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HOUSING FINANCE

Improving the Federal Home Loan Bank System's Affordable Housing Program

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GAO United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

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Congressional Recipients

This report, mandated by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, assesses the Federal Home Loan Bank System's implementation of the Affordable Housing Program by addressing (1) how the program's funds have been used to support affordable housing initiatives, (2) how the program has been administered, and (3) what opportunities exist for improvement. The report contains recommendations aimed at improving the program's administration and assistance to the intended beneficiaries.

We are sending copies of this report to congressional committees and subcommittees interested in affordable housing; the Secretary of Housing and Urban Development; the Chairman, Federal Housing Finance Board; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request.

If you or your staff have any questions about this work, please call me at (202) 512-7631. Major contributors to this report are listed in appendix VIII.

Judy England-Joseph

Judy A. England-Joseph
Director, Housing and Community
Development Issues

List of Recipients

The Honorable Connie Mack
Chairman
The Honorable John F. Kerry
Ranking Minority Member
Subcommittee on Housing Opportunity
and Community Development
Committee on Banking, Housing,
and Urban Affairs
United States Senate

The Honorable Rick A. Lazio
Chairman
The Honorable Joseph P. Kennedy II
Ranking Minority Member
Subcommittee on Housing and
Community Opportunity
Committee on Banking and
Financial Services
House of Representatives

Executive Summary

Purpose

Decent and affordable housing for every American family has been a goal of national housing policy since 1949. A shortage of affordable housing has prompted the Congress to expand the capital available to finance such housing. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 required, among other things, that the Federal Home Loan Bank System establish an Affordable Housing Program to help finance housing for households with very low, low, and moderate incomes and directed that GAO evaluate this program.

This report examines (1) how the program's funds have been used to support affordable housing initiatives, (2) how the program has been administered, and (3) whether there are opportunities to improve the program as a source of housing finance.

Background

The primary function of the Federal Home Loan Banks (banks) is to make loans to their members for use in financing housing and economic development. In addition, the law requires the banks to provide subsidies, assessed annually from their net income, to support affordable housing. The federally chartered, privately owned Federal Home Loan Bank System comprises 12 regional banks and over 5,300 member institutions, including savings and loan associations, savings banks, commercial banks, credit unions, and insurance companies. To regulate the System, the 1989 act created the Federal Housing Finance Board (Finance Board), whose five directors are responsible for making policy decisions and enforcing the program's regulations.

Within the Finance Board, the Office of Housing Finance is responsible for day-to-day oversight and administration of the program, and the Office of Examination and Regulatory Oversight is responsible for reviewing the banks' compliance with the program's policies and regulations. In each bank, a community investment officer and staff manage the program and an advisory council provides information on the diverse needs for affordable housing within the bank's jurisdiction.

Member institutions compete for program funds by submitting applications to their bank semiannually on behalf of housing projects' developers/sponsors. Banks evaluate and rank applications on the basis of systemwide and bank-specific criteria and the program's objectives. The highest-ranked projects are then submitted to the Finance Board for final approval.

Results in Brief

Through 1993, the Federal Home Loan Bank System provided nearly $234 million for the program. These funds were used to help leverage an additional $3 billion from other sources to finance over 1,600 projects containing over 62,000 units of affordable housing in urban, suburban, and rural communities. Aside from its direct impact on the beneficiaries, the program has also encouraged more lenders and sponsors to finance and develop affordable housing.

The administration of the program by the banks and the Finance Board has continued to improve. In response to problems identified by the Board's examiners, the banks have significantly improved their documentation of critical decisions on how they select and fund projects and of their compliance with the program's requirements. Likewise, the Office of Housing Finance has increased its oversight of applications and its responsiveness to requests from the banks concerning applications and clarification of the program's regulations.

However, the Finance Board's examiners continue to cite several banks for deficiencies in selecting projects and in calculating the amount of their Affordable Housing Program subsidies. Also, reporting and monitoring responsibilities are not well defined for the participating banks, members, and project sponsors or well coordinated with those of other housing programs. The goals of the Affordable Housing Program may also be weakened because many Federal Home Loan Banks currently do not have adequate procedures for documenting and verifying that the projects' beneficiaries are eligible for such benefits on the basis of their income and for ensuring that projects comply with any unique commitments made in the original applications. Finally, the Board of Directors of the Finance Board lacked a quorum from January 1994 to May 1995. While the absence of a quorum may not have impeded the enforcement of some of the Affordable Housing Program's existing regulations, it delayed the Finance Board's action on compliance issues requiring policy determinations in cases in which existing regulations are silent or unclear.

Principal Findings

Program Has Increased Supply of Affordable Housing and Financing Capacity of Housing Providers

The program has generally met the Congress's intention that it be used as a flexible source of funding to increase the supply of affordable housing. In the program's first 4 years, the 12 Federal Home Loan Banks committed about $234 million in subsidies, and these funds helped leverage an additional $3 billion from public and private sources. Nationwide, over 1,600 projects, encompassing over 62,000 housing units, were financed. For 1993, the average subsidy was $3,800 per unit, or about 7 percent of the average cost of developing a unit.

The program has served a diverse group of beneficiaries. For single-family housing, subsidies have been used to reduce a property's purchase price, lower mortgage interest rates, and help prospective home buyers with down payments and closing costs. For multifamily housing, the program has been used as both a source of equity and a way to reduce the costs of financing projects' construction or rehabilitation. Of the approximately 1,600 projects, 31 percent include units for the handicapped, 28 percent include units for the homeless, 16 percent include units for the elderly, and 7 percent include single-room-occupancy units.

The program has also been a key resource in helping lenders and sponsors broaden their capacity to finance affordable housing. In a GAO survey of lenders participating in the program, 58 percent said the program was a "very" or an "extremely" important factor in giving them the additional experience they needed to increase their financial commitment to affordable housing. In the same survey, 87 percent of the projects' sponsors called their participation in the program "very" or "extremely" important in developing affordable housing. These sponsors said that without funding from the program, the costs of the projects would have been higher and about half the projects may not have been developed.

Program's Administration Has Improved, but Some Problems Remain

The banks' administration of the program has progressively improved in response to examinations conducted by the Finance Board's Office of Examination and Regulatory Oversight and as a result of increased oversight and guidance by the Office of Housing Finance. Furthermore, the boards of directors and affordable housing advisory councils of all the banks have helped strengthen the program's administration. Initial examinations in 1992 disclosed a pervasive lack of documentation to substantiate decisions on how they select projects and calculate the funding as well as their compliance with the program's requirements. The examiners were thus hampered in evaluating how well the program was meeting its statutory and regulatory objectives. Most of the banks responded to these findings by significantly improving their internal controls and adequately documenting their actions. These improvements have contributed to a proposal to delegate greater administrative authority to the banks, including the final approval of applications. In addition, an increase in staff in the Office of Housing Finance has enabled it to more effectively review applications and provide more timely responses to requests from the banks for modifications to approved applications and clarifications of the program's regulations. Finally, while some sponsors of subsidized projects may not have received the entire amount of the subsidies provided by the banks through their member financial institutions, partly because an inefficient procedure was used to calculate some subsidies, this procedure has been corrected. In GAO's opinion, this change ensures compliance with the statutory requirement that subsidies provided by the banks to their members are passed on to the ultimate borrower (the project's sponsor).

Despite this progress, problems persist. First, some banks continue to be cited by the Finance Board's examiners for not following regulations requiring them to make clear distinctions among applications. Unless such distinctions are made, less deserving applicants may be funded at the expense of more deserving ones. Second, the program's regulations implementing the act do not adequately define or link the responsibilities of the banks, members, and projects' sponsors for reporting and monitoring. As a consequence, the Board's examiners and GAO found a lack of (1) documentation and verification that the beneficiaries of projects assisted by the program were eligible for such assistance and (2) information about the success of a project in meeting its unique commitments to communities and residents. These features are a large part of the reason the projects were approved. If left uncorrected, the problems resulting from inadequate monitoring could worsen. According to the Office of Housing Finance's estimates, the number of projects in need of monitoring will grow to about 5,000 in 10 years. Such growth increases the importance of better coordinating the monitoring of these projects with that of other housing programs that also subsidize the same projects.

The resolution of these problems has been hampered because the Finance Board's Board of Directors did not have a quorum between January 1994 and May 1995. In May 1995, the Congress confirmed two new Board members. This congressional action established a quorum and restored full authority to the Finance Board to clarify existing policy, formulate new policy, and consider proposed changes in the program's regulations.

Opportunities Exist for Improving the Program

The Affordable Housing Program could be more effective if, among other things,

- the Board of Directors resolved those cases in which the subsidies provided under the program may not have fully benefited the projects' sponsors or the subsidies may have been used for ineligible purposes and
- the reporting and monitoring responsibilities of all participants in the program were better defined and integrated, as well as better coordinated with the efforts of other housing agencies monitoring the same projects.

Recommendations

To ensure that the Federal Home Loan Banks continue to meet their statutory and regulatory obligations under the Affordable Housing Program and to improve the program's utility in developing affordable housing, GAO is recommending that the Board of Directors of the Federal Housing Finance Board (1) ensure that the banks' contributions to the program are used for eligible purposes and that the full amount of these contributions is passed on to the projects' sponsors; (2) resolve both current and future cases in which the above conditions may not be met; (3) ensure that any revised regulations for the program clearly define and integrate the monitoring and reporting responsibilities of all participants in the program; (4) direct the Federal Home Loan Banks to improve, as necessary, their procedures for documenting and verifying that the beneficiaries of the program are eligible on the basis of their income and that any unique commitments made in applications are fulfilled; and (5) encourage the banks to improve their monitoring and reporting of projects through closer coordination with experienced agencies monitoring housing programs that also provide funds for these projects.

Agency Comments and GAO'S Evaluation

In commenting on a draft of this report, the Federal Housing Finance Board stated that it agreed with GAO's findings that the Affordable Housing Program has successfully increased the supply of affordable housing and that there has been significant improvement in the Federal Home Loan Banks' administration of the program. While generally agreeing with the report's conclusions, the Finance Board did not believe that the report adequately communicated the technical complexities involved in calculating the amount of subsidies. Nor did the Board believe that the lack of a quorum on its Board of Directors for nearly a year and a half has delayed the enforcement of existing regulations. GAO continues to believe that the report accurately addresses both of these issues. Specifically, this report acknowledges the technical complexities of calculations and offers an alternative for minimizing the technical problems associated with projects funded under the program. GAO also points out that the Finance Board could not make clarifying policy decisions without a quorum in cases in which existing regulations are silent or unclear. The Finance Board's comments on a draft of the report did not address the report's proposed recommendations. The full text of the Finance Board's comments and GAO's response appears in appendix VII.

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Abbreviations

AHP	Affordable Housing Program
AIDS	acquired immune deficiency syndrome
CIO	community investment officer
CRA	Community Reinvestment Act
FHLBank	Federal Home Loan Bank
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
GAO	General Accounting Office
HFA	Housing Finance Agency
HUD	Department of Housing and Urban Development
OHF	Office of Housing Finance

Introduction

Decent and affordable housing for every American has been a goal of national policy since 1949. In recent years, however, the shortage of affordable rental and owner-occupied housing, particularly for households with low and very low incomes, has been growing.[1] As a partial response, the Congress expanded the role of the Federal Home Loan Bank (FHLBank) System in lending for affordable housing through the passage of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989. This act, among other things, created the Affordable Housing Program (AHP) for the purpose of increasing the FHLBank System's support for affordable housing.

Background

The Congress created the FHLBank System in 1932. The System's purpose is to support housing finance through a nationwide structure of 12 regional FHLBanks[2] and over 5,300 member institutions. These financial institutions, which become members by purchasing stock in their regional FHLBank, include savings and loan associations, savings banks, credit unions, commercial banks, and insurance companies.[3]

The primary function of the 12 regional FHLBanks is to make loans, known as credit advances, to their members. These loans provide members with additional financial liquidity and can be used to help finance housing and economic development projects. The FHLBanks' sources of funds for making advances are (1) consolidated obligations, which are debt securities issued in the capital markets jointly by the 12 FHLBanks; (2) stock purchased by member institutions; and (3) members' deposits at the FHLBanks.

In addition to creating the AHP, FIRREA abolished the FHLBank System's old regulator (the Federal Home Loan Bank Board) and created a new regulator, the Federal Housing Finance Board (Finance Board). The Finance Board is governed by a five-member Board of Directors consisting of a chairperson and four board members. The Finance Board is required to ensure the financial safety and soundness of the 12 FHLBanks. It also ensures that the FHLBank System accomplishes its broad public policy

[1]Under this program, low-income households are defined as those with incomes of 80 percent or less of an area's median income adjusted for family size, while very low-income households are those with incomes of 50 percent or less of an area's median income adjusted for family size.

[2]See app. I for a list of the states served by each FHLBank.

[3]FIRREA expanded voluntary membership in the System to include commercial banks and credit unions that had at least 10 percent of their assets invested in residential home mortgage loans. In the past 5 years, the number of commercial institutions has increased substantially and now exceeds the number of thrifts that are members.

mission of supporting housing finance and fulfilling statutory requirements under the AHP.

How the Affordable Housing Program Works

Under the AHP, the 12 district FHLBanks provide subsidies to members engaged in long-term lending for owner-occupied and rental housing targeted to households with very low, low or moderate incomes. Subsidized loans (advances) are provided to members who lend the funds at reduced interest rates for specific projects. Direct subsidies (grants) are provided to members who pass the subsidies directly to specific projects or who use the subsidies to reduce the interest rate on loans that the members themselves provide to specific AHP projects. These subsidies—awarded semiannually through a competitive process among members within each FHLBank's district—are designed to encourage the FHLBanks' members to increase their overall support for affordable housing. FIRREA allows AHP subsidies to finance

- owner-occupied housing for households whose income does not exceed 80 percent of the area's median income, or
- rental housing, in which at least 20 percent of the units are occupied by and affordable to very-low-income households for the building's remaining useful life or the term of the mortgage.

When the AHP was established, its supporters envisioned that it would help stimulate and expand the System's overall involvement in community lending and thus help develop much-needed housing for lower-income households. Given the costs and complexities of developing housing for these households, the AHP was intended to encourage new and creative relationships among member institutions and local developers that would help attract other private and public sources of development capital. The AHP was also intended to help meet the housing needs of diverse populations and encourage the development of affordable housing projects in underserved areas, such as rural communities.

To finance the AHP, the Congress required each FHLBank to annually designate a specified percentage of its previous year's net income to finance subsidized advances to the member institutions. For 1995 and beyond, the contributions are 10 percent of the System's annual net income in the preceding year or $100 million, whichever is greater.[4] FIRREA mandates that if the income-based contributions do not meet these

[4]FIRREA mandated that the systemwide contribution would be 5 percent of net income, or $50 million, through 1993, increasing to 6 percent of net income, or $75 million, whichever was greater, in 1994.

requirements, each of the FHLBanks must contribute additional funds on a pro rata basis so that the minimum annual contribution is attained.

The Program's Administration

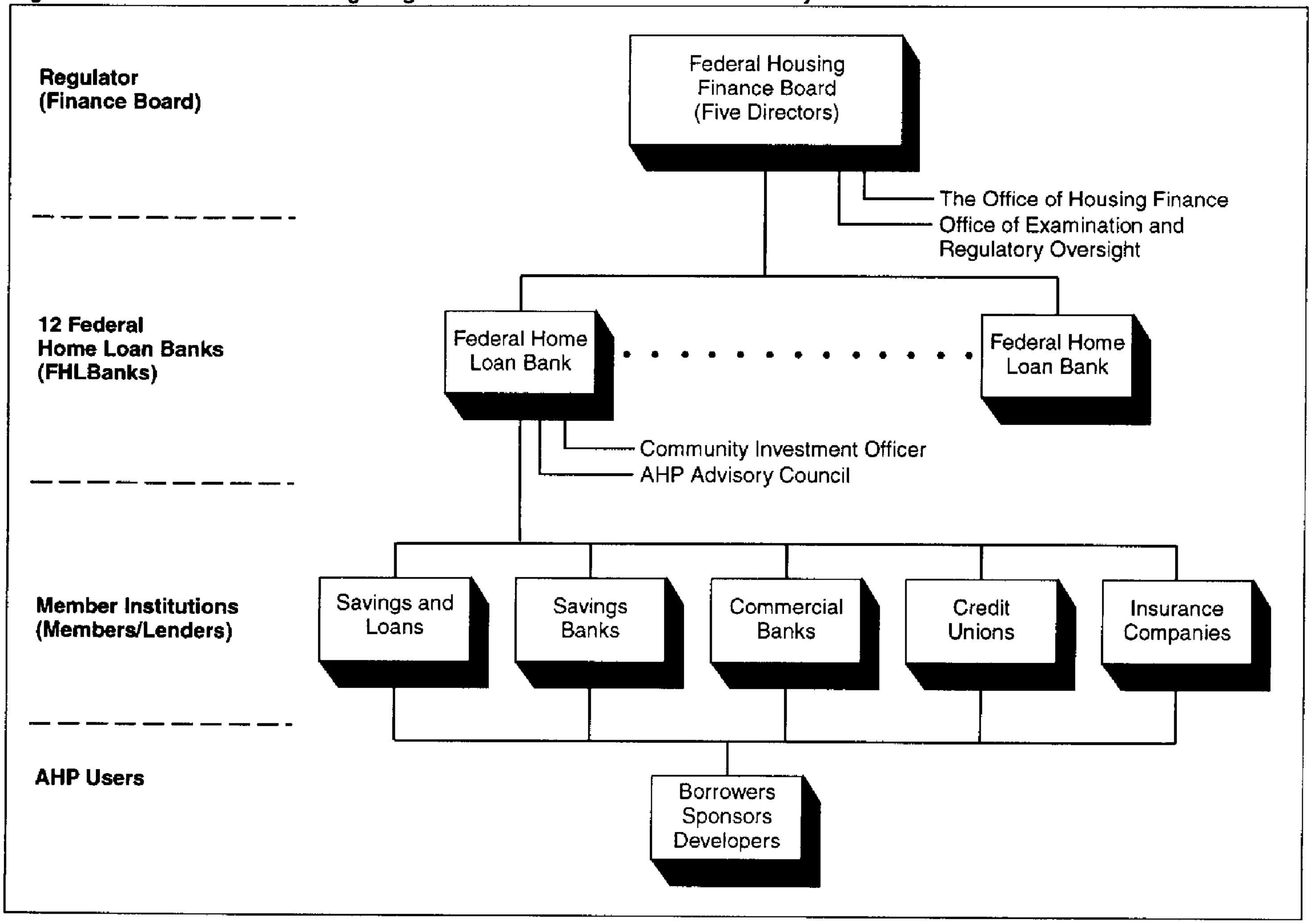
The Finance Board oversees and helps administer the AHP. Its Board of Directors is responsible for issuing the program's regulations and establishing and interpreting the program's policies. Also, the Board of Directors decided that in the program's formative years it would take an active role in helping to ensure implementation of the program and operational consistency among the 12 FHLBanks.

