

**Testimony of Martin Eakes,  
Chief Executive Officer, Self-Help Credit Union and Center for Responsible Lending  
Before the Senate Committee on Banking, Housing and Urban Affairs  
Hearing On  
The Federal Home Loan Bank System  
April 13, 2005**

Chairman Shelby, Ranking Member Sarbanes, and members of the Committee, thank you for holding this important hearing and for inviting me to testify before you today. I am CEO of Self-Help Credit Union and the Center for Responsible Lending (CRL). Self-Help Credit Union has been an active member of the Federal Home Loan Bank of Atlanta for eleven years. It forms, along with its nonprofit affiliates, a community development lender that creates ownership opportunities for low-income and minority families through homeownership and small business financing. Self-Help has provided more than \$3.9 billion in financing to almost 45,000 homeowners, small business owners and nonprofits across the nation. CRL, an affiliate of Self-Help, is a nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families. CRL is dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

In my testimony, I will emphasize five points:

1. In my experience, the Federal Home Loan Bank of Atlanta (FHLBank Atlanta) does a terrific job in administering a number of community development subsidy programs that provide significant leverage and impact, and I hear that the other FHLBanks do too.
2. There is a potential issue with FHLBank mission, since states subsidize FHLBank activities through the income tax exemption of FHLBank debt, the largest banks in the country receive the majority of advances, and a significant amount of advances fund jumbo loans to higher income people.
3. FHLBanks should have statutory, or at least regulatory, affordable housing goals for their core business of making advances to financial institutions, as well as for their mortgage purchase programs.
4. FHLBanks should be commended for recognizing the predatory lending problem and applying strong anti-predatory lending guidelines to the Mortgage Partnership Finance program. These guidelines should also largely be applied by statute or regulation to their advance business.
5. Disclosure of a loan-level data file comparable to HMDA and the FannieMae/Freddie Mac public use database for the home loans used as collateral for FHLBank advances, and those purchased, as of the end of each quarter, should be required.

**Introduction**

*Self-Help*

For the past twenty years, Self-Help Credit Union and its nonprofit affiliates have

aggressively sought to increase homeownership opportunities as a strategy to help low-wealth Americans take their first steps towards the middle class. Our mission is to expand wealth and ownership opportunities for all families, with a particular emphasis on groups traditionally denied access to these opportunities: women, minorities and rural residents. We do this by providing home and business ownership financing.

Self-Help has provided more than \$3.9 billion in financing to almost 45,000 homeowners, small business owners and nonprofits across the nation. We have created or preserved 23,000 jobs, 21,000 child care spaces, 13,000 school spaces and helped 41,000 families buy homes. And the borrowers have paid us back: a testament to the viability of targeting motivated low-wealth families is our loan loss rate of less than 0.5 percent per year. This figure is comparable with traditional financial institutions' loss rates. Self-Help Credit Union is state-regulated and federally-insured and received the highest possible CAMEL rating from its regulator. Our assets have grown to almost \$1 billion.

Self-Help is committed to the idea that ownership allows people to improve their economic position and provides communities with a solid foundation on which to grow and prosper. In particular, we have found that homeownership is the bedrock for economic security, as homeownership has been the primary way for families to build wealth. In the U.S. today, one-half of all homeowners hold at least 50% of their net worth in home equity.<sup>1</sup> And home equity comprises over 60% of the net worth of minority and low-income families.<sup>2</sup> This equity is used by families to send children to college, start new businesses, or weather crises such as job loss or extended illness.

Self-Help's Secondary Market Program is a major component of our home lending work. Through the program, Self-Help buys packages of nonconforming loans from financial institutions in return for their commitment to re-lend the money to an equivalent number of low-wealth home buyers in the future. We have financed \$3.4 billion of loans to 39,000 families across the country through over thirty lenders. Forty-one percent of the program's home loans had been made to minority families, 39% were made to female heads of household, and 20% of the loans were made to rural families. Additionally, these programs are reaching working-class families: the average income of the homebuyer is 64% of the relevant area median income. Losses have been well below one-half of one percent a year. Our program has also enabled us to develop a deeper understanding of the complexity of the secondary market and the issues that both lenders and borrowers face in today's home lending market.

#### *Center for Responsible Lending*

For the first 20 years of my professional life, I worked to make subprime home purchase loans to low-wealth families unable to get a loan from a bank. In 1998, my perspective on Self-Help's mission expanded when a middle-aged African American home loan borrower broke into tears in my office. He told me his wife had died three years before, leaving him to care for their

---

<sup>1</sup> See, e.g., Joint Center for Housing Studies of Harvard University. *State of the Nation's Housing 1997*: p.18.

<sup>2</sup> "Net Worth and Asset Ownership of Households, 1998 and 2000," at 15 tbl. I (U.S. Census Bureau, p70-8, May 2003).

six-year old daughter. He desperately wanted to hold onto his house, telling me, “This house is more than a home. It is also the physical memory of my daughter’s mother.” For ten years, he said, he had tried to refinance a home loan he had taken at 14% interest; he insisted that the lender would not let him pay off the loan. The loan documents showed that this man’s loan of \$29,000 had been inflated with \$15,000 in fees. The lender would not tell him -- or me -- the pay-off balance.

