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It's time for FHLB Banks to pursue their mission

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Sandra Thompson and the Federal Housing Finance Authority (FHFA) should be applauded for questioning the Federal Home Loan Bank banks (FHLB Banks) they oversee about their level of community development lending. For decades, the FHLB Banks have been gaslighting the public about their community development activities while primarily serving as government subsidy providers exclusively for their bank members.

The reality is that far from having a positive impact on affordable housing and community lending, the FHLB Banks are actively engaged in wholesale redlining by providing better terms to bank members who serve wealthier, whiter borrowers, than CDFI members who serve Black, Hispanic, and lower-income borrowers. In short, at the FHLB, non-bank CDFI members pay the same membership fees but are provided a second-class membership that results in lower advance rates, fewer member benefits, and more stringent covenants.

In 2019, The Change Company, the nation's largest CDFI non-bank lender, was granted membership in the FHLB-SF. Remarkably, Change was then told that the FHLB-SF would not provide the same financing to Change that it provided to bank members even if the financing was secured against identical collateral (i.e., the same loan to the same borrower with the same terms). Next, Change was informed that FHLB-SF would not purchase loans from any of its CDFI members to meet the FHFA's mandated community development goals – loan purchases would be made exclusively from bank members. Finally, Change was informed that CDFI members were not eligible participants in several of the FHLB-SF's most important programs, and that no level of due diligence or credit enhancement could change that.

The FHLB bias against CDFIs is so strong that they would not even allow Change to use the FHLB's Mortgage Partnership Finance (MPF) program that its bank members utilized to sell loans to Fannie Mae and Freddie Mac. Amazingly, the FHLB-SF allowed banks who were not approved seller-servicers with Fannie Mae and Freddie Mac to use the program, while denying access to Change that was an approved seller-servicer with Fannie Mae and Freddie Mac.

More recently, the FHLB Banks have avoided public transparency as they have imposed new lending policies that strangle liquidity to non-bank CDFI members. The FHLB Banks quietly reduced advance rates to their members who are non-bank CDFIs by over 10% compared to their banking members – even for an advance secured by an identical loan to the same borrower.

For instance, if a CDFI buys a loan from an existing FHLB Bank member, the FHLB will provide the CDFI with a lower advance – often to the tune of 13% – on the same loan. This results in lower CDFI liquidity, lower CDFI profitability, and a higher CDFI cost of capital. This, in turn, results in a higher cost of capital to the Black, Latino, and low-income borrowers of CDFIs relative to the richer, whiter private bank customers. In short, the FHLB Banks are subsidizing the mortgage rates of private bank clients at the expense of CDFI borrowers. FHLB Banks are imposing lower advance rates on loans that are originated by CDFIs. Even if the loan has the same credit terms as an identical loan originated by a member bank.

These new FHLB bank practices were adopted during the Trump administration without any public notice, without publication, and without formal rulemaking or approval by the FHFA. President Biden's FHFA should not let these Trump policies stand. They are resulting in wholesale redlining where minority and low income CDFI borrowers get higher cost loans and loans that are less liquid because of FHLB practices.

Today's community development lending practices at the FHLB Banks are a clear example of government sponsored, systemic racism in our financial markets.

FHLB hostility to loans originated by CDFIs is not new. In the 1930s, the predecessor of the FHLB-SF was credited with the invention of redlining when it determined that advance rates should be lower in communities with higher Black populations – regardless of the creditworthiness of the loan itself. Sound familiar?

Legally-sanctioned redlining was outlawed over half a century ago, through laws like the Fair Housing and Equal Credit Opportunity Acts. But redlining never went away, it simply evolved.

Here's what it looks like today. Over $125 billion in mortgage applications with loan-to-value ratios *below* 60% were denied in 2020. These are, by and large, loans that should have been approved had only economic factors been taken into consideration. Many of these loans are denied to minority borrowers for entirely non-economic reasons.

It will come as no surprise that the FHLB Banks do not report the race and ethnicity of the borrowers of the loans their member banks pledge to secure financing. They hide those numbers because they know that their lending is simply serving as a subsidy for big, private banks. We call on the FHFA to require FHLB Banks to provide transparency into the race, ethnicity, and income of the borrowers of the home loans that they accept as collateral for their lending. To the extent they allow a bank to pledge its entire portfolio of loans to secure its borrowing base, we call for the FHLB to include the race and ethnicity of the member bank's entire loan portfolio, on a pro rata basis, for its reporting.

Fortunately, the FHLB-SF can't hide its lack of community development from the public completely. For instance, from Securities and Exchange Commission filings, we learn that only 7 CDFIs in the FHLB-SF's region (approximately 5%) were able to obtain credit facilities from FHLB-SF, for a total of $135 million, as of year-end 2021. This compares to almost 100% of banks in the region with credit facilities in excess of $245 billion. Said another way, less than 0.05% of FHLB-SF financing has gone to CDFI members.

In fact, FHLB-SF has lent First Republic Bank and Union Bank, both big private banks headquartered in California, over one-third of all FHLB-SF outstanding loans at year-end 2021. These two banks received loans for 50-times the total loan amounts the FHLB-SF provided to all CDFIs combined. Using the FHLB Banks to subsidize First Republic Bank and Union Bank is hardly bringing greater equity to homeownership in America. It is unclear how the FHLB-SF's financing of these banks has resulted in any new lending to any Black, Latino, or low-income Americans that would not have otherwise happened.

The FHLB-SF has made net income of almost $1 billion over the past three years. Clearly, the FHLB-SF could increase lending to lenders who serve Black, Latino, and lower income Americans without compromising profitability – or the safety and soundness of the FHLB system. From 2019-2021, FHLB-SF has made annual net income of about 10x the average outstanding loan balance to CDFIs. This means that if 100% of all CDFI loans ended up worthless, the FHLB-SF would have still returned over $900 million of government subsidized profits to its bank members. It is time for the FHFA put an end to FHLB-SF's use of government subsidies to generate windfall profits and below market financing for big banks in lieu of meeting its mission and community development obligations.

Ultimately the FHLB Banks must provide secured lending to CDFI's on the same footing as its bank members. In short, the same loan to the same borrower should get the same financing from the FHLB Banks, even if one loan is made by the CDFI and the other by a private bank. Such a core institution of the American financial system as the FHLB Banks cannot be allowed to continue its systemic racism and modern redlining by providing CDFI members a second-class membership that comes with worse terms and worse options than what the FHLB Banks offer to bank members.

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