The Board of Directors has to a large extent delegated oversight of the program's day-to-day activities to the Office of Housing Finance (OHF), which is aided in its responsibilities by the Finance Board's Office of General Counsel and the Office of Examination and Regulatory Oversight. In fiscal year 1993, about five full-time-equivalent staff administered the program from the Finance Board's headquarters in Washington, D.C. Key activities of this office include publishing and interpreting regulations, making recommendations to the Finance Board about which projects should be approved for funding, advising the FHLBanks of revised or recommended policies and procedures, and ensuring that the FHLBanks comply with these policies and procedures. Additional responsibilities include providing policy guidance and technical support to the examination staff and maintaining a computerized data base containing information on all approved AHP projects.

Within each of the 12 FHLBanks, a designated community investment officer (CIO) and staff administer the AHP program. Their administrative activities include (1) marketing the program to member institutions and project sponsors; (2) providing technical assistance to members and project sponsors that are preparing applications; (3) evaluating, scoring, and ranking all applications within the FHLBank district and making recommendations to the Finance Board; (4) monitoring the projects; and (5) enforcing the program's requirements.

Each FHLBank is also required to appoint a 7- to 15-member advisory council charged with providing information on affordable housing needs throughout its region. These councils must offer suggestions on how the program's funds should be used. Each council is required to prepare an annual report for the Finance Board that assesses the operation and the results of its FHLBank's activities in the AHP. These councils, which are required to meet at least quarterly with FHLBank representatives, must draw their membership from among developers of low-income housing, housing advocates, and nonprofit and community-based organizations. The council also can include representatives of state and local government agencies. Figure 1.1 shows the participants in the program.

Figure 1.1: the Affordable Housing Program of the Federal Home Loan Bank System



Source: Based on information from the Federal Housing Finance Board.

The Application and Evaluation Process

Applications for AHP funding are submitted semiannually by member institutions, on behalf of project sponsors, to their respective regional

FHLBank. FHLBanks evaluate, score, and rank the applications on the basis of systemwide and bank-specific criteria and the program's objectives, using a 100-point scoring system outlined in the program's regulations. These regulations require FHLBanks to give the maximum point score available to the project or projects that best achieve each criterion; the remaining projects are scored on a declining scale.

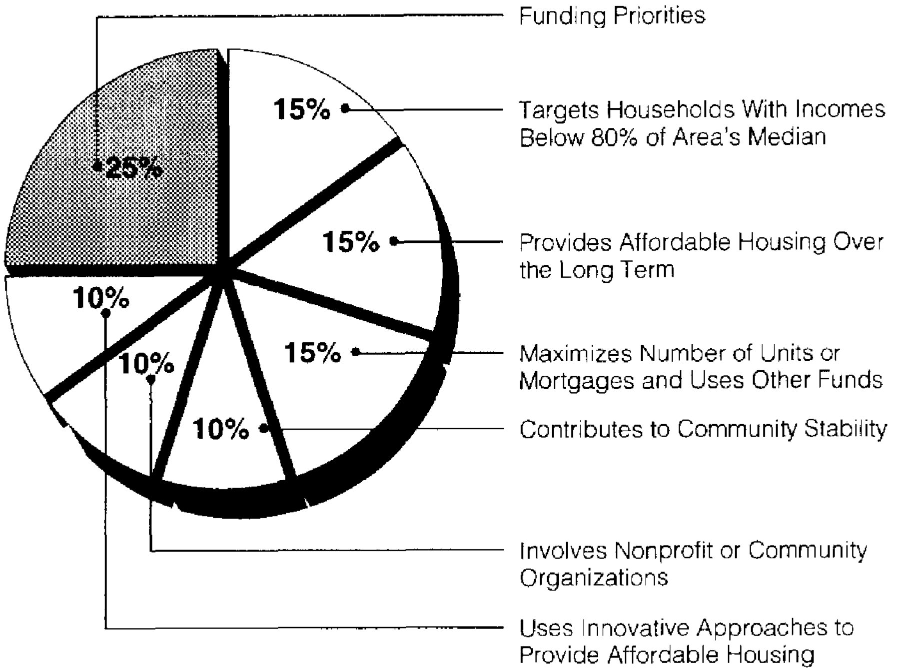
Projects must meet four threshold tests to qualify for consideration.[5] After satisfying the threshold tests, projects may earn up to 75 points depending upon the extent to which the (1) homeownership projects target low-income households below the statutory maximum income level of 80 percent of an area's median income, or rental projects target more than 20 percent of the units for very-low-income households—those with incomes 50 percent or below of an areas' median income; (2) sponsors of proposed projects plan to retain the housing as affordable for the beneficiaries of the project; (3) projects maximize the number of units built per AHP subsidy dollar; (4) projects involve local support by community organizations other than project sponsors; (5) projects maximize community stability and minimize the displacement of other moderate- to very-low-income households; and (6) projects use innovative and experimental financial and nonfinancial approaches for providing affordable housing.

The remaining 25 points may be awarded to projects depending upon the extent to which they meet seven specific funding priorities.[6] Projects that meet three or more of these funding priorities are considered for funding ahead of those that do not. The relative importance of all scoring categories is depicted in figure 1.2.

[5]The four threshold tests are (1) compliance with fair housing laws and regulations, (2) the feasibility of the project, (3) the ability of the member to qualify for an advance to fund the project, and (4) the ability to begin the project within 12 months.

[6]These priorities are (1) provide financing for owner-occupied housing for households with very low, low, and moderate incomes, in that order; (2) provide financing for rental housing in which at least 20 percent of the units are occupied by and affordable to very-low-income households; (3) finance housing projects that are currently held by a U.S. government agency or instrumentality; (4) finance projects that are sponsored by nonprofit organizations, states, or local and state housing authorities; (5) finance projects that empower the urban or rural poor through resident management, homesteading, self-help housing, or similar programs that meet critical housing needs in urban or rural areas; (6) finance projects that provide permanent housing for the homeless; and (7) finance housing developments that meet specific housing objectives within the FHLBank's district.

Figure 1.2: Categories for Scoring Applications



Source: GAO's depiction of information in the AHP's regulations.

Although each FHLBank operates under these general funding priorities, each has some flexibility to refine the national guidelines to ensure that they appropriately reflect bank-specific funding priorities.[7] For example, in 1993 several FHLBanks established as their priority the funding of rural projects. Another FHLBank established as its priority applications received from members that had not previously obtained an AHP subsidy, while another had a priority for a state in which no AHP application was approved in the prior round of funding.

Once the FHLBanks develop lists of their highest-scored applications and several alternates, they submit these applications to the Finance Board for final review and approval. After the Finance Board reviews and approves the applications, the FHLBanks and their members enter into formal financial

[7]See app. II for the FHLBanks' priorities for the districts in 1993.

agreements that detail how the funds will be used and how members will report on the status of their projects, among other things. Monitoring and reporting activities for both FHLBanks and members are based on statutory and regulatory provisions.

Objectives, Scope, and Methodology

As required by section 721 of FIRREA, this report assesses the FHLBank System's implementation of the AHP by addressing (1) how AHP funds have been used to support affordable housing, (2) how the AHP has been administered, and (3) what opportunities exist to improve the program as a source of housing finance.

To examine how the program's funds have been used to support affordable housing initiatives, we reviewed nationwide and district-specific data on funding from 1990 through 1993. These data identify all participants in the projects, the types of projects, the terms of the subsidies, the extent to which other funds were used in addition to those from the AHP, and the types of beneficiaries of each project. In addition, we (1) reviewed annual reports from AHP advisory councils that provide data on regional housing priorities and how the AHP has helped meet these priorities, (2) surveyed by questionnaire the community investment officers responsible for administering the program at each of the FHLBanks and the chairpersons of each district's AHP advisory council, and (3) surveyed by telephone a random sample of FHLBank System members and project sponsors[8] and conducted focus groups with various members and sponsors to discuss their experiences with the AHP on selected projects. Additionally, we visited AHP-assisted projects in California, New York, New Jersey, Maryland, and the District of Columbia to gain a first-hand perspective on the use and results of AHP funding on various projects.

To determine how the AHP has been administered and whether there are opportunities for improvement, we assessed how the FHLBank System (1) markets the AHP, including providing technical assistance to members and project sponsors; (2) calculates project subsidies and evaluates, scores, and selects projects; and (3) monitors approved projects and enforces the program's requirements. As part of this assessment, we reviewed the program's regulations, the Finance Board's and FHLBanks' operating guidelines, all Finance Board examination reports between 1992 and the first half of 1994, various FHLBank audit reports, and Finance Board

[8]We randomly selected projects completed as of December 31, 1992, and contacted the members and sponsors associated with these projects. See app. III for a detailed description of our survey methodologies.

staff memorandums and reports. We also interviewed a current and a former member of the Board of Directors of the Finance Board, key senior managers and staff of the Finance Board, and the AHP staff affiliated with the FHLBanks of New York and San Francisco. We also held discussions with the national chair of the 12 AHP district advisory councils and other council members.

To obtain additional perspectives on members' and sponsors' experiences with the AHP, we held six focus group sessions in New York and California. For these sessions, we judgmentally selected members and sponsors that had received at least one AHP subsidy. In New York, we also convened a focus group comprising housing sponsors that had applied for funding but whose projects had not been approved. We also held a panel discussion with representatives of the Federal Home Loan Bank of New York's AHP District Advisory Council. To obtain additional perspectives on how the AHP has been administered to date, we sent surveys to the community investment officers affiliated with each of the 12 FHLBanks and to the chairpersons of each of the AHP district advisory councils. We also conducted telephone surveys of randomly selected FHLBank members and project sponsors that had participated in the program to obtain their perspective on the program's administration.

Our work was conducted at the Federal Housing Finance Board's headquarters in Washington, D.C.; the FHLBanks located in New York City and San Francisco, California; the offices of various housing developers in San Francisco and Los Angeles, California, New Jersey, and New York; and several judgmentally selected housing developments supported by the program. Housing developments we visited were judgmentally selected on the basis of various factors, including housing type (i.e., single-family homeownership and multifamily rentals), target groups served (i.e., people with low and moderate incomes and special needs, including the elderly), and stage of development. For our telephone surveys, we randomly selected member institutions and sponsors that had completed one or more AHP-assisted projects.

Written comments from the Finance Board on a draft of this report are included in appendix VII. We have incorporated these comments and our evaluation of them where appropriate. Finance Board officials also offered a number of technical suggestions and clarifications, which have also been included where appropriate. We conducted our review between November 1993 and December 1994 in accordance with generally accepted government auditing standards, except that we did not verify or validate the reliability of information on the program generated by the Finance Board's computerized data base for the AHP program. However, through discussions with FHLBank program officials, members, and sponsors and information obtained from them, we determined that the Finance Board's data were generally reliable and usable for our purposes.

AHP Has Expanded Lending for Affordable Housing

Through 1993, the FHLBank System's Affordable Housing Program helped finance over 62,000 affordable rental and owner-occupied housing units in central city, suburban, and rural communities. These units serve a variety of beneficiaries, including households with very low incomes, elderly households, and households with special needs. Subsidies provided through the AHP have helped to reduce down payments and closing costs for first-time homeowners as well as the financing costs of developing multifamily rental housing.

The AHP is viewed by members of the FHLBank System and project sponsors as a flexible source of funding, which is often needed in developing affordable housing projects. The AHP has helped members expand their interest and experience in financing affordable housing while helping them meet their statutory requirements on community lending. The AHP has been particularly useful to sponsors by helping them leverage the additional sources of capital necessary in developing their individual projects.

Although individuals involved with the AHP are very supportive of the program, suggestions have been made to enhance the program's usefulness. Specific suggestions include increasing the number of members participating in the AHP to help improve sponsors' access to the program's benefits. Also, some program participants have suggested changing the scoring criteria to achieve a better competitive balance between rental projects and homeownership projects. Finally, some lenders, sponsors, AHP district council representatives, and FHLBank program officials suggest expanding the purposes for which AHP subsidies can be used—to include, for example, the predevelopment costs associated with determining the feasibility of undertaking an affordable housing project, social services such as on-site child care for working parents, and homeownership counseling for first-time homebuyers. The Finance Board and the FHLBanks are aware that there are advantages and disadvantages to the various suggested changes and plan to consider them in future revisions to the program's regulations.

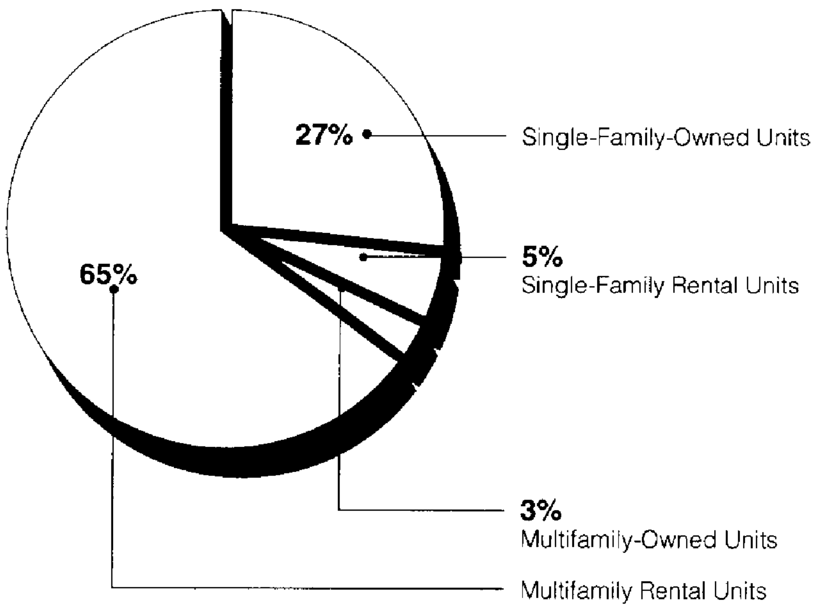
A Nationwide Overview of AHP Projects

Since the AHP's inception in 1990, the program has become a valuable new source of housing finance that has been used in conjunction with other funding sources to help finance owner-occupied and rental housing designed to meet the diverse needs of households with very low, low, and moderate incomes.

Type and Location of Projects

According to the Finance Board's data, through 1993 the FHLBank System made approximately $234 million in subsidies available through the AHP.[9] Together with an additional $3 billion from other sources, these funds helped finance about 1,600 projects with over 62,000 units nationwide, according to the Finance Board's data. Almost two-thirds of these were multifamily projects in which AHP subsidies were targeted to households with very low and low incomes. Most of the remaining projects tended to support homeownership initiatives, many for first-time homebuyers with low incomes. Figure 2.1 shows the distribution of projects supported by the AHP by type.