We soon discovered that the problem was larger than one loan. This same lender was making 18,000 mortgage loans per year in North Carolina alone. As I attempted to help this man refinance his loan with Self-Help -- and to help others who followed him -- I learned how an unscrupulous lender can steal a lifetime’s accumulation of wealth in the few seconds it takes a homeowner to sign his name. We realized all our efforts to build wealth through homeownership are unlikely to result in lasting changes for the communities we work in unless we also work to protect wealth from predatory practices and unscrupulous lenders.

In response, Self-Help joined with a remarkable coalition of bankers, credit unions, mortgage brokers, mortgage bankers, consumer advocates, the NAACP, AARP, and other community organizations to develop a state law with strong standards that would preserve the important benefits of the subprime market while weeding out the worst abuses. The resulting anti-predatory lending law, enacted in North Carolina in 1999, was the first in the nation, and its success continues to be a model for efforts in other parts of the country.

Since enactment of the law, Self Help has established an affiliate, the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families. CRL draws on Self-Help’s experience as a lender in advocating common-sense approaches to market failures and lender abuses that harm homeowners -- and those who want to become homeowners -- in their pursuit of security and opportunity. See [www.responsiblelending.org](http://www.responsiblelending.org).

## **I. FHLBanks run superb subsidy programs.**

Through our use of various FHLBank Atlanta programs, we have seen first-hand how the combination of strong targeted subsidies and first-rate management and administration can lead to extremely positive community development outcomes. In total, FHLBank Atlanta has provided us or our borrowers approximately \$510 million of below-market rate loans, enabling 7,200 families to become homeowners, plus \$8.8 million in loans enabling the rehabilitation of five downtown and inner-city real estate projects.

FHLBank Atlanta has been a critical and effective partner for four of our primary development strategies:

### *1. Home Lending -- First-Time Home Buyer Program*

To spur homeownership, Self-Help Credit Union makes direct home loans to families falling outside of conventional guidelines. FHLBank Atlanta’s First-Time Home Buyer program provides down payment assistance -- a forgivable loan of up to \$5,000 partially matched with

homebuyer funds -- to low-income borrowers of our direct lending program. This allows families who cannot afford the down payment/closing costs or the monthly payments on a first mortgage to buy a home rather than to continue renting.

In the four years the program has been available, we have administered \$830,000 of such loans to 186 families, leveraging almost \$15 million in Self-Help loans to borrowers who otherwise could not have qualified for them. Over two-thirds of these families are minority, 40% are women-headed households, 38% are rural and all are low-income.

### *2. Home Loan Secondary Market Program – Community Investment Program*

Through a nonprofit affiliate, Self-Help funds non-conforming loans to low-income families made by larger financial institutions through Self-Help's home loan secondary market program. Our secondary market program has used approximately \$500 million of Community Investment Program (CIP) advances to help make mortgages affordable to over 7,000 low-income and minority families across the country.

This funding was absolutely essential to us when we did not have access to any other low-cost, large-scale source of funding; without it, we would not have been able to initiate our program. In this sense, FHLB Atlanta and CIP deserve some credit for enabling all of this program's families – 39,000 with \$3.4 billion in financing -- to become homeowners.

### *3. Residential Housing Development – Affordable Housing Program*

To increase homeownership opportunities and help revitalize communities, Self-Help develops single-family real estate for sale to low-income homebuyers. We've received four Affordable Housing Program grants for almost \$200,000. These grants enabled Self-Help and Durham Habitat for Humanity to build (or completely renovate) and finance homes for 38 first-time, very low-income buyers. Although the total AHP grant in each home averaged only \$5,184, the impact was significant – in almost every case, the buyer would not have been able to purchase these homes without AHP assistance.

These grants are especially useful because nonprofit builders can use them with such flexibility. They bridge two gaps:

- First, they help bridge the gap between buyer incomes and housing costs. Self-Help has used these grants to assist borrowers with down payments and closing costs, so that they only have to invest \$800-\$1,000 to buy a home. This makes the homes affordable to buyers whose incomes are low and fixed.
- Second, because these funds are grants, not loans, to the nonprofit, we can also use them to bridge the gap between high home building costs and the lower market value of new homes in pervasively disinvested neighborhoods. This enables developers to start improving a neighborhood before the market could ever reach it.

### *4. Commercial Real Estate Development – EDGE Loans*

Self-Help purchases, renovates and manages historic commercial buildings in downtown

areas, providing nonprofits and small businesses with flexible, affordable space and revitalizing cities and towns. Self-Help has received \$8.8 million of Economic Development and Growth Enhancement (EDGE) Program loans to assist with five community economic redevelopment efforts. These loans leveraged \$19 million in private investment and placed 170,000 square feet of commercial real estate into service from largely formerly vacant buildings in five North Carolina cities.

