Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

In response to the Federal Housing Finance Agency's request for input regarding the current comprehensive review of the Federal Home Loan Bank system, I offer the following thoughts.

By way of background, I worked at three different FHLBs from 1997 through 2021, spending most of that time as the Chief Risk Officer at the Federal Home Loan Bank of Boston. Prior to that I oversaw the voracious use of FHLB Advances as treasurer at a mid-sized thrift institution.

Summary

My review of the system indicates that it works well but that it can and must evolve to the current and future landscape to both fulfil its mission and to remain relevant and worth sustaining. Fortunately, the analysis further indicates just one tweak to the system is required: a significant reallocation of Bank profits to housing and affordable housing initiatives similar to, but separate from, and more flexible than the existing Affordable Housing Program. Doing so will:

- Still maintain a very attractive business model with attractively priced advances available to member institutions
- Reduce the dividend paid to members, an outsized dividend that currently reduces the all-in cost of member borrowing to unnecessary attractiveness
- Provide substantial resources to affordable housing initiatives – thus reestablishing the strong link between the Bank and its mission
- Utilize the existing expertise and regional structure of the system to tailor and experiment with alternative approaches to better meet the overwhelming need for more affordable housing

The numbers bear out a solution that meets all these goals. It should be embraced by the FHLBanks with enthusiasm – it is sustainable, it is mission consistent, the system has the expertise (along with its partners) to make a difference, and it re-establishes a reason for being.

Background

The economics of the FHLB system as estimated in several recent analyses indicate an annual value of between $5 and $6.5 billion attributed to access to low-cost debt and the exemption from income taxes. This seems a reasonable estimate. Currently, as a cooperative, this value overwhelmingly benefits the providers of the capital - the members of the FHLBanks. But, the evolving FHLB business model, the core mission of the System and the new realities of the housing and mortgage markets warrant a reassessment of this value allocation.

Access to Low-Cost Borrowings

The primary activity of the Banks is lending to member institutions at interest rates that are well below a reasonable comparison benchmark, High-Quality Corporate Bonds, and thus represent a very attractive offering right out of the gate. The borrowing rate for members is then made even more attractive due to the outsized dividend paid - with the resulting borrowing cost much closer to Treasury rates than to the benchmark. The observed clamor to preserve the status quo from existing members, and requests to extend membership by and for those currently outside looking in is understandable – FHLB membership is valuable!

Mission Drift

Further, the focus and mission of the FHLBanks has shifted as the mortgage markets have evolved. Housing related mortgage lending by member institutions has dwindled, and the primary focus of the Banks is now providing members with liquidity, but with an increasingly weak link to home lending. As a result, the value realized by member institutions is still further enhanced as liquidity management – an activity typically incurring a cost – is, through the FHLB, made cheap and on demand. This value too accrues exclusively to FHLBank members.

What's Needed

The FHFA's current comprehensive review of the FHLBank System has revealed two recurring themes: the vital role the FHLBanks play in providing liquidity and funding for member institutions, and the acute need for more funds for affordable housing. Rebalancing the distribution of FHLB value more evenly between members and affordable housing/community development initiatives is both achievable – and compelling. Members will still access low-cost funding (and liquidity) and the FHLBanks and members can reassert their role in home lending directed to an underserved market.

Importantly, this recommended reallocation need not create undue operational burdens on the FHLBanks. On the contrary – the mechanisms to distribute additional funds towards affordable housing initiatives exist – through the Advisory Councils, the Boards of Directors, and employees at each Bank. Initiatives that lever the local ownership of each FHLBank, the local knowledge of housing experts and the community bank members is an inherent and core strength of the FHLBank System and should prove very effective.

Recommendation

My analysis indicates a reallocation that provides an incremental 30 to 40% of adjusted net income (in addition to the current allocation to the AHP) for geographically targeted and innovative affordable housing and community investment initiatives – allows the FHLBanks to reassert their role in home loan activity, clarify their mission, still preserve an attractive core business value proposition to members and lever the combined expertise of the FHLBanks, the members and the housing constituent partners to meaningfully improve the housing markets.

I look forward to future discussions on this topic and appreciate the opportunity to provide comments.

Sincerely,

George Collins
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