Figure 2.1: Percentage of Approved Projects by Type, 1990-93

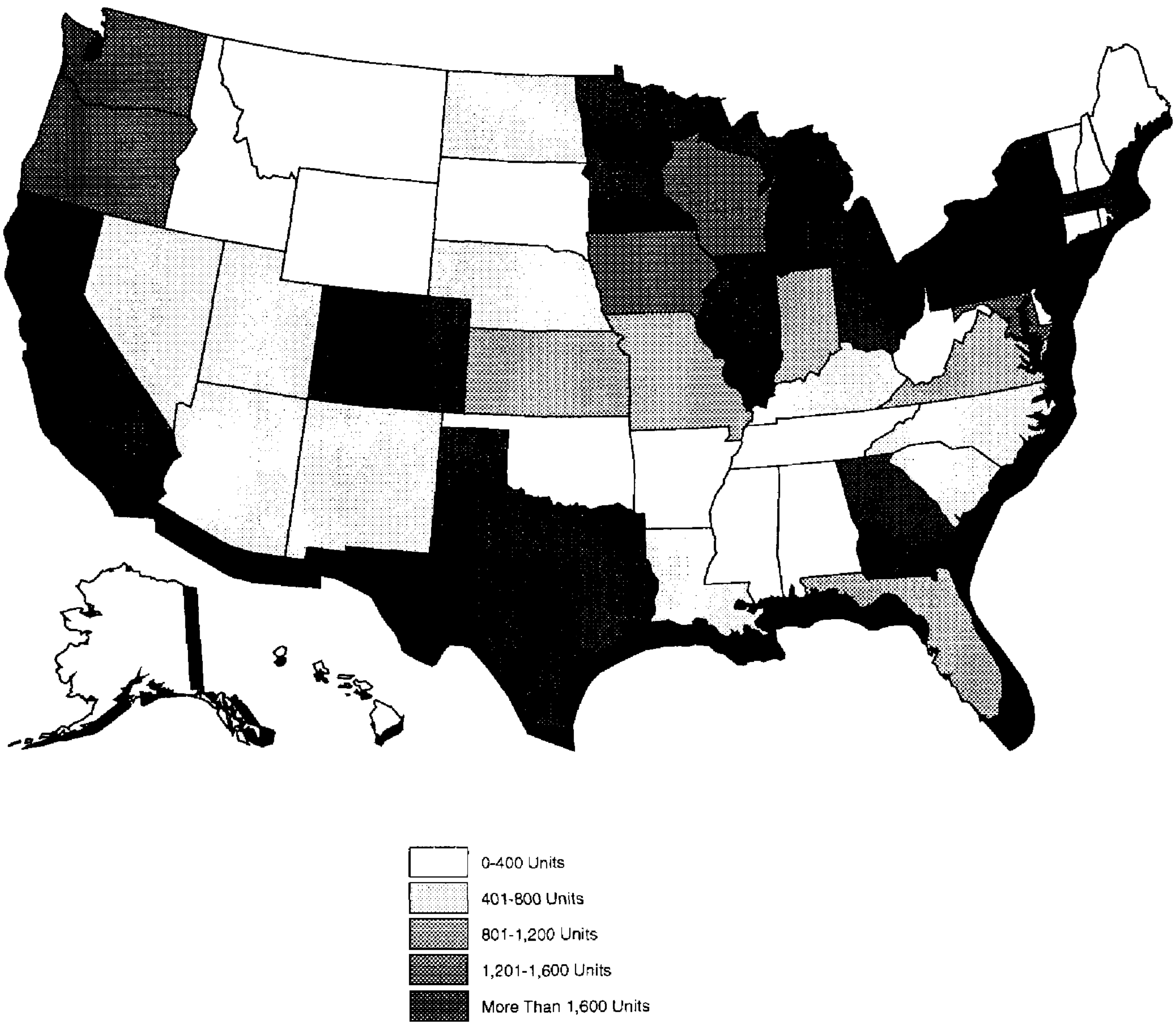


Source: Based on data from the Federal Housing Finance Board.

[9] The FHLBank System was required by law to contribute at least $50 million annually over the period 1990-93. Therefore, the $234 million total contribution is the sum of funding over 4 separate years, not adjusted for changes in inflation.

AHP-assisted projects are located throughout the nation; however, they tend to be concentrated in the more populated Mid-Atlantic and midwestern states, and in California, Texas, Colorado, and Georgia. (See fig. 2.2.)

Figure 2.2: Geographic Distribution of AHP Units by State



Source: Based on data from the Federal Housing Finance Board.

Uses of AHP Funds

The Congress intended the AHP to be a flexible source of funding that could be used in various creative ways to develop affordable housing. The AHP has generally met this expectation. For example, in the development of affordable single-family housing, AHP subsidies have been used to (1) reduce a property's purchase price, (2) lower interest rates on mortgages, (3) provide homebuyers with assistance with down payments, and (4) provide homebuyers with assistance with closing costs. In the case of multifamily housing, the AHP has been used, for example, as both a source of equity and a means to reduce interest rates on debt financing for constructing a project.

AHP funds have thus served to benefit a diverse constituency, including the homeless, the elderly, single working parents, people with physical and mental disabilities, and people living with AIDS and suffering from substance abuse. As reported by the Finance Board, of the approximately 1,600 projects subsidized by the program through 1993, about 31 percent include units for the handicapped, about 28 percent include units for the homeless, about 16 percent include units for the elderly, and about 7 percent include single-room-occupancy units.

The following examples show how the AHP has been used with other funding sources to serve the diverse population of lower-income households:

- A $125,104 AHP subsidy was used in North Amityville, New York, to help low-income families, including single working parents, purchase their first home. The subsidy was used in connection with a 72-unit 2-bedroom townhouse complex, in an area with a predominately minority population where there was a serious lack of affordable housing. The complex cost approximately $6 million to develop. With the help of a $1.8 million grant from the state of New York, the purchase price per unit was reduced from about $84,000 to about $59,000, making the entire complex more affordable to lower-income households. The AHP subsidy was used to further reduce the purchase price for 23 of the complex's 72 units by up to $13,500. This enabled households with incomes between $21,000 and $39,700 to qualify for mortgages that they otherwise may not have qualified for.
- A $2.6 million AHP subsidy was used to help finance the construction of a $36 million 175-unit multifamily rental housing project in San Francisco, California. This subsidy is the largest awarded to date in the program. The project, which is located in one of the more rundown neighborhoods in the city, benefits both large families and senior citizens with very low

incomes. It is unusually costly because, in addition to the residential units, it contains a child care center, retail shops, an underground parking garage, and a large interior courtyard. In addition to the AHP subsidy, the project received other subsidized financing, including $15 million in low-income housing tax credits and several million dollars in grants and loans from the city of San Francisco and the state of California. As a result of all the subsidized financing, including that from the AHP, rents at the project reportedly were at least 50 percent below comparable market rents.

- A $74,660 AHP subsidy was used in West Hollywood, California, to help finance the construction of a new 22-unit multifamily rental project accessible to the disabled whose total development cost was about $3.7 million. Nineteen units were targeted to households with incomes no higher than 50 percent of the area's median income, two units were targeted to households with incomes between 51 and 60 percent of the median, and one unit was targeted to households with incomes at 25 percent or less of the median. In addition to considering these eligibility requirements based on income, the project gives a preference for the units to persons living with AIDS. The AHP subsidy was used in conjunction with approximately $2.6 million from the state of California and the city of West Hollywood, along with $1.1 million in low-income housing tax credits. Without the early commitment of the AHP subsidy, the project may not have been developed since the award of the tax credits was reportedly dependent on obtaining the AHP funding.

AHP Has Expanded Participation by Lenders and Sponsors in Developing Affordable Housing

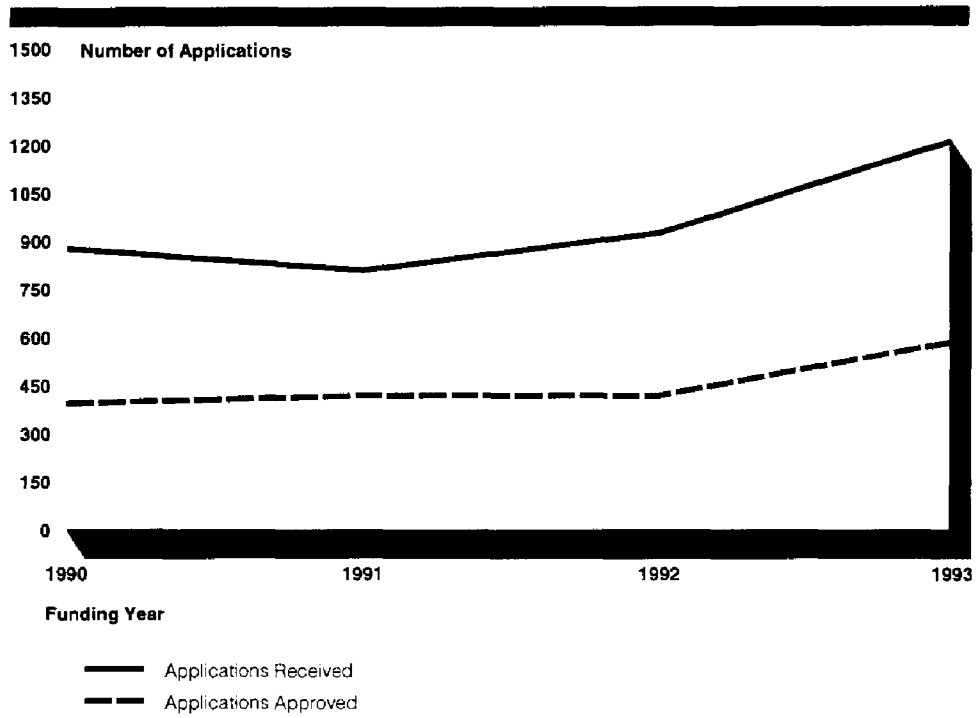
We found a broad consensus among members of the FHLBank System and housing sponsors that the AHP has provided them with additional opportunities to expand their involvement in developing affordable housing.[10] For members, the AHP has been a valuable resource in helping them gain experience in lending for affordable housing and in meeting their obligations to invest in the community. For project sponsors, the AHP has reportedly often been a critical financial component to their development of affordable housing.

[10]We surveyed members and sponsors on the basis of a random sample of AHP projects completed by December 31, 1992. Sampling errors for the response estimates discussed in this chapter are contained in app. IV.

Lenders Request AHP Subsidies to Expand Their Affordable Housing Activities

Demand for AHP funds by FHLBank System members has consistently surpassed the amount of funding available. Specifically, over the AHP's first 4 years, approximately 50 to 60 percent of applications were not approved in the funding round in which they were submitted. Moreover, as figure 2.3 shows, this gap between the number of applications submitted and those approved remained relatively constant between 1990 and 1993.[11]

Figure 2.3: Summary of AHP Applications Nationwide, 1990-93



Source: Based on data from the Federal Housing Finance Board.

The high demand for AHP funds results from, among other things, the (1) positive experiences of the members using the program; (2) statutory requirements that banks meet community investment needs, which the AHP helps them fund; and (3) outreach efforts of the FHLBanks. Our nationwide survey of the members that have obtained AHP subsidies and our focus group discussions in New York and California disclosed that most members generally have had positive experiences with the program. For

[11]See app. V for members' AHP application history by FHLBank district.

example, the members surveyed reported that the program's administrative costs for most projects were not burdensome. Furthermore, of the members who plan to increase their AHP participation, about half would cite the projects' profitability and relatively low risk among the reasons for doing so. Also, we estimate that about 58 percent of the members would say that their participation in AHP was a "very" to "extremely" important factor in giving them the additional experience they needed to increase their financial commitment to affordable housing. This response is particularly noteworthy because our survey showed that before becoming involved with the AHP, many members had only limited experience in this type of lending.

Another key reason for members' increased demand for AHP subsidies is a reaction to growing regulatory pressure that members meet their obligations under the Community Reinvestment Act (CRA).[12] This act mandates that federally regulated financial institutions have "a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered." Supporting the development of affordable housing can help members meet their obligations under the CRA. We estimate that 82 percent of the members would cite the CRA as a factor in their decision to become involved with the AHP. Also, we estimate that among members planning to expand their AHP activity, about 34 percent of the members would cite the CRA as the most important reason in their decision.

A third major reason for members' involvement in the AHP stems from the marketing and outreach efforts of the 12 FHLBanks. Because they recognize the importance of marketing and outreach to the success of the program, the FHLBanks have used a variety of strategies to inform their members and others about the availability and the benefits of the AHP to their financial institutions. Our survey of CIOs disclosed that most of the FHLBanks have used site visits, mass mailings, personal correspondence, and presentations to a "great" or "very great" extent to publicize the availability of the program to members and project sponsors. In fact, the FHLBanks reported to us that in 1993 alone, they had made almost 1,100 site visits and were involved in about 180 presentations about the program.

Although the nature and extent of the FHLBanks' efforts have varied, our focus groups and our nationwide survey of the FHLBanks' members disclosed that the FHLBanks' marketing and outreach activities have indeed contributed to members' decisions to participate in the program. Based on

[12]Enacted as part of the Housing and Community Development Act of 1977.

our nationwide survey, we estimate that 78 percent of the members would say that among the reasons they became involved in the program was the encouragement they received from FHLBank staff. Furthermore, this survey indicates that the FHLBanks' efforts to educate members have helped to lessen some members' concerns about the riskiness of making loans for affordable housing lending. We estimate that 53 percent of the members involved in AHP who planned to increase their participation—including those having little or no previous experience with developing low- or moderate-income housing— would cite the relatively low risk of these types of projects as a contributing factor in their decision to remain involved in the program.

AHP Benefits Sponsors of Affordable Housing

Project sponsors are largely satisfied with the AHP. Specifically, we estimate that 87 percent of sponsors believe that their participation in the AHP was "very" to "extremely" important in giving them valuable experience in developing affordable housing. Also, the program is particularly beneficial because its flexibility helps sponsors achieve the kind of creative financing that is often needed in developing affordable housing. Reportedly, this flexibility is particularly beneficial in the early stages of project development.

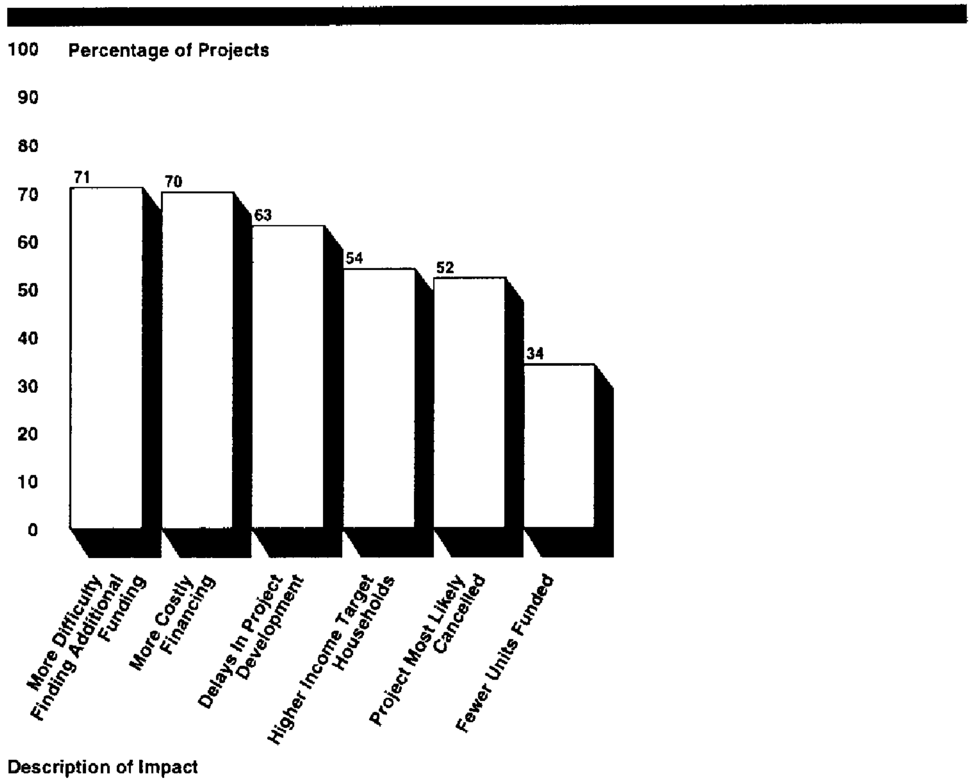
Sponsors often must secure subsidized financing from multiple sources in order to make their projects affordable to households with lower incomes. However, a key problem for many sponsors is finding public and private capital that can be committed early in a project's development so that capital can be leveraged from other sources. Many of the sponsors we contacted said they have been successful in leveraging other capital by getting an initial commitment from the AHP. Project sponsors we interviewed, as well as FHLBank officials, cited the availability of an early AHP commitment as particularly beneficial for multifamily projects whose developers seek to use low-income housing tax credits[13] because some states place a higher priority on approving projects for tax credits if other funds are already committed.

Furthermore, based on our nationwide survey, most sponsors believe that without the AHP their projects would have experienced difficulties. Although sponsors for most projects would cite multiple impacts, we estimate that sponsors for about 70 percent of projects would say that (1) additional funding sources would have been harder to find and

[13]The Low-Income Housing Tax Credit Program was authorized in the Tax Reform Act of 1986 to provide an incentive for investors to construct or rehabilitate low-income housing.

(2) financing would have been more costly. On the basis of our survey, we also estimate that sponsors for 52 percent of the completed projects would say that without AHP subsidies their projects would likely not have been developed. Figure 2.4 summarizes the views of sponsors on the likely impact on projects if they had not received AHP subsidies.

Figure 2.4: Impact on Projects If AHP Subsidy Were Not Received

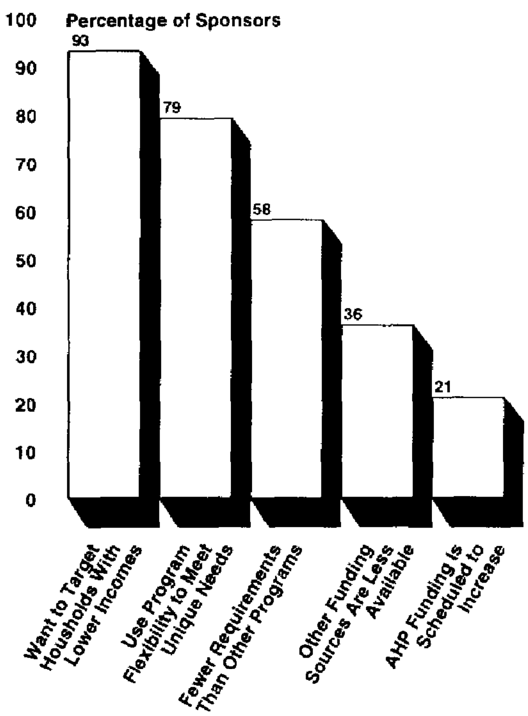


Note: Sponsors could indicate one or more potential impacts on the project.