As one example, a \$1.5 million, 1% interest rate, 20-year EDGE loan enabled us to undertake a \$3.5 million renovation of 100 Hay Street, in Fayetteville, North Carolina. The loan transformed Fayetteville's landmark building, a 10-story vacant and decaying former bank building on the city's major downtown intersection, Market Square, into a 100% leased home to nonprofits and small businesses. The building had been vacant for a decade prior to Self-Help's renovation.

The EDGE program fills a critical need both from a pricing perspective (rents in these areas cannot yet support market-rate debt) and from a risk perspective (markets are unproven and conventional lenders largely will not yet lend). The EDGE program is well-designed and administered, efficiently targeted, and is practically the sole source of funds (other than historic tax credits) for projects like the one in Fayetteville to jumpstart downtown and inner-city revitalization.

## **II. The FHLBank mission issue.**

Let me start with three disparate facts in order to formulate the FHLBank mission problem, as I see it.

### *1. State governments subsidize the debt of the Federal Home Loan Banks.*

The interest paid by the FHLBanks on their debt issued to private debt holders is exempt from state income taxes.<sup>3</sup> This is not the case for other private corporations who issue debt to raise funds, or even other GSEs: holders of Fannie Mae's and Freddie Mac's debt and mortgage-backed securities do pay state income taxes on the income received.

The interest that FHLBanks must pay for investors to buy their debt offerings is presumably lower than it would be otherwise, just as it is for other tax-exempt debt. For North Carolina, with a 7% state income tax, the state's lost tax revenue would be \$7 million for every \$100 million of interest on debt paid to North Carolina tax-paying individuals.

The potential subsidy that this tax exemption provides to FHLBank members from state coffers is up to \$1 billion. Interest income to FHLBank debtholders in 2004 was \$15.2 billion.<sup>4</sup> We've calculated that the weighted average state income tax rate based on state population is

---

<sup>3</sup> See 12 U.S.C. Section 1433.

<sup>4</sup> According to Federal Home Loan Banks, Quarterly Financial Report, June 30, 2004, p 82, the six-month interest expense for FHLBank debt was \$7.6 billion. Total income for FHLBank debtholders in 2004 was therefore \$7.6 billion times two, or \$15.2 billion.

6.5%. Therefore, the estimated potential state subsidies to FHLBank debtholders in 2004 was \$15.2 billion times 6.5%, or \$988 million.

The actual state subsidy will be less than this amount because some unknown portion of the FHLBank's debt will be held by foreign and tax-exempt entities, such as pension funds and nonprofit foundations.

2. *The majority of FHLBank advances are made to the largest banks in the country.*

One and one-half per cent of FHLBank member-borrowers take out 63% of the total FHLBank advances, as of June 30, 2004 (86 financial institutions out of 5,718 total financial institution borrowers). These institutions hold \$355 billion of the \$564 billion of total advances outstanding. Each of these institutions had outstanding advances of \$1 billion or more.<sup>5</sup>

Spreading the 86 institutions across the 12 FHLBanks means that, on average, the largest seven borrowers at each FHLBank account for 63% of total FHLBank advances. The top ten advance holding members of the system as a whole had \$154 billion of FHLBank advances, or 28% of the total.<sup>6</sup>

I don't report these facts to imply that big banks are bad, or undeserving of participation in the FHLBank system. In fact, FHLBanks may, by making large advances to their largest members, be able to cross subsidize the costs of making smaller advances to their smaller members. Of course, tiered FHLBank pricing, with lower rates on large advances, cuts against this argument.

3. *A significant portion of FHLBank advances are used for jumbo home mortgages to higher income homeowners.*

The Congressional Budget Office estimated that 52% of FHLBank advances are used to fund and are secured by jumbo home loan mortgages.<sup>7</sup> For 2005, the general conforming loan limit is \$359,650 for single-family home loans. Annual family income to qualify for a loan right at the jumbo cutoff (assuming an 80% loan-to-value ratio or below so that no private mortgage

---

<sup>5</sup> Id. at 74, 55.

<sup>6</sup> Id. at 56.

<sup>7</sup> "Federal Subsidies and the Housing GSEs," Congressional Budget Office, May 2001, page 27.

insurance is required) at current interest rates is \$104,643,<sup>8</sup> which represents the highest 14% of household incomes in the country.<sup>9</sup>

Of course, there are certain areas of the country, such as California, where housing costs are so high that jumbo loans will be much more frequent than in other areas of the country with average or below average house prices. Some jumbo loans in high cost areas will therefore be to upper middle class families.

The CBO estimate was based on 1999 data. We have heard reports of unpublished research that suggests that the jumbo percentage number is much lower for 2003 data. Whatever the percentage, it is certainly higher than for the other housing GSEs, who are not permitted to fund jumbo loans at all.

