of an advance in that it involves an extension of credit by the FHLBank to its member. Because the FHLBB considered the authority to issue standby LOCs to derive from the authority to make secured advances, the 1983 FHLBB Guidelines, and the 1985 and 1989 revisions thereto, applied the statutory and regulatory requirements pertaining to advances to standby LOC transactions. The substance of the FHLBB Guidelines was maintained when the Finance Board (created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 412 (1989), to succeed the FHLBB as regulator of the FHLBanks) adopted its first standby LOC policy in 1991.

FHLBank participation in standby LOC transactions currently is governed by the Finance Board's Interim Policy Guidelines for FHLBank Standby Letters of Credit (Interim Guidelines), which were adopted in 1993. The Interim Guidelines permit FHLBanks to issue or confirm standby LOCs on behalf of members to facilitate: the purchase of, or commitment to purchase mortgage loans; the collateralization of public unit deposits; the collateralization of

Internal Revenue Code (IRC) Section 936 deposits (deposits made in Puerto Rican financial institutions by corporations operating in Puerto Rico); interest rate swaps and other transactions that assist a member's asset/liability management; transactions that promote home financing, housing activity, or members' involvement in commercial and economic development activities that benefit low-and moderate-income families or activities that are located in low-and moderate-income neighborhoods (community development); and tax-exempt bonds or notes designed to promote housing or the financing of community development. In addition, the Interim Guidelines permit FHLBanks to issue LOCs on behalf of nonmember mortgagees eligible to obtain advances under section 10b of the Bank Act, 12 U.S.C. 1430b, for transactions that promote home financing, housing activity, and community development.

Because the Finance Board retained the substance of the FHLBB Guidelines and, by implication, the 1983 FHLBB legal analysis, the Interim Guidelines continued to impose upon LOCs all of the regulatory requirements and restrictions that apply to advances. For example, the Interim Guidelines require that LOCs: be fully secured with collateral eligible to secure advances under § 935.9(a) of the Finance Board's regulations, 12 CFR 935.9(a); be counted in the calculation of a member's FHLBank stock-to-advances ratio; be issued only for housing finance purposes if they have a term to maturity in excess of five years, or are issued on behalf of non-qualified thrift lender (non-QTL) members; and be included in the calculation of the limitation on advances to non-QTL members set forth in § 935.13 of the regulations, *id.* § 935.13, if issued on behalf of non-QTL members. In addition, the Interim Guidelines limit LOCs and confirmations used for purposes other than interest rate swap transactions to terms of ten years or less and prohibit use of LOC confirmations solely to promote a member's LOC program or to increase a member's profitability from this fee-based service.

As part of an ongoing effort to determine both how FHLBank standby LOCs might be made more useful to member institutions and nonmember mortgagees and how to encourage greater use of LOCs in carrying out the housing and community investment mission of the FHLBank System, the Finance Board recently undertook a survey of the FHLBanks to determine the uses of standby LOCs and the needs of the FHLBanks in issuing standby