Source: GAO's analysis of its telephone survey of housing sponsors based on a random sample of projects.

The positive experiences that sponsors had with the AHP were also reflected in their responses to a question in our survey asking whether they planned to increase, maintain, or decrease their involvement with the program in 1995. We estimate that 60 percent of sponsors currently plan to increase their level of participation, 37 percent plan to maintain their present level of involvement, and only 3 percent plan to decrease their participation. For those sponsors we estimate would increase their participation, their reasons for doing so are summarized in figure 2.5.

Figure 2.5: Reasons Sponsors Plan to Increase Participation



Note: Sponsors could indicate one or more reasons to increase participation.

Source: GAO's analysis of its telephone survey of a random sample of AHP project sponsors.

AHP Could Be More Responsive to Project Sponsors

We identified three areas in which the AHP could be more responsive to the needs of project sponsors. The first, expanding members' participation in the program, would afford sponsors more options for financing affordable housing projects. The second, revising the scoring criteria for applications, would allow sponsors interested in developing homeownership projects to compete more effectively with sponsors proposing to develop rental projects. Finally, expanding the purposes for which sponsors can use AHP subsidies would add to the program's present flexibility, thereby making it even more attractive to sponsors. However, expanding the use of AHP subsidies has potential drawbacks, such as funding certain predevelopment costs for an affordable housing project that ultimately is not constructed.

Opportunities for Expanding Members' Participation in AHP

Our review of the FHLBank System's data on project applications submitted by members from the program's inception through 1993 showed that each FHLBank is making progress in getting the members who previously had not participated in the AHP to submit applications. However, the FHLBanks' degree of success has varied, as has the overall participation rate of members among the 12 FHLBanks. The participation rate is the number of members that have submitted at least one AHP application compared with the total number of members in the district. This rate averages 27 percent across the System and ranges from a high of 42 percent to a low of 18 percent in the 12 FHLBank districts.[14]

It is reasonable to expect fluctuations in participation rates among the FHLBanks since there is considerable variation among FHLBank districts in the number of members and the amount of AHP funding available. Consequently, a FHLBank with a comparatively large number of members in relation to its level of AHP funds would find it more difficult to increase its participation rate than a FHLBank with fewer members and a greater share of AHP funding. Also, participation rates among FHLBanks are influenced by the varying numbers of sponsors in their districts and their capacity to develop affordable housing. Regardless of the number of members, the level of program funding, and the number and capabilities of sponsors, all the FHLBanks have developed strategies to further expand members' participation in the AHP.

As we discussed earlier, the FHLBanks have used a variety of marketing strategies to stimulate members' interest in the AHP, and, after 4 years' experience with the program, are beginning to strategically target their marketing efforts to further increase members' involvement. For example, eight FHLBanks we surveyed stated that they planned to increase their marketing efforts among their members that had not submitted any applications. Furthermore, five FHLBanks stated that they were going to target their marketing activities to a "great" or "very great" extent to those members located in rural areas—where smaller member institutions are

[14]Appendix VI presents additional information on (1) the growth in membership in each FHLBank between 1992 and 1993, (2) the relationship between members submitting applications for the first time in 1993 and those members that had previously submitted applications, and (3) the relationship between the total number of members in each FHLBank district and the number that have applied for AHP funding.

frequently located. Most of the AHP advisory council chairpersons believe there is a continued need for additional marketing and they therefore support these strategies.

Finance Board and FHLBank officials are equally supportive of expanding marketing strategies to increase participation in the program. In fact, the Board has encouraged the FHLBanks to market the program to areas that are underserved by the AHP, including geographic areas where members' participation is low. Nonetheless, some FHLBank officials have expressed some concern about the impact these expanded marketing efforts could have on the AHP. They pointed out that because the program is already oversubscribed (see fig. 2.3), encouraging more members to submit AHP applications could frustrate those members and sponsors that are unsuccessful in obtaining subsidies because of the limited funds that are available in each funding round. While this concern is valid, it should be weighed against the benefits that could be gained by increasing members' involvement. These benefits include (1) better assurance that all geographic areas are served by the AHP, (2) more members developing the capacity to make affordable housing loans, and (3) sponsors having a larger pool of experienced members to draw on in financing their projects.

Changing AHP's Scoring Criteria So That Rental Projects Are Not Favored Over Homeownership Projects

The program's current regulations on scoring can discourage some sponsors and members from participating in the AHP. These regulations favor rental projects over homeownership projects by including criteria that rental projects can more readily meet. Specifically, multifamily rental projects generally can obtain more points in the scoring process because (1) their development costs per unit are generally lower than those for single-family housing, (2) their financial structure typically enables them to more effectively target very-low-income households, and (3) they generally are required to remain affordable for low-income families for longer periods than homeownership projects.

A regulatory review committee established in 1993 by the presidents of the FHLBanks cited this issue as one to be considered in making needed changes to the program's regulations. This committee noted that modifying the selection criteria could help provide more equal treatment between homeownership and rental projects. In January 1994, the Finance Board published for comment revised program regulations that proposed separate scoring in certain categories for rental projects and homeownership projects. Those who specifically commented on this proposed change supported it. However, these revised regulations require approval by the Board of Directors of the Finance Board and, from January 1, 1994, until May 25, 1995, the Board of Directors has been without a quorum. On May 25, 1995, the Congress added two members to the Board of Directors, thereby establishing a quorum. As a result, these and other proposed revisions to the program's regulations can now be decided.

Expanding Purposes That Are Eligible for AHP Subsidies

Despite the AHP's flexibility, a majority of community investment officers and AHP Advisory Council chairpersons, along with some FHLBank members and housing sponsors, believe that the AHP's utility could be enhanced if the program's funds could be used for various additional purposes—which often are integral components of an affordable housing project. For example, some supported the use of AHP subsidies to help finance (1) the predevelopment costs associated with conducting studies to determine the feasibility of undertaking an affordable housing project; (2) social services, such as on-site child-care facilities; and (3) counseling on homeownership.

Some concerns have been raised, however, about expanding the uses of the AHP, including funding the costs of the predevelopment studies designed to determine the feasibility of developing a proposed affordable housing project. For example, several community investment officers were opposed to allowing sponsors to use AHP funds for certain predevelopment activities. They pointed out that AHP funds could be lost entirely if such feasibility studies were funded but the project was not undertaken.

The Finance Board and the FHLBanks are aware that some members and sponsors would like to see the program's regulations revised to allow for a broader use of AHP subsidies. Accordingly, they plan to consider such revisions in future changes to the program's regulations.

Conclusions

In the 4 years since AHP funding first became available, the program has become an important financial mechanism, helping lenders and housing sponsors across the nation provide opportunities for households with very low, low, and moderate incomes to own or rent affordable homes. Members and sponsors are also very satisfied with the program, and the demand for program funding consistently exceeds the available supply. Nevertheless, the AHP could be made more responsive to project sponsors by expanding members' participation, making applicants for homeownership projects more competitive with rental projects, and increasing the options for using AHP funding. The Finance Board is aware of these and other proposed options for expanding the use of AHP funding. It plans to consider them, along with any negative consequences that could result from implementing them, in future revisions to the program's regulations.

AHP Can Be Improved by Addressing Several Issues in the Program's Administration

The administration of the AHP has improved during the program's first 4 years of operation. While there were problems in getting the program started, examiners from the Finance Board's Office of Examination and Regulatory Oversight agree that many of these problems have been addressed, including how AHP subsidies are calculated and subsequently awarded to applicants. Also, the Finance Board has developed and proposed comprehensive revisions to existing regulations to further improve the program.

Despite these actions and the overall positive impact this program has had on the development of affordable housing, several compliance issues remain unresolved. Some of these issues apply to the FHLBank System; others pertain only to the practices of individual FHLBanks. Systemwide compliance issues concern the way projects are selected for funding and the need for improvements in the monitoring and reporting of program results to better ensure that projects are complying with commitments made in applications and that the program's overall requirements are being met. The Finance Board's examiners have also identified specific compliance issues in three FHLBanks. In one case, the parties disagree over whether the FHLBank had made its full contribution to the AHP. In two other cases, the examiners raised questions about whether FHLBanks had used AHP subsidies appropriately. In all three cases, the Finance Board must determine whether these findings are valid and, if so, whether each FHLBank needs to fully or partially reimburse the pool of funds used to support the program.

It is important that compliance issues both throughout the System and in individual FHLBanks be addressed promptly, since the program's funding will increase from 5 percent of the FHLBanks' profits in 1990 to 10 percent of the FHLBanks' profits in 1995, or a minimum of $100 million. With these additional resources, the number of projects will grow substantially over the coming years.

Part of the solution to addressing these outstanding issues rests with the Board of Directors of the Finance Board, which has the statutory authority to enforce the program's policies and regulations. However, from January 1, 1994, through May 25, 1995, a period of nearly a year and a half, the Board of Directors did not have a quorum—the minimum number of members necessary to use its full statutory authority.

Not having a quorum complicated program administration and enforcement during this time period. Compliance issues identified by the

Finance Board's examiners pertaining to individual FHLBanks could have been resolved only if they were found to involve clear violations of law, regulations, or existing policies because, without a quorum, the Board could not clarify current policy or craft new policy as a remedy. No determinations were ever made by the Board of Directors on these issues during this time. Similarly, without a quorum, the Board could not interpret or formulate policies to resolve systemwide compliance issues involving the way projects are selected for funding and the program's results are monitored. Finally, proposed regulations covering such changes as expanding the FHLBanks' authority to approve applications could not move forward without a quorum.

Administration of AHP Has Improved, and More Authority Is Envisioned for FHLBanks

We reviewed examination results covering a period of 2-1/2 years and found a clear pattern of continued improvement throughout the administration of the program. Our assessment of program management and supervision of the FHLBanks by the Office of Housing Finance (OHF) has also been positive. This progressive improvement, together with the FHLBanks' increasing experience in administering the AHP, has led the FHLBanks to request greater autonomy in administering the program. Consistent with this request, regulations have been proposed by the Finance Board that would give the FHLBanks considerably more administrative discretion, including the authority to approve applications. Along with this increased authority, the proposed regulations would require that the FHLBanks develop comprehensive plans for implementing the program that address the unique housing needs in their districts while also conforming to national program requirements.

Administration of the AHP Has Improved

Most of the serious compliance problems found in the first round of AHP examinations conducted in 1992 have been satisfactorily addressed by a large majority of the FHLBanks. Among the most serious problems found by the Finance Board's examiners was a pervasive lack of documentation to substantiate the decisions made on virtually every issue of program administration, including the selection of projects, funding, and compliance with program requirements. This lack of documentation made the initial compliance reviews very difficult for the examiners.

Most of the FHLBanks responded positively to the initial examination reports by significantly improving their internal controls and providing adequate documentation of the actions they took. By 1994, the Finance Board's examiners found that most of the FHLBanks' files contained sufficient documentation on the selection and funding of projects. However, as discussed later in this chapter, the examiners found that FHLBanks still needed to improve their monitoring and reporting on the program's results to provide reasonable assurances that AHP funds were being used in a manner consistent with the program's policies and regulations.

Aside from improvements made by the FHLBanks, OHF has also increased its oversight of AHP applications. During most of the first 2 years of the program, 1990-91, OHF had a small staff and no permanent director. These conditions hindered oversight of applications. As a result, some applications that were approved were later criticized by the Finance Board's examiners. However, by 1992, with the addition of a permanent director and other staff, the office improved its review of applications. In contrast to the first 2 years, when there were no conditional approvals or denials of applications, during 1992 the Finance Board conditionally approved 20 applications and denied 4. The FHLBanks took positive steps to correct problems noted in 1992 because the following year, despite a large increase in the number of applications approved, the Finance Board conditionally approved only five applications and denied none.

OHF has also improved its responsiveness to the FHLBanks' requests for modifications to their applications and clarification of program regulations. Specifically, during the program's first 2 years, the FHLBanks were critical of OHF's limited responsiveness to their requests to modify pending or previously approved applications. Delays of over 3 months occurred, largely because OHF had a policy of approving all changes to previously approved applications but did not have the staff to do so in a timely manner.

In response to the FHLBanks' criticism of these delays, OHF issued revised procedures[15] that allowed the FHLBanks to make minor modifications to their applications without the Finance Board's approval. This procedural change reportedly has helped reduce the number of requests for modifications sent to OHF as well as the time required to process such requests. Specifically, in 1993 the number of requests for modifications declined by about one-third from the previous year, and these requests were processed in an average of 55 days, compared with 100 days in 1992. In 1994, the Finance Board issued a blanket approval for the FHLBanks to make all modifications except those that require additional funding as long as the project, as modified, would continue to score high enough to be

[15]Special Notice Number 1, issued March 10, 1992, provided guidance to the FHLBanks' staff on making minor modifications to previously approved projects as long as these modifications would not materially affect the basis on which the project was approved.

funded in its original scoring round. Requests for increases in AHP awards continue to be reviewed and approved by either OHF or the Finance Board. Finally, according to the Chief Examiner of the Finance Board, the FHLBanks are increasingly satisfied with OHF's responsiveness to questions concerning interpretations of the program's policies and regulations.

Proposed Regulations Are Intended to Delegate Increased Responsibility to FHLBanks

As a result of the FHLBanks' improved administration of the program, the Finance Board has proposed regulations that would delegate considerably more administrative control to them. Among the most fundamental changes proposed are (1) devolving authority for the final approval of applications to each FHLBank and (2) requiring each FHLBank to develop a comprehensive implementation plan for administering the program in its district. Proposed implementation plans must address nine specific elements, such as scoring criteria and income verification procedures, and must be approved by the Finance Board.

Devolving the authority to approve applications to individual FHLBanks has several potential advantages. First, the processing time and associated administrative costs would likely be reduced because the Finance Board would not be involved in the approval process. Second, because the FHLBanks are more familiar with the housing needs in their respective districts, they are in a better position than the Finance Board to make final funding decisions. Finally, removing the responsibility for reviewing applications from OHF would enable it to spend more time providing technical assistance to the FHLBanks and facilitate greater coordination between the banks and other agencies that administer housing programs.

Requiring the FHLBanks to develop comprehensive plans for implementing the AHP also has advantages. First, it requires each FHLBank to take a holistic approach in implementing the program by outlining how it will meet national program goals while also addressing those housing needs unique to its district. Second, it requires the FHLBanks to articulate how they will administer a growing program within the constraints of their staff and resources. Third, it provides the Finance Board with a measure of accountability for evaluating each FHLBank's performance in administering the program. Finally, by requiring that each bank's implementation plan be approved by the Finance Board, OHF is in a position to request modifications to any of the specific elements that these plans are to include.

The proposed regulations were published for public comment in early 1994. Most of the comments supported devolving approval authority to the FHLBanks to gain the perceived advantages cited above. However, several concerns were also raised—among them, that devolving the authority to approve applications could hamper the ability of the Finance Board and the Congress to exercise effective centralized oversight of the AHP and that placing greater authority in the hands of each FHLBank could set back the progress that the Finance Board has made in creating a single nationwide AHP. Other comments on the proposed regulations were that (1) approval authority should be granted on a case-by-case basis to individual FHLBanks, presumably on the basis of their past performance in administering the program and (2) the Finance Board should rescind this delegated authority if the FHLBanks do not administer the AHP to its satisfaction. Final action on the proposed regulations can now be decided by the Board of Directors of the Finance Board.

Problems in Scoring Applications, Calculating Subsidies, and Monitoring Projects Have Not Been Resolved

Despite the overall improvements in the FHLBanks' administration of the program, the Finance Board's examiners have repeatedly cited some FHLBanks for compliance issues in three areas. These areas pertain to the methodology used by some FHLBanks to (1) score applications and select projects for funding, (2) calculate the amount of subsidy actually provided to individual projects, and (3) monitor and report on the use of AHP funds. Once these issues concerning subsidy calculation were brought to the attention of the FHLBanks by the examiners, the FHLbanks were generally very responsive to changing their practices and policies. However, the FHLBanks' responsiveness to issues of scoring and monitoring compliance has been mixed. While certain FHLBanks have improved their scoring and monitoring procedures, the Finance Board's examinations and our assessment found that problems remain in other FHLBanks.

Problems Persist in Scoring Applications

The FHLBanks continue to be cited by the Finance Board's examiners for the methodology they use to score applications for AHP funding. The principal problem that the FHLBanks have been cited for is not following the program's regulations, which require them to make adequate distinctions among projects applying for funding. Because the AHP is highly competitive, it is critical that the scoring methodology clearly differentiate among applications.

The program's regulations identify 13 categories in which applications are scored relative to each other. Some of these categories are easily quantifiable and therefore very objective, such as the percentage of very-low-income households targeted for a proposed project or how long a project is to be retained as very- low-income housing. For these categories, it is relatively easy to make scoring distinctions among applications. Other categories, however, are more subjective. For instance, weighing the relative value of one community's involvement in a project compared with another's can be particularly difficult, partly because such involvement can take many different forms, such as granting zoning variances, donating land, or providing financing below the market rate. It can also be difficult to quantify the relative differences among applicants regarding goals for "empowering" residents, such as forming residents' councils or providing counseling services for tenants.

Regardless of whether a scoring category is essentially objective or subjective, the AHP regulations used to rank applications state that the maximum point score available for each category must be awarded to the applicant(s) that achieves the best result for that category (known as the maximum point rule). However, examination reports on nearly half the FHLBanks have identified deficiencies in applying this rule. Such results show that many FHLBanks have not clearly distinguished among projects in various scoring categories.