What we do know is that FHLBank system had \$9 billion of Community Investment Program (CIP) advances outstanding as of June 30, 2004, or 1.6% of total advances outstanding.<sup>10</sup> These CIP advances are made available to financial institution members in order to finance loans made for home purchase or rehabilitation for families whose incomes do not exceed 115% of the area median income levels, or to finance commercial and economic development loans that benefit low- to moderate-income families and neighborhoods.

This 1.6% number does not compare very well with the HUD goals for Fannie and Freddie that 52% of total financing activity must benefit homeowners with incomes not to exceed 100% of area median income.

Perhaps FHLBank member institutions are indeed funding low- and moderate-income borrowers, but not bothering to apply for the 5 to 15 basis point lower rate offered by the CIP program.<sup>11</sup> Perhaps loans to low- and moderate-income borrowers are funded with “overnight”

---

<sup>8</sup> This amount represents gross income to support payments of mortgage principal, interest, property tax and hazard insurance (PITI). According to the current issue of *Inside Mortgage Finance*, Issue 2005:13 p. 2 (April 1, 2005), the 30-year fixed jumbo mortgage rate is 6.125%. The monthly mortgage payment for a loan of \$359,650 at 6.125% is \$2,185, with an annual payment of \$26,220. Assuming 80% LTV and 1% property tax rate, the annual property tax payment will be \$4,496. The Insurance Information Institute estimates the average annual cost for hazard insurance in 2005 will be \$677; see <http://www.iii.org/media/industry/additional/2005homeoutlook/>. Taken together, we estimate the total annual PITI payments for a loan of \$359,650 will be \$31,393 per year. Given a standard 30% housing debt to income ratio assumption, family annual gross income to support such payments would be \$104,643.

<sup>9</sup> According to the *Income, Poverty and Health Insurance in the United States: 2003* issued by US Census Bureau, household income of \$86,867 and \$118,200 places a family at the 80th and 90th percentile, respectively. Through interpolation, we estimate that an annual income of \$104,643 places a household at the 86th percentile of all household incomes in the country. This percentile is slightly overstated, since census data provides 2003 incomes while the 2005 conforming loan limit is based on 2004 housing prices; on the other hand, most jumbo loans will be larger than the conforming loan size cutoff, which would imply that the borrowers would have higher incomes.

<sup>10</sup> Federal Home Loan Banks, Quarterly Financial Report, June 30, 2004, p 33.

<sup>11</sup> Each basis point is 1/100<sup>th</sup> of 1%, so 10 basis points is 0.10%. FHLBanks vary on how much of their subsidy they pass onto their member-borrowers through lower base interest rates versus higher stock dividends, so the CIP benefit will vary at different banks. Of the 7 of 12 FHLBanks that post their rates on their websites, the average CIP price advantage is 17 basis points.

or daily rate advances, for which the CIP discounted rate is not available. However, this would not be a rational course for the member bank, since the favorable CIP rate is generally available for very short, 30-day term advances.

It is possible that a large portion of the FHLBank advances funding non-jumbo loans are used for financing higher-cost, subprime mortgage loans, the most rapidly growing segment of home lending finance, particularly for minority borrowers. Without additional data disclosure and regulatory monitoring, an unknown portion of funded subprime home loans could be abusive or predatory mortgages. For a public housing mission, there simply must be additional data disclosure and policy controls in place to ensure (and know) that FHLBank advances are not being used to fund predatory or abusive home loans.

In summary, let me restate the “mission problem”:

Cash-strapped state treasuries are currently subsidizing FHLBanks to make advances to large banks to fund loans to higher income families, and perhaps to fund abusive home loans.

Therefore, I offer three recommendations for your consideration:

- Establish affordable housing goals for the core advances business, as well as the mortgage purchase programs.
- Follow the excellent lead of the Mortgage Partnership Finance program and establish anti-predatory lending standards for the FHLBank advances business.
- Require disclosure of a loan-level data file comparable to HMDA and the Fannie/Freddie public use database for the home loans used as collateral for FHLBank advances and those purchased, as of the end of each quarter.

It may be the case that the FHLBanks are doing extremely well now in providing funding for affordable housing loans to underserved families and that these loans would not fail the anti-predatory lending standards. If so, then these recommendations, once implemented, will demonstrate that fact without requiring any changes to the lending practices of either the FHLBanks or their member-borrowers.

**III. Establish affordable housing goals for the core FHLBank advances business as well as the mortgage purchase programs.**

Congress has mandated and HUD has implemented three overall housing goals for Fannie Mae and Freddie Mac. These housing goals for 2005 are:

- 52% of Fannie/Freddie housing units financed must be for low- and moderate-income families, defined as families with incomes not exceeding 100% of area median income (low-mod income housing goal).

- 22% of Fannie/Freddie housing units financed will be for very low-income families, defined as families at or below 60% of the area median income, or low-income families in low-income areas below 80% of area median income (special affordable housing goal).
- 37% of housing units financed will be for families living in low-income census tracts or in middle-income census tracts with high minority populations (underserved areas housing goal).<sup>12</sup>

*1. Establish housing goals for mortgage purchase programs.*

FHLBanks hold \$116 billion in mortgage loans purchased under the Mortgage Partnership Finance program and the smaller Mortgage Purchase Program.<sup>13</sup> These programs were set up as an alternative to banks selling loans to Fannie Mae and Freddie Mac, with the primary difference being that the bank retains the credit risk, leaving the FHLBank with the interest rate risk.

Given that both FHLBanks and Fannie/Freddie are both government-sponsored enterprises created with significant advantages over private entities and that are, in this case, serving a similar mortgage purchase purpose, I cannot think of a reason why this program ought not to have similar affordable housing goals. This is not a new idea by any stretch, and was suggested by FHLBank Seattle last year.<sup>14</sup> According to the American Banker, “Privately, FHLBank officials have indicated they have no problem with . . . Fannie’s and Freddie’s . . . affordable housing goals.”<sup>15</sup> The Seattle Bank makes the point, however, that the goals should be adjusted downward to take into account the fact that FHLBanks do not purchase multi-family loans, and Fannie and Freddie do.

*2. Establish housing goals for the core advance program.*

These housing goals should not stop with the purchase programs, however, but should also be applied to the FHLBank core advance program.

There used to be housing goals applied to advances of a sort. Beginning in 1997, FHLBank CEO salary was tied, in part, to the amount of Community Investment Program advances outstanding.<sup>16</sup> This incentive standard was overturned, however, in the Gramm-Leach-Bliley legislation that deregulated CEO salaries three years later.<sup>17</sup>

---

<sup>12</sup> <http://www.hud.gov/offices/hsg/gse/gse.cfm>.

<sup>13</sup> Federal Home Loan Banks, Quarterly Financial Report, June 30, 2004, p 74.

<sup>14</sup> See “Should the FHLBanks have Fannie/Freddie Type Affordable Housing Goals? Bring it on, says one,” American Banker, September 10, 2004.

<sup>15</sup> Id.

<sup>16</sup> See 62 Fed. Reg. 4-01, 1998 WL 1140 (F.R.) Final Rule, effective January 2, 1997 (CFR section 932.41(c)(2)(ii)). In 1998 the section changed in numbering to section 932.19(c)(2)(ii).

<sup>17</sup> Title VI of the Gramm-Leach-Bliley Act, effective January 1, 2000, section 606(d)(1)(B), amended the Bank Act by removing Finance Board approval of selection and compensation of FHLBank officers.

It could be argued that the “purchase” of home loans by Fannie and Freddie is different from the “funding” of home loans used as collateral for the FHLBanks, and therefore advances should not be held to an affordable housing goal standard. It is true that a FHLBank member institution might use the funds from its FHLBank advance for some purpose other than making the home loans that are pledged as collateral. However, it is equally true that a financial institution that sells a home loan to Fannie might use the proceeds for a purpose other than additional home loans. In fact, from the perspective of “safety and soundness,” application of affordable housing goals is easier in the context of FHLBank core advances because the FHLBank advances involve virtually no credit risk or interest rate risk. The member financial institution retains these risks, which is why none of the 12 FHLBanks has in the course of the last 70 years EVER incurred a loss on a core funding advance!

One might also argue that the FHLBanks already meet their public mission by contributing each year 20% of net income to REFCORP to retire the remaining clean-up debentures for the 1980s savings and loan crisis, and by contributing 10% of the remaining net income for the program subsidies under the Affordable Housing Program (AHP). In total, these two funding responsibilities present a burden, or implied tax, of 28% of the total operating income of the FHLBanks. However, these payments are in lieu of paying a federal income tax, which presents a 35% marginal tax burden on other corporations, including Fannie Mae and Freddie Mac.

(As an aside, with current FHLBank asset growth and profitability trends, the REFCORP obligations could be extinguished in as few as five or six years. Will Congress decide, as we would recommend, to consolidate the 20% payment into an expanded AHP program?)<sup>18</sup>

Try the following legislative experiment: offer to Fannie or Freddie a cancellation of their federal income tax obligations (while keeping all affordable housing goals) in exchange for a requirement that they contribute 20% of net income to the Treasury and 8% of net income in the form of affordable housing grants to deserving (and grateful) housing organizations and projects all across the country. I bet it would not take long for Fannie and Freddie to provide an answer.

There will clearly be implementation issues to deal with when lenders provide the FHLBanks with a blanket lien on mortgage loans. One way to deal with this issue is for the member bank to report aggregate income or targeting data on loans provided in the blanket lien, rather than loan-by-loan reporting. Assume, for example, the affordable housing requirement is that 50% of FHLBank advances need to meet a particular borrower income target. Bank X has

---

<sup>18</sup> Quarterly Financial Report, June 30, 2004, pp. 34-35. Title VI of the Gramm-Leach-Bliley Act, effective January 1, 2000, changed the REFCORP payment from \$300 million annually to 20% of each FHLBank’s net earnings. Any quarterly payment in excess of \$75 million is used to extinguish the liabilities to REFCORP at the end of the liability period. As of June 30, 2004, the last REFCORP installment not extinguished was the payment scheduled for October 15, 2019. This is a little over 14 years from now. At current profitability levels and trends, each quarter’s 20% assessment pays the current installment and extinguishes 2.5 quarters of installments at the end of the obligation period. Five to six years of steady and growing earnings could conceivably extinguish the remaining REFCORP indebtedness. Profitability set-backs, of course, would extend the term.

taken out \$1 billion in advances and has pledged as collateral a \$5 billion home loan portfolio. Bank X reports to FHLBank that, in the aggregate, 50% of the home loans in the portfolio meet this income target. If Bank X were FHLBank's only borrower, FHLBank would meet its affordable housing goals.