In 1993, the Finance Board's examiners cited 5 of the 12 FHLBanks for deficiencies in applying the maximum point rule. At one of these banks, all approved projects in one of the two 1993 funding rounds received the maximum point score for three categories. These categories represent 40 of the 100 points available to a project. The examination report states that without greater delineation in scoring each criterion, the ability to effectively differentiate between applications is diminished. On the other hand, the same FHLBank was cited in the same funding round for not assigning to any project the maximum point score available for two other criteria. Again, not ensuring that a maximum point score is assigned for a criterion lessens its value in comparison with the other criteria.

This problem continued in the first half of 1994: three of the six FHLBanks examined during this period were cited for problems with the maximum point rule. Furthermore, our review of all the FHLBanks' scoring guidelines indicated that four did not effectively implement the maximum point rule for several categories. For example, in the scoring category known as "targeting," we noted that one FHLBank's procedures specify that all applications for homeownership projects will receive the maximum points available if no application targets very-low-income households. This policy does not differentiate between those applicants that may have targeted families with incomes between 50 and 60 percent of an area's median income from those that target families with incomes between 70 and 80 percent of the median. Such a policy appears inconsistent with the maximum point rule.

Deficiencies in applying the maximum point rule were also noted by two banks' advisory councils in their 1993 annual reports. The advisory council for one FHLBank reported that 32 out of 33 successful applications received the maximum number of points for empowerment goals for residents. In another FHLBank, the advisory council reported a concern that the scoring system was not distinguishing outstanding projects from mediocre ones.

The proposed regulations offer a partial solution to the problems identified in scoring. Specifically, each FHLBank would be required to submit its scoring criteria to the Finance Board for approval as part of its proposed implementation plan. The existing regulations for scoring have no such requirement. The advantage of the proposed approach is that the Finance Board and OHF would be able to review the FHLBanks' scoring criteria and require changes in cases, like those we noted, in which there were inconsistencies with the maximum point rule.

However, the proposed regulations will not by themselves provide a solution to the problem of the FHLBanks' not applying the maximum point rule effectively. While the proposed changes to the current regulations for scoring have added and removed scoring categories and adjusted maximum point awards within the categories, the maximum point rule as applied in current regulations would still apply in the proposed regulations. Therefore, the problem of effectively differentiating among applications will still exist if not addressed by individual FHLBanks.

Problems in Calculating Subsidies Reduce Available Funding

Despite the statutory requirement that FHLBanks make specific annual contributions to the AHP to be passed on to the ultimate borrowers, ambiguities in the regulations and the inherent complexities of calculating subsidies have been barriers to achieving these goals. The two major compliance issues cited in the Finance Board's examinations involve (1) FHLBanks not recalculating the subsidy at the time the program funds are disbursed and (2) sponsors not receiving the entire subsidy because of differences in the FHLBanks' and the members' loan amortization schedules. The impact of these problems has been to reduce the amount of funding available to AHP-supported projects. The FHLBanks have worked with the Finance Board's examiners and OHF staff to address both these issues.

Timing of Subsidy Calculations Overstates Banks' Contributions to AHP

According to regulations, the baseline for establishing the value of the FHLBanks' contributions to individual AHP projects is the present value of the lost cash flow between the market rate cost of funds to the FHLBank and the interest rate of the subsidized advance to the member. These regulations, however, do not specify when an FHLBank should calculate its market rate cost of funds; that is, at the time the bank commits to the loan or at the time the bank disburses the funds. As a result of this ambiguity, there was considerable confusion among the FHLBanks concerning the timing for calculating their cost of funds.

During the first round of FHLBank examinations in 1992, the examiners found that most FHLBanks calculated their AHP subsidies when they committed to the loan rather than when they disbursed the funds. Because 2 or more years may pass between the time a project is approved and the time the funds are actually disbursed, interest rate fluctuations can significantly affect the FHLBanks' actual cost of funds and, accordingly, their contributions to the AHP. Consequently, the Office of Examination and Regulatory Oversight interpreted the regulations to require that FHLBanks calculate the AHP subsidy on the basis of their cost of funds when they disburse the subsidized advance in addition to a calculation based on their cost of funds when they commit the advance. The former reflects a FHLBank's cost of funds when the advance is issued, while the latter represents an estimate at the time the applicant applies for a subsidized advance.

A hypothetical example illustrates the impact of this timing issue in an environment of declining interest rates. Assume that the cost of funds to a FHLBank is 10 percent at the time it makes a commitment to an AHP-supported project. Also, assume that a member needs a 5-percent advance. In this example, the amount of the AHP subsidy would be based on the difference between the 10-percent cost of funds to the FHLBank and the 5-percent rate charged to the member for the advance. If the amount of the FHLBank's advance was $500,000, then the AHP subsidy for the first year would be $25,000.[16] If, however, the FHLBank's cost of funds decreased to 7.5 percent at the time the advance was actually disbursed, then the amount of the subsidy for this project in the first year would decrease to

[16]The amount of the advance ($500,000) times the 5-percent difference in the FHLBank's estimated cost of funds and the subsidized advance rate.

$12,500.[17] An exception to this example, would occur if a FHLBank guaranteed the 5-percent rate by "hedging"[18] its commitment. In this case, its funding contribution would still be $25,000.

During the early years of AHP, interest rates generally declined. As a result, the FHLBanks claimed greater contributions to the program on the basis of the higher rates prevailing at the time they committed to the loan rather than the lower rates at the time the funds were disbursed.

The Finance Board was unaware of this timing problem until the first round of AHP examinations in 1992 documented that it was occurring in most of the FHLBanks. In response, OHF issued policy guidance on this matter to all FHLBanks, including those that had not been examined. This guidance, known as Special Notice Number 3, was issued in May 1992 and clarified how FHLBanks are to calculate their cost of funds. Special Notice Number 3 states that

> "If the indicated subsidy decreases in response to a change in interest rates, the Bank should allocate subsidy funds at the lower level, and the excess amount of subsidy shall be credited to the AHP fund at the Bank. Increases in interest rates should be funded out of any unused AHP funds, and if necessary, may be borrowed against the funds that will be available in the next AHP round."

The FHLBanks have generally followed this guidance in calculating their AHP contributions for those projects for which the funds had not yet been disbursed and generally have agreed to voluntarily recalculate their subsidies for projects that were funded before this notice.

Cash Flow Differences Result in Sponsors' Receiving Less Than FHLBanks' Contributions

During their 1993 examinations, the Finance Board's examiners found a problem with subsidy calculations at 8 of the 12 FHLBanks. Most of the banks were providing interest-only advances to their members, in which the principal is repaid at the end of the term of the advance. These FHLBanks also calculated their AHP subsidies on the basis of such advances.

However, when the members loaned these advances to the projects' sponsors, they generally did so as amortized loans. Unlike interest-only advances, amortized loans include repayment of principal throughout the term of the loan. Since the member retains the principal payments for the

[17]The amount of the advance ($500,000) times the 2.5-percent difference in the FHLBank's estimated cost of funds and the subsidized advance rate.

[18]Hedging is a practice used by FHLBanks to negate their interest-rate risk when the subsidized AHP advance is not immediately drawn down by the member. A bank generally does this by purchasing an option to lock in the prevailing market interest rate at the time the AHP funds are committed.

subsidized loan until the end of the advance term (up to 30 years), a portion of the subsidy may not be passed on to the ultimate borrower but instead may benefit the member. This result would be inconsistent with the statute requiring that AHP subsidies be passed on to the ultimate borrower. Without adjusting for differences in the cash flows for an interest-only advance and an amortizing loan, the amount of subsidy the ultimate borrower actually receives will be less than the amount the FHLBank credits against its contribution to the program.

A memorandum sent by Finance Board staff to the FHLBank presidents in December 1993 refers to this problem. It points out that for individual projects, and for such advances in the aggregate, the amount of this difference can be significant. The memorandum cites a case in which a $395,000 AHP subsidy was used to reduce the cost of an interest-only, 20-year FHLBank advance from 7.17 percent to 2 percent. Because the member reloaned the advance to an AHP project sponsor as a 20-year amortizing mortgage, the actual subsidy received by the sponsor was only $256,400. If the FHLBank had used an amortizing subsidized advance, it could have used $138,600 less in AHP funds to subsidize the advance over its 20-year term.

The general purpose of the December 1993 memorandum was to alert the FHLBanks of this problem so that subsidies for future projects could be allocated more efficiently. The memorandum also asked the FHLBanks to estimate the impact of this problem by recalculating the subsidies for cases in their AHP portfolios in which nonamortizing advances are used to fund amortizing loans. However, FHLBanks responded that they were unable to accurately do so because cash flow differences between nonamortizing advances and amortizing loans would be extremely complicated to reconstruct.

The Finance Board's examiners have concluded, on the basis of the information received from the FHLBanks and subsequent discussions with FHLBank officials, that there is no way to precisely resolve this issue when interest-only advances have already been disbursed. The problems posed include the technical complexities of trying to reconcile cash flow differences between an amortizing and a nonamortizing loan. Moreover, because the funding has already been disbursed and the contract between the FHLBank and the member has been executed, legal concerns have been raised about whether the terms and conditions of the AHP subsidy can be modified. Given these problems, the examination staff focused on resolving this issue for those projects that have not yet been approved. As the examination office correctly concluded, the most effective way to prevent this problem from recurring is to require the FHLBanks to issue amortizing advances to members when the member is issuing an amortizing loan to the project.

Once the examiners identified this problem, the FHLBanks worked with Finance Board staff to develop a solution. In this case, within one year of the problem's being identified, FHLBanks had developed and put into use a new financing product, an AHP amortizing advance or its equivalent. We believe the use of this product has resulted in a more efficient use of AHP funds.

While this change addresses prospective problems, it does not resolve whether the FHLBanks should attempt to convert their funded as well as unfunded commitments for interest-only advances to amortizing advances, particularly if technical and legal problems could be minimized. One alternative for minimizing the technical problems associated with funded projects would be to renegotiate, on an amortizing basis, the terms of the contract between the FHLBank and the member for the remaining period of the advance. This approach, along with relieving the member of any obligation to reimburse its FHLBank for subsidies not passed through to the sponsor before the contact is renegotiated, should minimize the technical problems discussed earlier concerning the difficulty in reconciling past discrepancies in cash flows between amortizing and nonamortizing advances. Legal issues could be minimized to the extent members that recognize that the full amount of the AHP subsidies are not being passed on to sponsors and are therefore willing to renegotiate their prior contracts with their FHLBank. In the case of unfunded commitments, because the FHLBanks have not yet issued these advances to their members, the cash flow problems associated with funded projects could be avoided. Any legal issues concerning committed advances for unfunded projects could also be minimized with the members' cooperation. These issues require resolution by the Board of Directors of the Finance Board.

Problems with calculating subsidies in general were reflected in our survey of community investment officers. Specifically, half of the officers we surveyed expressed either "strong" or "general" dissatisfaction with the training and technical assistance they have received from the Finance Board in determining methods for calculating subsidies. This was the highest dissatisfaction ranking the officers expressed in choosing from seven categories on the adequacy of training and technical assistance. Similarly, when we asked the officers how much more training and technical assistance they would like to receive from the Finance Board, they again ranked assistance in calculating subsidies highest.

Monitoring and Reporting Requirements Are Vague

The reporting and monitoring responsibilities of participants in the AHP are neither well defined nor integrated. This vagueness undermines the statutory requirement to ensure that each project maintain long-term affordability for program beneficiaries and also makes it difficult to determine whether the commitments made in the original applications are being satisfied. Unless corrected, the effects of this situation will be magnified as the program's funding grows.

Because funds from the AHP are typically combined with funds from other federal and state housing subsidy programs, the law requires the Finance Board and the FHLBanks to coordinate AHP activities to the maximum extent possible with those of other sources for funding affordable housing. Improved coordination and cooperation among these funding sources could ease the monitoring and reporting burden facing all participants in the program. However, several programmatic obstacles would have to be overcome to implement these improvements.

FHLBank System Lacks Comprehensive Reporting and Monitoring Strategy

Reporting and monitoring are two elements critical to determining how well any program is satisfying its statutory and regulatory requirements. These two elements are also interdependent, since accurate reporting of the program's results depends on effective monitoring to ensure that the reported data are reliable. Yet AHP regulations do not adequately define or link the responsibilities of the FHLBanks, members, and project sponsors for reporting on and monitoring the program, or the interdependency of these two functions.

The law requires that AHP subsidies be used only to assist projects for which adequate, long-term monitoring is available. According to the statute, such monitoring is intended to guarantee that standards for the affordability of the housing and other AHP requirements are satisfied. Similarly, the statute requires members to report annually to their FHLBank on how they used their AHP subsidy but does not specify the reporting requirements of FHLBanks and sponsors.

The program's regulations only partly clarify the reporting and monitoring responsibilities of participants in the program. According to the regulations, FHLBanks must provide reports and documentation to the Finance Board as requested, and the members are required to provide reports to their FHLBanks at least annually. These latter reports are to be supported by appropriate documentation, which must at least state the way the member used the subsidy, that it was passed through to the borrower, and that it continues to be used for the approved purposes. However, the regulations omit any reference to the reporting and monitoring responsibilities of the projects' sponsors.

Regarding monitoring, the program's regulations state that the Finance Board shall have the responsibility and authority to monitor, audit, and review the FHLBanks' and members' compliance with these regulations. The regulations also set out explicit monitoring responsibilities of the FHLBanks in 11 areas, ranging from such technical areas as subsidy calculations and loan pricing to more subjective areas such as the extent of community involvement in a proposed project. However, the regulations do not specify how frequently the FHLBanks should monitor their projects. This omission has led each FHLBank to implement its own distinct monitoring and reporting procedures. For example, some FHLBanks have established detailed procedures for on-site project visits, including their frequency, while others have not.

The omission from the regulations of any reference to the responsibilities of the projects' sponsors for reporting and monitoring the results of the program is significant because the members, FHLBanks, and Finance Board largely depend on the accuracy of the information provided by the sponsors to substantiate a project's compliance with the program's overall requirements and with the provisions of the application on which the project was approved. If data generated by the projects' sponsor and reported by the members to the FHLBank are inaccurate or incomplete, the FHLBank's ability to efficiently monitor the project's compliance with these requirements is severely restricted.

The implications of not having a comprehensive reporting and monitoring strategy were evident during the 1992 examinations. Specifically, the Finance Board's examiners noted many problems with the way the FHLBanks were monitoring their members' use of AHP funds and the lack of documentation substantiating the projects' compliance with both the regulations and the terms of the applications. Generally, while FHLBanks have improved their monitoring of members' use of AHP funds, recent examinations have also shown that some FHLBanks still need to strengthen their monitoring procedures.

Our review of AHP examinations through mid-1994 and the FHLBanks' monitoring procedures confirm that improvements are still needed in monitoring and reporting for the majority of the FHLBanks. The most significant problems we found were (1) the lack of adequate documentation and verification that the beneficiaries of AHP-assisted projects had income levels that made them eligible for such assistance and (2) inadequate information requested from members by the FHLBanks about the success of a project in meeting its unique commitments concerning the community and residents.

Examination reports have consistently cited the FHLBanks for the lack of sufficient documentation and verification procedures to substantiate the eligibility of beneficiaries of AHP-assisted projects. For example, in the first half of 1994, applying each FHLBank's monitoring procedures, the examiners found incomplete documentation on the income of the beneficiaries and inadequate verification of these incomes by FHLBank staff in five of the six FHLBanks examined. Given the statute's overall emphasis on providing assistance to lower-income households, it is important that the incomes of beneficiaries be adequately documented and verified.

Documenting and verifying that projects satisfy the unique commitments made in the applications is the second monitoring and reporting issue needing attention. This issue is significant because over 30 percent of the points available in scoring applications can be awarded for these commitments. Our survey of members and sponsors disclosed problems in both how this information is monitored and how it is reported. On the basis of our survey of sponsors, we estimate that 46 percent of completed projects (133 out of 288) included unique commitments to communities and residents. Sponsors for an estimated 109 of these 133 projects had documented their projects' compliance with these commitments, but sponsors for only an estimated 79 of these 109 projects reported this information to their member lending institutions. Such incomplete reporting could be anticipated because members had required sponsors to submit information on these unique commitments for only an estimated 20 percent of the projects.

We believe that these information gaps are partly due to inconsistencies among the FHLBanks in the information they require their members to provide to substantiate these commitments. In reviewing the monitoring procedures of the 12 FHLBanks, we found that only 2 specifically requested documentation from members to validate a project's compliance with the unique commitments described in the application. Two FHLBanks requested only general information from members on these commitments, while the monitoring procedures of eight FHLBanks made no reference to necessary documentation.

Although community investment officers receive compliance letters that outline specific procedural problems found by the Finance Board's examiners during all AHP examinations, these officers indicated dissatisfaction with the level of training and technical assistance they received from the Finance Board on developing policies and procedures for monitoring projects. Of the 12 community investment officers, 5 were either "generally dissatisfied" or "very dissatisfied." They ranked this category second among seven categories when asked to indicate whether they could use more training and technical assistance from the Finance Board in developing such policies and procedures. The only category they ranked higher in terms of needed training was calculating AHP subsidies.