Over time, lenders would be incented to provide pledges on loans that pro rata meet an affordable housing test, either through blanket liens provided on certain groups of loans, perhaps sorted by loan size, or through specific loan pledges. Such a result would be only appropriate given the public subsidy provided through the FHLBanks.

Public policy favors homeownership and affordable housing in many important ways, from the mortgage interest deduction to the favored status of the housing GSEs. I believe that the broader benefits to society, neighborhoods and families have proven the case over many decades that the policy preferences for homeownership and affordable housing are warranted.

Until recently, the benefits and purpose of the FHLBank system were naturally targeted to relatively small savings and loans that for the most part funded homeownership for ordinary, working families. Now, with larger banks, larger "jumbo" homes, subprime lending, and much larger subsidy dollars at stake, Congress and/or the FHLBank regulator should implement affordable housing goals that ensure an accountable public mission commensurate with the GSE status and the implied and explicit public subsidy.

#### **IV. Establish anti-predatory lending standards for the FHLBank advances business.**

The Federal Home Loan Bank System deserves kudos for taking significant steps to address the problem of predatory mortgage lending. The Mortgage Partnership Finance (MPF) Program's policies include an excellent discussion of predatory lending and effective policies against it.<sup>19</sup> This means that the 75% of the \$116 billion in FHLBank mortgages under the MPF program were purchased with effective predatory lending curbs in place; I don't know if Mortgage Purchase Program has comparable standards or not.

In addition, at least one FHLBank, the FHLBank of Atlanta, has had anti-predatory guidelines that apply to its core advance business since 2000.<sup>20</sup> And the Federal Housing Finance Board publishes on its website an excellent brochure and worksheet to protect home loan borrowers from abusive lending practices.<sup>21</sup>

The subprime market is largely a market for refinance loans -- approximately two-thirds of subprime originations in 2002 were refinances<sup>22</sup> -- which present unscrupulous actors with opportunities to strip homeowners' built-up equity. Unfortunately, the combination of

---

<sup>19</sup> Chapter 2, General MPF Policies, MPF Origination Guide, Revision Date December 4, 2003, pages 2-3 to 2-7 and Addendum 2.6.6 adopted July 2004.

<sup>20</sup> [http://www.fhlbatl.com/misc/MPSG/MPSG\\_Mar05.pdf#page=1](http://www.fhlbatl.com/misc/MPSG/MPSG_Mar05.pdf#page=1), page 38.

<sup>21</sup> [http://www.fhfb.gov/PressRoom/pressroom\\_pub.htm](http://www.fhfb.gov/PressRoom/pressroom_pub.htm).

<sup>22</sup> SMR Research Corporation, "Subprime Mortgage Loans, 2004" (2004).

tremendous growth in subprime lending, the lack of standards for this rapidly growing industry, and subprime borrowers' frequent lack of financial sophistication has created an environment ripe for abuse. While by no means are all subprime loans predatory, almost all predatory loans are subprime. As a result of the growth of subprime lending, the pressing issue today is no longer the availability of credit in America's communities. Rather, the debate has shifted to the terms on which credit is offered.

Predatory mortgage lending is now epidemic, costing U.S. families an estimated \$9.1 billion each year in lost homeowner equity, back-end penalties, and excess interest paid.<sup>23</sup> Abusive practices include stripping equity from homeowners through excessive fees; steering homeowners into unnecessarily expensive loans on the basis of race, ethnicity, age, and gender; and interfering with the ability of homeowners to protect their homes from foreclosure with legitimate defenses. I know from experience that predatory lending robs families of the home equity wealth that could otherwise be used to send children to college, start small businesses, weather crises such as unanticipated medical expenses, and enjoy some measure of security in old age. Even worse, because predatory lending can lead to increased foreclosures across a neighborhood, abuses have a devastating impact on communities.

1. *Strong predatory lending guidelines are already applicable to Mortgage Partnership Finance Program.*

Banks are authorized to invest in Acquired Member Assets – eligible single-family whole mortgages. There are risk sharing and AA rating credit risk requirements imposed, but so long as these are met, subprime loans would be eligible AMAs. The MPF Program recognizes that it is important that FHLBanks do not inadvertently provide liquidity to – and therefore support for -- loans with harmful or predatory characteristics. There is also the recognition that, although predatory practices often generate short-term profits by depleting the wealth of unsophisticated homeowners, these practices ultimately impair the safety and soundness of institutions engaged in predatory lending. When borrowers have equity stripped away, their loans are at significant risk of default and the actual collateral value may often be less than the loan amount.