Growth in AHP Will Increase Burden and Costs of Monitoring, Principally for FHLBanks

Nearly all the FHLBanks and some members are concerned about AHP monitoring requirements. The FHLBanks have expressed concerns that their cost to monitor AHP-supported projects is disproportionate to the program's relatively small size. The AHP subsidy averaged about 7 percent of the total costs of developing projects through 1993. In addition, FHLBanks and members alike point to the number of different agencies frequently involved in monitoring an AHP-supported project, leading them to question whether their role is duplicative and largely unnecessary.

The FHLBanks will increase their annual AHP funding to at least $100 million in 1995. On the basis of the 1993 average per-unit subsidy of $3,800, this would add approximately 26,000 low-income housing units annually to the program. According to estimates made by OHF, approximately 1,800 projects will be in need of monitoring and reporting in 1995. OHF estimates that given the program's future funding level, about 5,000 projects will need to be monitored by the year 2000 and about 10,000 projects by 2010. This projected growth has led one FHLBank to approach the Congress for statutory relief on AHP monitoring. This FHLBank maintains that if future monitoring costs are not contained and rationalized according to costs and benefits, members' and sponsors' participation in the program will diminish.

While this FHLBank and others anticipate significant increases in monitoring costs as a result of the future growth in AHP-supported projects, precise estimates of these costs have been difficult to determine. One critical problem is that some FHLBanks lack specific monitoring strategies, such as determining the frequency and scope of visits to projects. Also, the wide variety and complexity of AHP-supported projects complicates estimates of each FHLBank's overall monitoring costs. Moreover, these costs are likely to vary significantly among the FHLBanks, depending on, among other things, the number of projects each FHLBank has to monitor, the monitoring period for each project, and the geographic distribution of the projects in a FHLBank's district.

Project monitoring does not appear to present as great a problem for the member financial institutions participating in the AHP as it does for the FHLBanks. We estimate that the members associated with 64 percent of completed projects believe that the costs of monitoring the program were either "reasonable" or "very reasonable." Members associated with an estimated 16 percent of completed projects believe that the monitoring costs were "unreasonable" or "very unreasonable." We estimate that the annual costs to members for monitoring completed projects were (1) no more than $500 per project for 50 percent of the completed projects, (2) between $501 and $1,000 per project for 19 percent of the completed projects, and (3) over $1,000 per project for another 19 percent of the completed projects. However, because individual members have generally funded only one or two AHP projects, their monitoring costs have been limited. According to data from OHF, for the 1,354 active and completed AHP projects through mid-1993, 61 percent of participating members had only one project to report on, 81 percent had two or fewer, and only 4 percent had more than six projects.

AHP Monitoring Could Be Improved Through Closer Coordination With Other Housing Programs

The statute that established the AHP requires that the program be coordinated with other federal or federally subsidized programs on affordable housing to the maximum extent possible. Since AHP subsidies are usually combined with subsidies from other housing programs that have their own reporting and monitoring requirements, opportunities exist for closer coordination of monitoring activities between these programs and the AHP.

The low-income housing tax credit program offers perhaps the greatest opportunity for coordinating monitoring activities with the AHP. Through 1993, 43 percent of the rental units assisted by AHP subsidies also received low-income housing tax credits. Since 1992, state housing finance agencies have been monitoring projects that use tax credits on behalf of the Internal Revenue Service.

Aside from tax credits, the AHP has been used in conjunction with several programs of the Department of Housing and Urban Development (HUD), including HOME,[19] community development block grants, and Section 8 rental subsidies. In addition, the AHP has been used with mortgage revenue bonds, the Resolution Trust Corporation's Affordable Housing Disposition Program, and a variety of state and local housing subsidy programs, all of which have monitoring requirements to ensure compliance with their programs' respective goals and objectives. Given these requirements, OHF has encouraged FHLBanks to use the experienced agencies responsible for monitoring these other programs to assist them in monitoring projects for compliance with AHP requirements.

There are, however, several barriers to closer cooperation between these agencies and the FHLBanks. One barrier is the difference in income eligibility requirements among housing programs. For example, one state's affordable housing program uses a different definition for an area's median income than federal housing programs do. Specifically, while federal housing programs use the metropolitan area's median household income for nonrural communities, this state's housing program uses the county's household median income for all rural and nonrural communities throughout the state. Moreover, some jurisdictions do not adjust household incomes on the basis of household size. In contrast, federal housing programs—including rental housing programs subsidized by the AHP—adjust household income to reflect household size.

Finally, the AHP also differs from other programs because of the commitments to community involvement and the empowerment of residents contained in some AHP applications. Because these applications are approved competitively, it is important that any unique commitments made by applicants be validated through monitoring. Because no other affordable housing programs that we know of monitor for these features, they would present an obstacle to other agencies that would have to monitor for them on behalf of the FHLBanks.

Despite these impediments, the value of closer coordination in improving the effectiveness of the AHP was reflected in the responses we received from the community investment officers. In response to a question asking these officers to rank the importance of 11 different factors in increasing the AHP's effectiveness, closer coordination of monitoring requirements with those of other housing programs was most important. They

[19] HUD's HOME program was enacted under title II of the Cranston-Gonzalez National Affordable Housing Act of 1990. Using formulas, this program provides assistance to state and local governments to help them address the housing needs of low-income households.

considered this factor more important than, for example, increased flexibility in the scoring system or giving FHLBanks final authority to approve AHP applications.

Unresolved Enforcement Issues at Three Selected FHLBanks

Aside from the issues that affect the entire FHLBank System, several key examination findings concerned three FHLBanks. These issues have not been resolved voluntarily and will likely need to be addressed by the Finance Board's Board of Directors. These findings concern whether (1) a FHLBank made its full contribution to the AHP, (2) a FHLBank should be required to replenish the AHP fund for subsidies provided to a project whose beneficiaries were ineligible, and (3) a negotiated settlement reached between a FHLBank and a member to recapture that portion of an AHP subsidy used for ineligible purposes is sufficient.

Examiners Question One FHLBank's Calculation of Guaranteed Rate Advances

Officials at one FHLBank have been unable to resolve a compliance issue with the Finance Board's examiners regarding the calculation of AHP subsidies on advances with guaranteed interest rates. This FHLBank's policy was to establish an estimated subsidy based on the member's requested interest rate and the FHLBank's cost of funds as of the date the funds were committed. This policy affected 22 subsidized guaranteed-rate commitments made by the FHLBank in 1990 and 1991, before Special Notice Number 3, which, as mentioned earlier, states that AHP subsidies are to be recalculated on the date a project is actually funded. This FHLBank has stated that because it accomplishes this guaranteed rate lock by "hedging" its cost of funds at the time of commitment, it has incurred an actual cost in doing so. The FHLBank claimed that as a result of its hedging policy, it would incur a significant loss if it were required to reprice these guaranteed-rate commitments at the time of funding.

The Finance Board's examiners have not questioned the use of guaranteed-rate lock by individual FHLBanks as a means of protecting against interest rate risk. However, they have identified two problems with the manner in which this FHLBank implemented this policy. First, the examiners have been unable to document that the FHLBank actually hedged its AHP commitments in accordance with generally accepted accounting principles. The FHLBank, however, maintains that no generally accepted accounting principles apply and that it hedged all its guaranteed-rate advances, including its advances under AHP, rather than making such a decision for individual transactions.

The Finance Board's examiners also said that they found no evidence of an appropriate contract guaranteeing the interest rate between the FHLBank and its members. The examiners found that unlike regular advances, which always have a specific drawdown date, guaranteed-rate advances under AHP do not. As further noted by the examiners, it is not a usual business practice to commit to a guaranteed rate without a specific term or expiration date. The FHLBank claims that it did not require a specific funding date for these advances, and that it took on additional interest rate risk in so doing, in order to accommodate the development of affordable housing. Notwithstanding this bank's position on these issues, the Finance Board's examiners said that without sufficient evidence of hedging that meets generally accepted accounting principles or a contract guaranteeing an interest rate for a specific duration or date, the FHLBank should have recalculated its AHP subsidy when it disbursed the funds rather than when it committed them.

Following an August 1993 examination, the examiners estimated that out of the AHP subsidy claimed by this bank of $8.3 million, only $4 million would have actually benefited the AHP projects on the basis of the cost of funds as of the funding date for funded projects or August 10, 1993, for unfunded projects. For one funded project alone, the examiners estimated that the FHLBank had overstated its contribution to the AHP by almost $1 million. Since the FHLBank has not accepted these examination findings, the issue of whether this FHLBank has actually funded the AHP program according to its statutory requirement will need to be determined by the Board of Directors of the Finance Board.

One FHLBank Funded a Project Whose Beneficiaries Were Ineligible

AHP regulations require that FHLBanks use the area's median income, as determined and published by HUD, in calculating the eligibility on the basis of income of those who benefit from AHP-funded projects. However, one particular FHLBank was cited by Finance Board examiners for improperly considering a project's residents qualified on the basis of the median income of the county in which the project was located instead of the median income in the metropolitan area, under HUD's criterion. Because the county's median income was substantially higher than the metropolitan area's median income, all 16 households benefiting from the AHP project were cited by the Finance Board's examiners as ineligible because of their income.

Although this FHLBank agrees that AHP funds were used for ineligible purposes, it has nonetheless requested that the Finance Board not require that it replenish the $266,000 of AHP subsidy. The FHLBank noted that the Finance Board originally approved the project's application, which clearly specified that the county's median income would be used as the basis for determining income eligibility. The FHLBank also noted in its request that it has implemented new procedures that will prevent a recurrence of this problem. This issue will likely require resolution by the Finance Board's Board of Directors.

Finance Board's Examiners Question Whether One FHLBank Misused an AHP Subsidy

One FHLBank disbursed a $250,000 direct subsidy to a member in support of a low-income multifamily housing project. The subsidy was intended to reduce the project's debt servicing by reducing the mortgage amount from $750,000 to $500,000. Although the member did reduce the mortgage amount to $500,000, the member charged an interest rate of 15.75 percent on this mortgage. The Finance Board's examiners considered the rate excessive, noting that it effectively offset much of the $250,000 direct subsidy. Consequently, because in the opinion of the examiners the subsidy did not fully benefit the ultimate borrower, the examiners found that this transaction may constitute an ineligible use of AHP funds.

Once the FHLBank was informed of this matter, it negotiated a settlement with the member wherein the member agreed to restore about $66,000 to the AHP pool. Both the member and the FHLBank asserted that this was the full amount due. But the Finance Board's examination office disagreed. According to the examiners, the amount used for the ineligible purposes totaled between $156,000 and $195,000. The issues for possible consideration by the Finance Board's Board of Directors are (1) determining whether a violation occurred and, if so, how much was used for ineligible purposes; (2) deciding whether a portion or the full amount of any subsidy used in a way determined to be ineligible should be restored to the AHP pool, assuming it exceeds $66,000; and (3) deciding whether the FHLBank or the member should be responsible for replenishing any shortfall to the AHP pool.

Lack of a Quorum Impeded Adoption of Proposed AHP Regulations and Some Enforcement Actions

The Board of Directors of the Finance Board has the authority to enforce all laws and regulations governing the operation of the FHLBank System, including the AHP. To change the FHLBank System's policies or rules, a quorum consisting of at least three of the Board's five seats must be filled. While two new members of the Board of Directors were confirmed on May 25, 1995, the Board had operated without a quorum since January 1, 1994. During this period, only two Board members remained following the resignations of three members at the end of 1993.[20] Absent a quorum, the Board of Directors was not able to adopt or amend rules, regulations, or policies, including changes in the scoring procedures for applications and the proposed delegation to the FHLBanks of the authority to approve applications.

Whether open examination findings could have been resolved by less than a quorum of the Board of Directors is not certain. Our discussions with the Finance Board's senior attorney indicate that the Board of Directors may have been able to enforce the program's existing regulations or policies without a quorum. Nevertheless, this issue is no longer applicable with the confirmation of two new Board members. This newly constituted Board of Directors can now use its full authority to resolve the three outstanding cases in which individual FHLBanks may have violated AHP regulations and those systemwide problems pertaining to subsidy calculations and reporting and monitoring responsibilities of all of the program's participants.

Conclusions

The Administration of the Affordable Housing Program by the FHLBanks and the Finance Board has shown consistent improvement since the program was created. This improvement should allow the FHLBanks to assume greater authority in the administration of the program, as included in proposed regulations, as long as the Finance Board recognizes that it may need to rescind this authority if necessary.

Regardless of how AHP is administered in the future, two issues require attention. First, because of compliance issues raised by the examiners about subsidy calculations and the use of AHP funds for potentially ineligible purposes, some FHLBanks may not have always met their statutory funding obligations for the program, and subsidies provided by the FHLBanks may not have always been passed through to the projects' sponsors. Thus, some FHLBanks may not have initially been held

[20]These three members resigned during the last two months of 1993 following passage of a law requiring that all Board members convert from part-time to full-time status effective January 1, 1994.

accountable for these two fundamental responsibilities under the program's regulations. Because most FHLBanks have responded positively to examination findings concerning subsidy calculations, this should no longer be an issue for future projects. However, the Board of Directors of the Finance Board still needs to resolve whether FHLBanks should attempt to renegotiate the terms of contracts between the FHLBanks and their members in those cases in which nonamortizing advances were used by members to fund amortizing loans to sponsors. In these cases, sponsors are not receiving the full amount of their AHP subsidy. To the extent that members recognize that the full amount of the AHP subsidies are not being passed on to sponsors and are therefore willing to renegotiate their prior contracts with their FHLBank, legal issues would be minimized.

In the case of unfunded commitments, because the FHLBanks have not yet issued these advances to their members, the cash flow problems associated with funded projects could be avoided. Any legal issues concerning already committed advances for unfunded projects could also be minimized with the members' cooperation. Should the Board of Directors decide to require the banks to convert to amortizing advances for existing AHP commitments, it should do so expeditiously to maximize the amount of AHP subsidy passed through to the sponsors. Furthermore, the Board of Directors of the Finance Board needs to determine whether to hold FHLBanks accountable in cases in which it determines that AHP subsidies are being used for ineligible purposes.

Second, while the statute requires that funds be used to assist only those projects for which adequate long-term monitoring is available, the current regulations do not clearly define or integrate the reporting and monitoring responsibilities of the projects' sponsors, the member financial institutions, and the FHLBanks. An accurate assessment of the program depends on a flow of information from participants at every level, and the lack of a comprehensive reporting and monitoring strategy may hinder achievement of the program's long-term aims.

The program's aims may also be undermined because some FHLBanks need to improve their procedures for documenting and verifying the income eligibility of beneficiaries of the projects and for ensuring that the projects comply with any unique commitments made in the original application. Although there are impediments to coordinating more closely the reporting and monitoring requirements of the AHP and other affordable housing programs, such coordination offers opportunities to share the reporting and monitoring capabilities of experienced housing agencies while helping to contain monitoring costs in the AHP.

Finally, in a draft of this report, we had a proposed recommendation that a quorum of the Finance Board's Board of Directors be established as soon as possible. We did this because we found that not having a quorum since January 1, 1994, had complicated the AHP's administration and enforcement. However, on May 25, 1995, prior to the publication of this report, the Congress confirmed two new Board members, thereby establishing a quorum. With a quorum, the Board of Directors will clearly be able to exercise its full authority in all matters pertaining to the administration and enforcement of the AHP.

Recommendations to the Board of Directors of the Federal Housing Finance Board

To ensure that the FHLBanks continue to meet their statutory and regulatory obligations under the Affordable Housing Program, we recommend that the Board of Directors of the Finance Board

- require the FHLBanks to reimburse their AHP funds in future cases in which the Finance Board determines that (1) the subsidy calculations resulted in an overstatement of a FHLBank's contribution to AHP, (2) the subsidies were used for ineligible purposes, or (3) a project's sponsor did not receive the full AHP subsidy;
- where the conditions mentioned above exist for projects already funded, determine, on a case-by-case basis, whether to require the FHLBanks to reimburse their AHP funds on the basis of the estimated amount of the shortfall;
- encourage the FHLBanks to work with their members to convert all outstanding nonamortizing advances to amortizing advances that match the terms of the amortizing loan provided to the projects' sponsors;
- ensure that any revised regulations for the program clearly define and integrate the monitoring and reporting responsibilities of the projects' sponsors, the members, and the FHLBanks;
- direct the FHLBanks to improve, as necessary, their procedures for documenting and verifying that the beneficiaries of the program meet the requirements for income eligibility and that any unique commitments made in applications are met; and
- encourage the FHLBanks to improve their monitoring and reporting of the results of the program through closer coordination with experienced agencies that are also responsible for monitoring housing programs.

Agency Comments and Our Evaluation

The Federal Housing Finance Board, in commenting on a draft of this report, generally agreed with our conclusions but believed that the report could have better explained the technical complexities involved in determining the appropriate amount of subsidy required for an AHP subsidized advance. The Finance Board also commented that it does not believe that the lack of a quorum on its Board of Directors has caused a delay in the enforcement of the program's regulations. We believe that the report acknowledges the technical complexities as testified to by the FHLBanks and the Finance Board's examiners in calculating AHP subsidies and offers alternatives for minimizing the technical problems associated with calculating AHP subsidies. The report also clearly points out the circumstances under which the lack of a quorum constrained the authority of the Board of Directors to make decisions regarding administration and enforcement issues. The comments provided by the Finance Board did not address the recommendations made in this report.

The Federal Home Loan Bank System

The Federal Home Loan Bank System is composed of 12 Federal Home Loan Bank (FHLBank) districts. Table I.1 shows the geographic area of each of these districts.

Table I.1: Composition of FHLBank Districts

FHLBank district	States and territories
Boston	Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont
New York	New Jersey, New York, Puerto Rico, Virgin Islands
Pittsburgh	Delaware, Pennsylvania, West Virginia
Atlanta	Alabama, District of Columbia, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia
Cincinnati	Kentucky, Ohio, Tennessee
Indianapolis	Indiana, Michigan
Chicago	Illinois, Wisconsin
Des Moines	Iowa, Minnesota, Missouri, North Dakota, South Dakota
Dallas	Arkansas, Louisiana, Mississippi, New Mexico, Texas
Topeka	Colorado, Kansas, Nebraska, Oklahoma
San Francisco	Arizona, California, Nevada
Seattle	Alaska, Guam, Hawaii, Idaho, Montana, Oregon, Pacific Islands, Utah, Washington, Wyoming

Source: Federal Housing Finance Board.

1993 Program Priorities for FHLBanks

Each year the FHLBanks, in conjunction with Affordable Housing Program (AHP) district advisory councils, identify AHP funding priorities within their districts on the basis of the program's results and continuing affordable housing needs. Table II.1 shows that while program priorities differed among the 12 FHLBanks, many of the banks' priorities in 1993 generally emphasized rural projects, projects that would increase homeownership opportunities for low-income households, and projects that would use AHP funds to leverage funds from other funding sources.

Table II.1: AHP Funding Priorities for 1993, by FHLBank District

FHLBank	1993 program priority
Boston	Finance projects in a state within its district where no applications had been approved in the previous funding round.
New York	Develop projects that are financed through a loan consortium or that include FHLBank Community Investment Funds.
Pittsburgh	Finance projects targeted to assist rural areas or encourage homeownership.
Atlanta	Finance projects targeted to assist rural areas.
Cincinnati	Finance projects targeted to assist rural areas and projects that support the preservation of housing in urban centers through rehabilitation or new construction.
Indianapolis	Finance projects that meet documented critical needs for housing that are part of a planned community revitalization strategy that will lead to homeownership and leverage funds from the AHP with those from other funding sources, including those from the Community Investment Program.
Chicago	Finance projects that use funds from the AHP to leverage those from other funding sources by demonstrating a reasonable effort to secure other sources.
Des Moines	In the first funding round, finance projects submitted by members making their first AHP applications, by members whose prior applications were not approved, or by a consortia of members that include a member participating in the AHP for the first time. In the second funding round, finance projects that provide housing to households located in federally declared disaster areas.

(continued)

FHLBank	1993 program priority
Dallas	Finance projects that include additional sources of funding to leverage AHP funds and projects located outside of entitlement cities designated by the Department of Housing and Urban Development (HUD).
Topeka	Finance projects located outside of urban areas or that provide homeownership opportunities.
San Francisco	Finance projects that target very-low- and low-income households beyond the level required by the program's regulations.
Seattle	Finance projects located in Hawaii or Guam.

Source: Federal Housing Finance Board.

Objectives, and Methodology for GAO'S Data Collection Instruments

Section 721 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) directed GAO to assess the Federal Home Loan Bank System's implementation of the Affordable Housing Program (AHP). Consequently, this report addresses (1) how program funds have been used to support affordable housing, (2) how the program has been administered, and (3) what opportunities exist for improvement. We used a variety of methods to collect data supporting these objectives, including mail-in questionnaires and telephone surveys. Copies of the mail-in questionnaires and telephone surveys with the aggregated responses and confidence levels are available on request by calling Judy A. England-Joseph, Director of Housing and Community Development Issues Area, at (202) 512-7631.

Mail-in Questionnaires

To obtain consistent information on the administration of the AHP in all 12 FHLBanks, we sent mail-in questionnaires to the designated community investment officers in the banks. We received responses from all these officers.

To obtain information from the FHLBanks' legislatively mandated district advisory councils, we sent a mail-in questionnaire to each council's designated chairperson. We received 11 usable questionnaires in return. The only nonrespondent was the chairperson of the advisory council in Dallas, Texas.

We called and sent one or more follow-up questionnaires to those who did not respond to our initial mailings. These surveys were conducted concurrently in March through August 1994.

Telephone Surveys of AHP Subsidy Recipients

To obtain information on member financial institutions' and project sponsors' interest in and experience with the AHP, we designed and conducted telephone surveys of random samples of those who received AHP subsidies and had completed one or more single-family or multifamily projects using program funds by December 31, 1992. We selected this completion date because a large proportion of our questions addressed monitoring of and reporting on the project. Therefore, we wanted to select projects that had been completed for a year or more and would have been subject to the program's monitoring and reporting requirements. We designed two surveys, one for members and one for sponsors. The telephone surveys were conducted concurrently from August through October 1994.

Methodology

The surveys of members and sponsors were designed to elicit information related to a specific project, as well as information about the members' or sponsors' general experiences with the program. We designed our sample to obtain both types of information. Because some of the questions were related to specific projects, we based our design on an initial sample of projects. However, this sample was also designed to be the basis for the questions not related to specific projects.

First, we separately enumerated all single-family and multifamily projects completed by December 31, 1992. For both lists, we determined the member and sponsor associated with each project. We then took a simple random sample of single-family projects and a simple random sample of multifamily projects. The sampling was done with replacement so that it could also be the basis for the general questions (the sampling of projects without replacement allowed us to correctly weight the members' and sponsors' responses to our general questions). However, for the project-specific questions, multiple selections of a project were disregarded, which is equivalent to sampling without replacement. We contacted the relevant members and sponsors for information related to these specific sampled projects. A member or sponsor could be associated with more than one project and thus could be contacted more than once. We analyzed this project-specific information as two stratified simple random samples without replacement, one for members and one for sponsors.

In addition, we asked members and sponsors about their general experiences with the program. Because this information was not related to a specific project, we only questioned the member or sponsor once but recorded the number of times they were selected for the project-specific questions. Again, we treated this as two stratified samples, one of members and one of sponsors. However, because we contacted the member or sponsor on the basis of the lists of projects, the members' or sponsors' chance of selection depended on the number of associated projects on the lists. Therefore, the information obtained from these questions was analyzed as a stratified probability proportional to size sample with replacement. The probability of selection for each member and sponsor was determined by the number of associated projects, separately for single-family and multifamily projects. For example, a member with three associated single-family projects would have three times the probability of being selected as a member with only one associated single-family project.

Our original listing of projects contained 106 single-family and 190 multifamily projects. The single-family projects were associated with 98 sponsors and 89 members, and the multifamily projects were associated with 173 sponsors and 131 members. For the project-specific information to be obtained from a survey of sponsors, we sampled 42 single-family projects and 60 multifamily projects. We obtained usable responses for about 93 percent of these single-family projects and 100 percent of these multifamily projects. For the project-specific information to be obtained from a survey of member financial institutions, we sampled 43 single-family projects and 60 multifamily projects. We obtained usable responses for about 84 percent of these single-family projects and 93 percent of these multifamily projects. To obtain information about sponsors' general experiences with the AHP, we sampled 58 sponsors of single-family projects and 92 sponsors of multifamily projects. We obtained usable responses from about 91 percent and 98 percent of these sponsors, respectively. To obtain information about members' general experiences with the AHP, we sampled 61 members associated with single-family projects and 94 members associated with multifamily projects. We obtained usable responses from about 82 percent and about 95 percent of these members, respectively.

Since we used probability samples of members and sponsors to develop our estimates, each estimate has a measurable precision, or sampling error, which may be expressed as a plus/minus figure. A sampling error indicates how closely we can reproduce from a sample the results that we would obtain if we were to take a complete count of the universe using the same measurement methods. By adding the sampling error to and subtracting it from the estimate, we can develop upper and lower bounds for each estimate. This range is called a confidence interval. Sampling errors and confidence intervals are stated at a certain confidence level—in this case, 95 percent. For example, a confidence interval, at the 95-percent confidence level, means that in 95 out of 100 instances, the sampling procedure we used would produce a confidence interval containing the universe value we are estimating.

Estimates and Sampling Errors for Responses to Surveys

The tables in this appendix provide the estimates used in this report and their sampling errors at the 95-percent confidence level. From our survey of sponsors, table IV.1 provides estimates of the projects' characteristics, and table IV.2 provides estimates of the sponsors' general experiences with the AHP. From our survey of members, table IV.3 provides estimates of the projects' characteristics, and table II.4 provides estimates of the members' general experiences with the AHP.

Table IV.1: Sampling Errors for Estimated Characteristics of Projects From Survey of Sponsors Based on Sample of Projects Completed as of December 31, 1992

Question asked of sponsor	Response	Estimated percentage of projects[a]	Sampling error at 95-percent confidence level[a]
If your organization had not received AHP funding for this project, to the best of your knowledge what would have happened to the project? (Check all that apply)	Entire project most likely would not have been done	51.8 (149)	8.1 (24)
	Income levels of beneficiaries would have been higher	53.5 (154)	8.1 (24)
	Would have been harder to find additional funding sources	70.6 (204)	7.2 (21)
	Project would have been delayed	62.7 (181)	7.6 (22)
	Project financing would have been more costly	69.7 (201)	7.5 (22)
	Number of units funded would have been reduced	34.2 (99)	7.5 (22)
	Other	8.3 (24)	4.6 (13)
Did the original AHP application include any commitments concerning empowerment, community involvement, or innovation?	Yes	46.0 (133)	8.1 (24)
	No	38.8 (112)	7.9 (23)
	Don't know/ uncertain	15.1 (44)	5.8 (17)
Do you document the project's compliance with these commitments?[b]	Yes	82.4 (109)[b]	9.1 (23)[b]
	No	13.3 (18)[b]	8.2 (11)[b]
	Don't know/ uncertain	4.3 (6)[b]	4.8 (6)[bc]
Do you report on the project's compliance with those commitments to your FHLBank that funded this project?[d]	Yes	72.3 (79)[d]	11.4 (21)[d]
	No	22.5 (25)[d]	10.5 (12)[d]
	Don't know/ uncertain	5.2 (6)[d]	5.8 (6)[cd]

(Table notes on next page)

Note: Unless otherwise noted, estimates apply to 288 plus or minus 6 of the 296 projects completed as of December 31, 1992, at the 95-percent confidence level.

[a]The number in parentheses is the estimated number of projects.

[b]At the 95-percent confidence level, estimates apply to between 109 and 156 of the 296 projects completed as of December 31, 1992 (those projects whose sponsors reported that the original AHP application included these commitments).

[c]Sampling error computations are not exact because of the characteristics of the sample results.

[d]At the 95-percent confidence level, estimates apply to between 87 and 132 of the 296 projects completed as of December 31, 1992 (those projects whose sponsors reported that they document the project's compliance with commitments).

Source: GAO's analysis of its survey of AHP sponsors.

Table IV.2: Sampling Errors for Estimated Experiences of Sponsors Based on Sample of Sponsors for Projects Completed as of December 31, 1992

Question asked of sponsor	Response	Estimated percentage of sponsors[a]	Sampling error at the 95-percent confidence level[a]
How important has AHP been in giving you the additional experience you believe that your organization needed to develop more affordable housing projects?[b]	Extremely or very important	87.4 (119)[b]	7.7 (23)[b]
	Somewhat important or little or no importance	12.6 (17)[b]	7.7 (11)[b]
What were the general reasons your organization has applied for AHP funding? (Check all that apply)	Needed to obtain funding from many sources	78.5 (209)	7.0 (20)
	Early AHP commitment helps obtain funds from other sources	44.4 (118)	8.3 (23)
	AHP was used to replace other funding not approved	3.2 (9)	2.8 (7)
	Wanted more experience in affordable housing development	51.8 (138)	8.4 (23)
	Wanted to assist lower income households	92.7 (247)	4.3 (16)
	Were encouraged to do so by FHLBank staff	71.1 (189)	7.6 (22)
	Were encouraged to do so by a FHLBank member	55.2 (147)	8.3 (23)
	Other	36.4 (97)	8.0 (22)
Do you plan to increase, decrease or maintain your level of participation in the AHP in 1995?	Increase	59.8 (159)	8.2 (23)
	Decrease	3.4 (9)	2.9 (8)

(continued)

Question asked of sponsor	Response	Estimated percentage of sponsors[a]	Sampling error at the 95-percent confidence level[a]
	Maintain	36.8 (98)	8.1 (22)
Are you planning to increase because...? (Check all that apply)[c]	AHP funding is scheduled to increase	21.2 (34)[c]	8.7 (15)[c]
	Some funding sources are no longer available	35.8 (57)[c]	10.2 (18)[c]
	Organization wants to target assistance to lower-income households	92.8 (148)[c]	5.5 (23)[c]
	AHP's funding flexibility allows for tailoring use to meet unique needs	79.4 (126)[c]	8.7 (23)[c]
	AHP has fewer administrative requirements than other programs	57.8 (92)[c]	10.7 (21)[c]
	Other	26.4 (42)[c]	9.2 (16)[c]

Note:Unless otherwise noted, estimates apply to between 266 plus or minus 12 of the 271 sponsors with projects completed as of December 31, 1992, at the 95-percent confidence level.

[a]The number in parentheses is the estimated number of sponsors.

[b]At the 95-percent confidence level, estimates apply to between 113 and 160 of the 271 sponsors with projects completed as of December 31, 1992 (those sponsors who reported that, prior to becoming involved with AHP, they had developed affordable housing to little or no, some, or a moderate extent).

[c]At the 95-percent confidence level, estimates apply to between 136 and 182 of the 271 sponsors with projects completed as of December 31, 1992 (those sponsors who reported that they are planning to increase their level of participation in the AHP in 1995).

Source: GAO's analysis of its survey of AHP sponsors.

Table IV.3: Sampling Errors for Estimated Characteristics of Projects From Survey of Members Based on Sample of Projects Completed as of December 31, 1992

Question asked of member	Response	Estimated percentage of projects[a]	Sampling error at the 95-percent confidence level[a]
Do you require the sponsor for this project to submit information on . . . ? (Check all that apply)	Income eligibility	69.4 (183)	7.5 (22)
	Maximum subsidy limitation	53.4 (141)	8.4 (23)
	Third-party verification	38.6 (102)	8.3 (22)
	Rent rolls by unit size	55.7 (147)	8.1 (22)
	Rent rolls by income categories	56.2 (148)	7.8 (22)
	Housing prices	15.9 (42)	6.0 (16)
	Affirmative marketing directives	40.1 (106)	8.3 (23)
	Special needs (e.g., homeless)	29.0 (76)	7.6 (20)

(continued)

Question asked of member	Response	Estimated percentage of projects[a]	Sampling error at the 95-percent confidence level[a]
	Commitments	19.5 (51)	6.7 (18)
	Long-term retention	43.4 (114)	8.4 (23)
	Not applicable[b]	16.8 (44)	6.1 (16)
Since you have been monitoring this project, about how much has it cost your bank each year to monitor this AHP project?	< $100 to $500	49.9 (132)	8.4 (23)
	$501 to $1000	19.1 (50)	6.7 (18)
	> $1000	18.8 (50)	6.7 (18)
	Don't know/unsure	12.1 (32)	5.6 (15)
In your opinion, how reasonable or unreasonable have the costs been to your bank to monitor this particular project?	Very reasonable or reasonable	64.2 (169)	8.1 (23)
	Neither reasonable nor unreasonable	19.5 (51)	6.7 (18)
	Unreasonable or very unreasonable	16.3 (43)	6.4 (17)
In your opinion, how reasonable or unreasonable have the costs been to your bank to report the information you have collected to your FHLBank?	Very reasonable	24.7 (65)	7.2 (19)
	Reasonable	42.3 (112)	8.3 (23)
	Neither reasonable nor unreasonable	16.7 (44)	6.4 (17)
	Unreasonable	16.3 (43)	6.4 (17)
	Extremely unreasonable	0 (0)	[c]

Note: Unless otherwise noted, estimates apply to 264 plus or minus 14 of the 296 projects completed as of December 31, 1992, at the 95-percent confidence level.

[a]The number in parentheses is the estimated number of projects.

[b]These member financial institutions reported that they did not submit an annual certification monitoring report to their FHLBank.

[c]We were unable to compute a sampling error because we did not observe any variation in our sample.

Source: GAO's analysis of its survey of FHLBank member financial institutions.