The FHLBanks participating in the MPF program have voluntarily adopted standards that would effectively protect borrowers and themselves.

- The participating financial institution must offer the borrower the lowest cost mortgage alternative for which the borrower qualifies. This provision effectively addresses the pernicious practice of *loan steering*, where minority and elderly borrowers are steered to more expensive loan products than they qualify for.
- Borrowers must have *ability to pay*, enabling them to successfully maintain homeownership.

---

<sup>23</sup> Stein, Eric. "Quantifying the Economic Cost of Predatory Lending", Coalition for Responsible Lending (2001) (available at <http://www.predatorylending.org/pdfs/Quant10-01.PDF>).

- *Points and fees are limited to 5%*, ensuring that excessive amounts of borrower wealth are not stripped away by financing high up-front fees. This policy is consistent with our belief that lenders should limit fees and reflect credit risk accurately in interest rates, even if that means increasing rates, so shopping is much easier for homeowners—and homeowners can also rectify mistakes through refinancing. The best defenders of borrowers from excessive interest rates are responsible lenders eager to refinance them to an appropriate rate; borrowers have no defense from a lender who overcharges on fees. That is home equity wealth that is lost forever at the stroke of a pen.
- The loans *cannot exceed high-cost thresholds of state or federal law*. A number of states have followed the lead of my own state of North Carolina to establish common-sense protections to supplement federal law. Most of these laws limit fees and allow interest rates room to increase; the laws provide greater protections for borrowers who are placed in loans that exceed the fee caps, which are normally 5%. Research has shown that this strategy is effective. As UNC Professor Michael Stegman reported based on significant research, “[t]he North Carolina predatory lending law is doing what it was intended to do: purge the market of abusive loans without restricting the supply of subprime mortgage capital accessible to North Carolina borrowers with blemished credit records.”<sup>24</sup>
- *Single premium credit life policies are prohibited*. This is in line with virtually all mortgage participants.
- *Prepayment penalties are prohibited*. One of the most common forms of equity stripping comes through abusive prepayment penalties in the subprime market. Prepayment penalties routinely amount to thousands of dollars, directly draining home equity when a borrower refinances and must pay the penalty. Alternatively, a prepayment penalty for subprime loans can serve as a high-cost trap, when the cost of the penalty is too high and a borrower is instead forced to continue paying a higher interest rate when they could otherwise refinance and qualify for a more affordable loan.

Several recent studies have clearly demonstrated the pervasiveness of discriminatory practices and the dangerous real world impact of prepayment penalties on subprime loans. Our organization recently published findings that borrowers in minority neighborhoods face greater odds of receiving a subprime prepayment penalty by a statistically significant margin.<sup>25</sup> New research by the

---

<sup>24</sup> R. Quercia, M. Stegman, & W. Davis, “Assessing the Impact of North Carolina’s Predatory Lending Law”, Housing Policy Debate Vol. 15, No. 3, pp 573-601 (2004) (available at [http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd\\_1503\\_Quercia.pdf](http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Quercia.pdf)).

<sup>25</sup> Bocian, Debbie and Zhai, Richard, *Borrowers in High Minority Areas More Likely to Receive Prepayment Penalties on Subprime Loans*, Center for Responsible Lending (January 2005), available at [http://responsiblelending.org/pdfs/rr004-PPP\\_Minority\\_Neighborhoods-0105.pdf](http://responsiblelending.org/pdfs/rr004-PPP_Minority_Neighborhoods-0105.pdf). Controlling for income, credit score, homeownership levels, and other factors, for borrowers living in zip code areas where more than half the

University of North Carolina at Chapel Hill found that prepayment penalties in subprime home loans increased the likelihood of foreclosure by 20%.<sup>26</sup> This is particularly of concern in light of UNC's additional finding that at least one in five subprime refinance loans end up in foreclosure -- ten times the rate for mortgages in the prime market.<sup>27</sup> Finally, an additional recent CRL study showed that, contrary to industry claims, subprime borrowers do **not** receive any net offsetting interest rate benefits in exchange for having a prepayment penalty on their loan.<sup>28</sup>

- *Mortgages with mandatory arbitration clauses are prohibited.* These clauses prevent borrowers from raising valid predatory lending claims against lenders in court, and therefore make a mockery of legal protections.

The MPF guidelines are very similar to the guidelines that both Fannie Mae and Freddie Mac have adopted.<sup>29</sup> HUD has applied most of these guidelines to Fannie and Freddie in the context of their Affordable Housing Goals.

In sum, the MPF guidelines are both strong and reasonable, and can be trusted to ensure that FHLBank purchases do not facilitate predatory lending at the same time that they permit the free flow of capital into home lending. The FHLBank regulator should do as HUD has done, and formalize the anti-predatory lending standards for all FHLBank mortgage purchase programs.

## 2. *Similar predatory lending guidelines should be applied to advances.*

In order for the FHLBank System to be certain that its advance business does not facilitate predatory or abusive lending, it should apply similar guidelines to this business line as well. Advances exist to provide FHLBank members an alternative to selling mortgages by enabling them to hold the loans in portfolio. There is no reason why advances should be exempt from predatory lending guidelines, since they can inadvertently cause an equal amount of harm by funding predatory loans as if such loans were sold to FHLBanks or to Fannie Mae or Freddie Mac.

The FHLBank Atlanta has made a good start in this regard, by voluntarily adopting

---

residents represent minority groups, these borrowers get loans with prepayment penalties 35% more frequently than borrowers similarly situated in zip codes where minorities comprise less than 10% of the population.

<sup>26</sup> See Quercia, Roberto, Stegman, Michael, and Davis, Walter, "The Impact of Predatory Loan Terms on Subprime Foreclosures" Center for Community Capitalism, Kenan-Flagler Business School, University of North Carolina at Chapel Hill (Jan. 25, 2005) (reporting that in a sample of 1999-originated retail-only subprime loans that 37% of loans with prepayment penalties prepaid while the penalty was still in effect by the end of 2003).

<sup>27</sup> Id.

<sup>28</sup> Ernst, Keith, *Borrowers Gain No Interest Rate Benefits from Prepayment Penalties on Subprime Mortgages*, Center for Responsible Lending (January 2005), available at [http://responsiblelending.org/pdfs/rr005-PPP\\_Interest\\_Rate-0105.pdf](http://responsiblelending.org/pdfs/rr005-PPP_Interest_Rate-0105.pdf).

<sup>29</sup> See Fannie Mae benchmark guidelines on predatory lending, April 2000; Fannie Mae seller servicer guide June 2002 update; Fannie Mae stops investing in mortgages that force borrowers to give up right to sue, Associated Press, February 4, 2004; Freddie Mac seller-servicer letter December 28, 2000.

predatory lending guidelines back in 2000 that apply to their advance program. The guidelines were modified in 2001 and state that loans cannot constitute advance collateral if they:

- Violate HOEPA;
- Violate state or local predatory lending laws; or
- Include single premium credit insurance.<sup>30</sup>

I would simply adopt MPF's guidelines for the advances program, but include an exception to the blanket prohibition of prepayment penalties for what we call conventional prepayment penalties, which are penalties no greater than 2% that are imposed on loans at or very near the conventional interest rate.<sup>31</sup> Prepayment penalties limited to 2% of the loan amount on loans that start at a low rate do not have the same potential for prepayment penalty abuse that subprime loans do.

As with the affordable housing goals, there will be complications introduced when lenders provide a blanket lien to the FHLBank. The FHLBank could take a lien on loans that violate the predatory lending standards, but these loans would not count when calculating collateral coverage ratios. In addition, just as with Fannie Mae and Freddie Mac, any loans that violate the predatory lending standards would not count as meeting the affordable housing goals.

**V. Require disclosure of a loan-level data file comparable to HMDA for mortgage purchases as well as home loans used as collateral for FHLBank advances.**

Without sunshine on the mortgages funded by FHLBank activities – both through mortgage purchase programs and advances – there is no way to know the positive or negative impact that these subsidized financings are having. Fannie Mae and Freddie Mac have public use databases that assist the public in tracking the impact of their activities. FHLBanks should have a similar requirement placed upon them, with reporting updated each quarter. Given that GSEs have public benefits, they should also have specific public understanding of their activities.

Banks already collect demographic data electronically on all loans for Home Mortgage Disclosure Act (HMDA) reporting, and should be able to link any remaining fields easily from origination software. Such reporting should not allow identification of individual lenders.

---

<sup>30</sup> See FHLBAtlanta Member Product and Services Guide, page 38.

<sup>31</sup> "Conventional mortgage rate" means the most recently published annual yield on conventional mortgages published by the Board of Governors of the Federal Reserve System, as published in statistical release H.15 or any publication that may supersede it, as of the applicable time set forth in 12 C.F.R. 226.32(a)(1)(i). "Conventional prepayment penalty" means any prepayment penalty or fee that may be collected or charged in a home loan, and that is authorized by law other than this Act, provided the home loan (1) does not have an annual percentage rate that exceeds the conventional mortgage rate by more than two percentage points; and (2) does not permit any prepayment fees or penalties that exceed two percent of the amount prepaid.

## **Conclusion**

FHLBanks have done much good throughout their history. My experience with FHLBank Atlanta and their subsidy programs has made this fact clear. For historical but outdated reasons, however, FHLBanks have not had the same mission requirements as their cousins Fannie Mae and Freddie Mac. This omission should be corrected in the new GSE legislation. FHLBanks should adopt, for both their mortgage purchase and advances programs, affordable housing goals, and the predatory lending standards that apply to the MPF program should also, in large part, be adopted to their advances program. Finally, FHLBanks should publicly disclose the mortgages purchased and taken as collateral in a public use database.