Table IV.4: Sampling Errors for Estimated Experiences of Members Based on Sample of Members With Associated Projects Completed as of December 31, 1992

Question asked of member	Response	Estimated percentage of members[a]	Sampling error at the 95-percent confidence level[a]
Prior to your bank's involvement in AHP, how much of your business was affordable housing lending as compared to your traditional housing lending business?[b]	All traditional lending	23.8 (33)[b]	9.3 (14)[b]
	Mostly traditional/some affordable housing lending	67.6 (95)[b]	10.1 (20)[b]
	About half traditional/half affordable housing lending	4.3 (6)[b]	4.4 (6)[bc]
	Mostly affordable housing/some traditional housing lending	4.3 (6)[b]	4.8 (7)[bc]
What were the key factors that influenced your bank's decision to get involved with AHP? (Check all that apply)	AHP helps your bank meet its CRA (Community Reinvestment Act) requirements	82.2 (157)	7.5 (20)
	Large unmet need for affordable housing lending in your area	68.1 (130)	8.9 (20)
	Your bank needs to compete in AHP lending with other lenders	31.7 (61)	8.4 (16)
	Your bank wants more experience in AHP lending	56.6 (108)	9.3 (20)
	AHP enables your bank to assist households at lower income levels	79.1 (151)	7.8 (20)
	Your FHLBank encouraged you to become involved	77.9 (149)	8.0 (20)
	Housing sponsors have asked your bank to participate	64.2 (123)	9.1 (20)
	Marginally feasible project became feasible with AHP	67.5 (129)	8.9 (20)
	Bank is part of consortium helping limit project's finance risk	24.7 (47)	7.9 (16)
	Other	17.9 (34)	7.0 (14)
How important is AHP in giving you the additional experience that you believe you need to do more affordable housing lending?	Extremely or very important	58.4 (112)	9.1 (21)
	Somewhat important or of little or no importance	41.6 (79)	9.1 (19)
Do you plan to increase, decrease or maintain your level of participation in the AHP in 1995?	Increase	41.3 (79)	9.2 (19)
	Decrease	3.2 (6)	3.5 (7)[c]

(continued)

Question asked of member	Response	Estimated percentage of members[a]	Sampling error at the 95-percent confidence level[a]
	Maintain	55.5 (106)	9.3 (20)
Are you planning to increase your participation because . . . ? (Check all that apply)[d]	AHP helps your bank meet its CRA requirements	78.7 (62)[d]	12.0 (18)[d]
	AHP funding is scheduled to increase	41.9 (33)[d]	14.3 (14)[d]
	AHP projects have been profitable	49.5 (39)[d]	14.6 (15)[d]
	AHP projects seem to be relatively low risk	52.6 (42)[d]	14.6 (16)[d]
	Your bank is allocating more resources to AHP lending	44.9 (35)[d]	14.4 (14)[d]
	Your bank has gained experience in AHP lending	76.2 (60)[d]	11.7 (18)[d]
	There is a growing demand for AHP funds	74.3 (59)[d]	12.8 (18)[d]
	Other	27.2 (22)[d]	13.2 (12)[d]
Which is the most important reason? (among those reasons for increasing participation in AHP in 1995)[d]	AHP helps your bank meet its CRA requirements	34.0 (27)[d]	13.5 (12)[d]
	AHP program funding is scheduled to increase	0 (0)[d]	[e]
	AHP projects have been profitable	9.5 (8)[d]	8.9 (7)[d]
	AHP projects seem to be relatively low risk	0 (0)[d]	[e]
	Your bank is allocating more resources to AHP lending	6.6 (5)[d]	7.2 (6)[cd]
	Your bank has gained experience in AHP lending	2.6 (2)[d]	5.0 (4)[cd]
	There is a growing demand for AHP funds	27.7 (22)[d]	13.1 (12)[d]
	Other	19.6 (16)[d]	11.9 (10)[d]

(Table notes on next page)

Note: Unless otherwise noted, estimates apply to 191 plus or minus 9 of the 220 member financial institutions with associated projects completed as of December 31, 1992, at the 95-percent confidence level.

[a]The number in parentheses is the estimated number of member financial institutions.

[b]At the 95-percent confidence level, estimates apply to between 120 and 161 of the 220 member financial institutions with associated projects completed as of December 31, 1992.

[c]Sampling error computations are not exact due to characteristics of the sample results.

[d]At the 95-percent confidence level, estimates apply to between 60 and 98 of the 220 member financial institutions with associated projects completed as of December 31, 1992 (those members who reported that they are planning to increase their participation in AHP in 1995).

[e]We were unable to compute sampling errors because we did not observe any variation in our sample.

Source: GAO's analysis of its survey of FHLBank member financial institutions.

Members' AHP Application History

Member financial institutions in the FHLBank System submitted 4,585 applications for AHP subsidies from 1990 through 1993. Table V.1 shows the total number of applications from members over this time period and the total number of such applications received each year by the FHLBanks.

Table V.1: Applications for AHP Subsidies Received by the FHLBanks, 1990-93

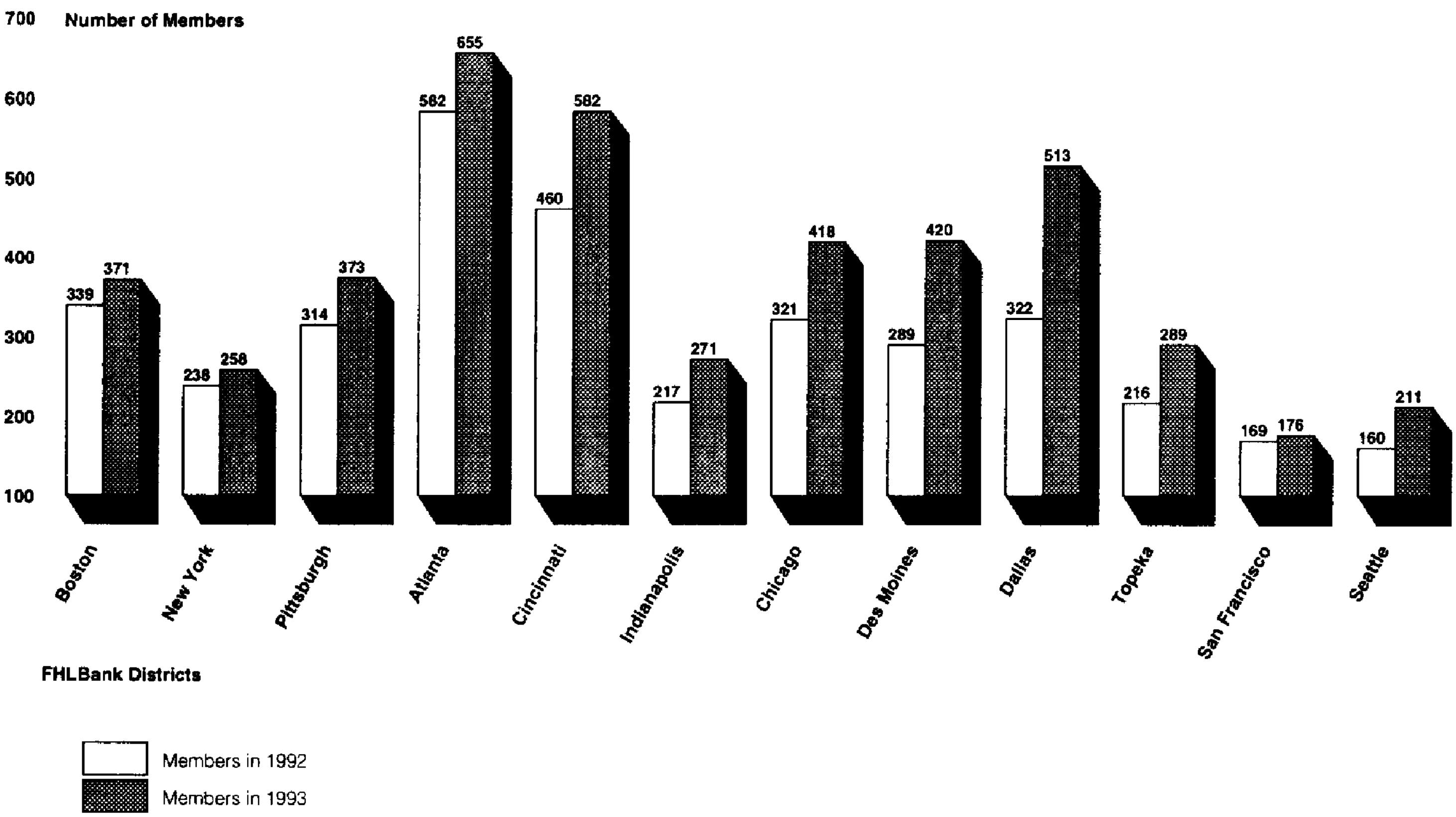
	Applications				
FHLBank	**Total**	**1990**	**1991**	**1992**	**1993**
Boston	368	108	87	100	93
New York	306	77	70	77	82
Pittsburgh	367	127	103	50	87
Atlanta	352	89	68	88	107
Cincinnati	353	78	41	75	159
Indianapolis	257	43	53	63	98
Chicago	213	37	44	49	83
Des Moines	297	57	79	63	82
Dallas	411	82	76	99	174
Topeka	170	35	47	52	36
San Francisco	412	89	93	114	116
Seattle	314	63	66	93	90
Total	4,585	875	807	923	1,207

Source: Federal Housing Finance Board.

Growth in Membership Within FHLBanks and Changes in Members' Participation in AHP

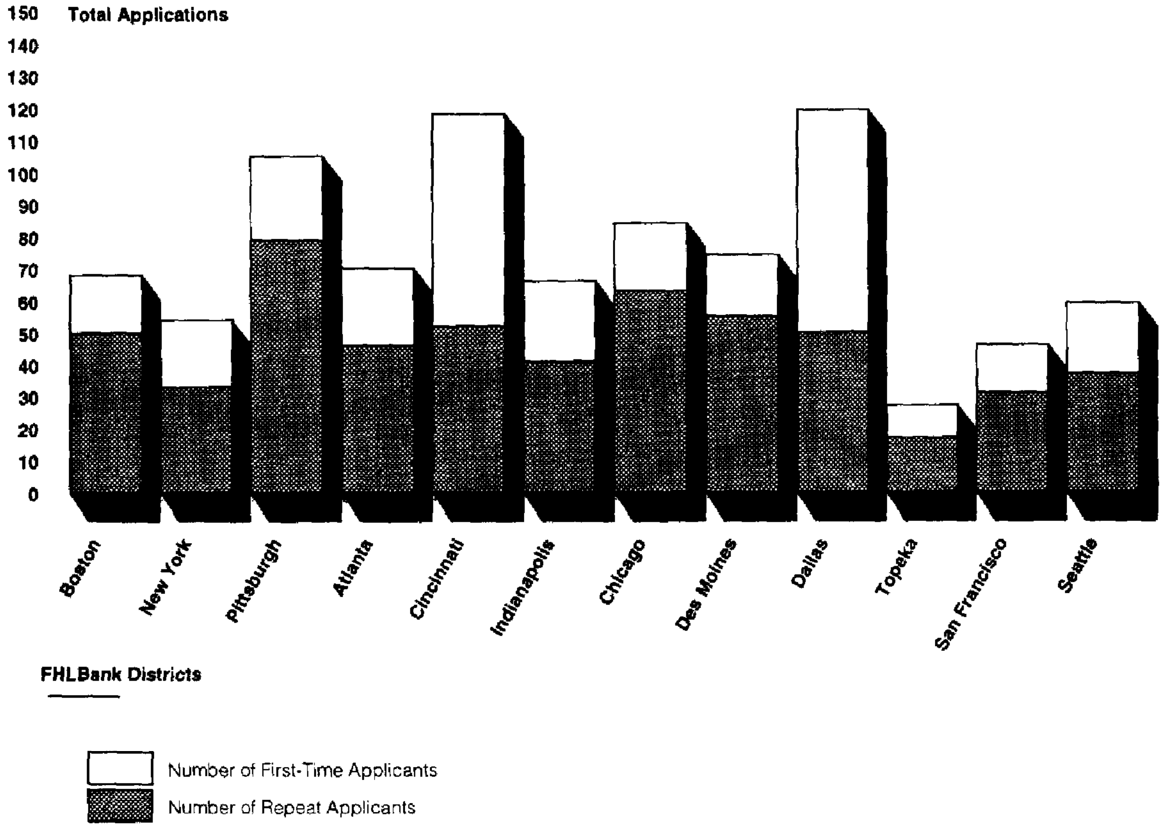
FHLBanks have been successful both in attracting new members to the FHLBank System and in increasing members' participation in the AHP. Figure VI.1 shows the growth in membership in the System from 1992 to 1993. Although this growth has been uneven from bank to bank, the membership in all but three FHLBanks grew by at least 10 percent.

Figure VI.1: Growth in Membership in the FHLBank System From 1992 to 1993



Source: GAO's Survey of FHLbanks' community investment officers and data from the Federal Housing Finance Board. Figure VI.2 compares those members applying for AHP funding for the first time in 1993 with those members that had applied previously. As this figure shows, a significant portion of AHP applications in all FHLBanks in 1993 came from first-time applicants.

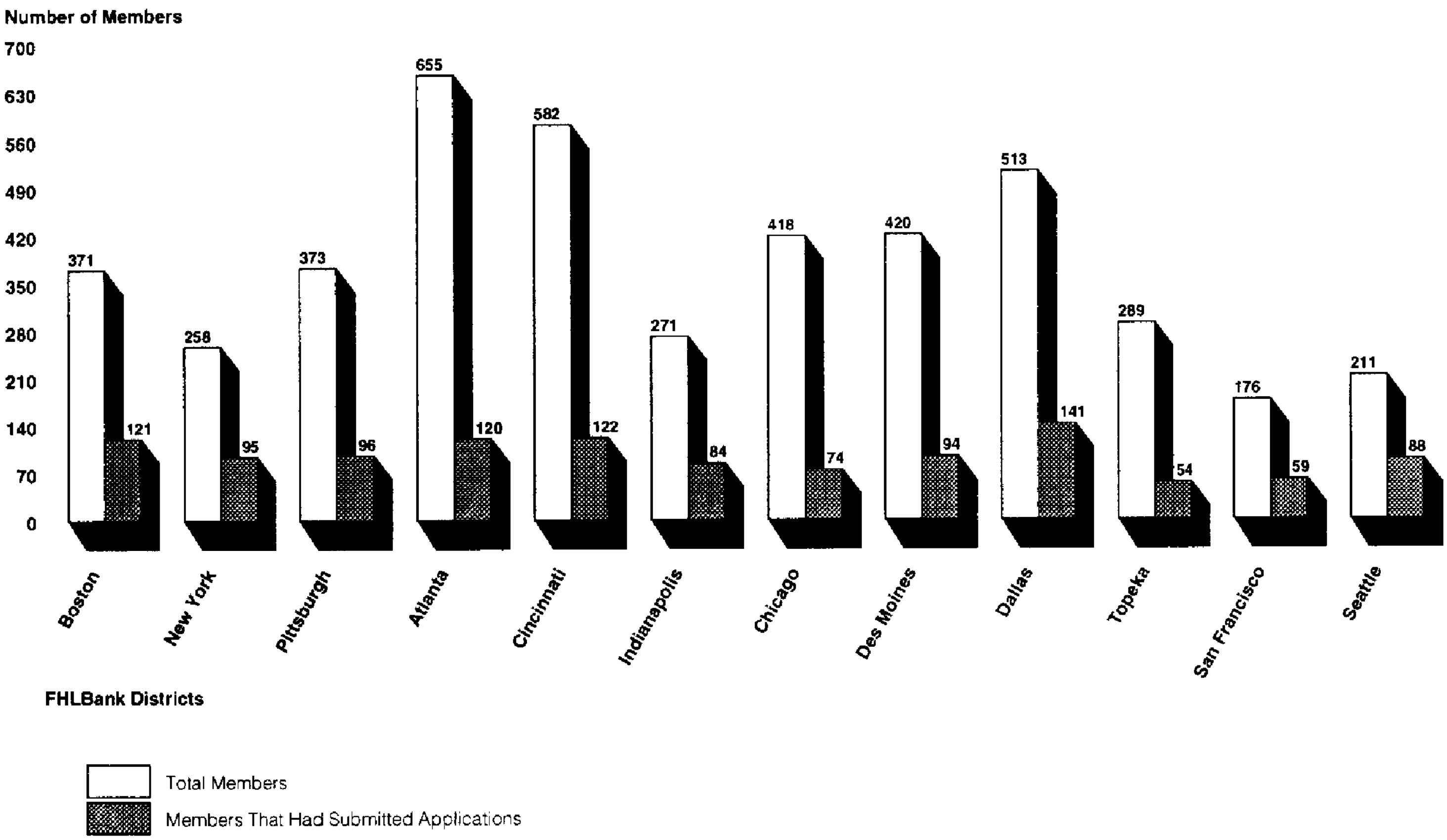
Figure VI.2: Comparison of First-Time Applicants With Repeat Applicants for AHP Subsidies in 1993, by FHLBank



Source: GAO's Survey of FHLBanks' community investment officers.

Figure VI.3 shows the number of members that have applied for AHP funding through December 31, 1993, relative to the total number of members in each FHLBank district. As this figure illustrates, some FHLBank districts have far more members than others. It is more difficult for these FHLBanks to achieve high participation rates than it is for those FHLBanks with fewer members.

Figure VI.3: Members That Had Submitted at Least One AHP Application Through December 31, 1993



Source: GAO's Survey of FHLBanks' community investment officers.

Comments From the Federal Housing Finance Board

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

Federal Housing Finance Board
1777 F Street, N.W., Washington, D.C. 20006
Telephone: (202) 408-2500 Facsimile: (202) 408-1435

May 1, 1995

Ms. Judy A. England-Joseph
Director
Housing and Community
Development Issues
Resources, Economic, and Community Development Division
United State General Accounting Office
Washington, D. C. 20548

Dear Ms. England-Joseph:

The Federal Housing Finance Board (Housing Finance Board) appreciates the opportunity to review and comment on the General Accounting Office's report on the Affordable Housing Program (GAO/RCED-95-82). We agree with the GAO's finding that the program -- in partnership with over 5,000 Federal Home Loan Bank member institutions and non-profit housing organizations -- has increased the supply of affordable housing in the United States. In addition, we support the GAO observation that an important indirect benefit of the Affordable Housing Program is that it has encouraged more lenders and sponsors to finance and develop affordable housing.

The report documents the good results achieved by the Affordable Housing Program and the significant improvements in the Federal Home Loan Banks' (FHLBanks) administration of the program. It is significant that the GAO report shows this effective young program as continuing to evolve and improve. Between 1990 and 1993, the program has contributed to financing over 62,000 units of affordable housing, has encouraged more lenders to become involved in developing affordable housing and has increased the financing capacity of housing providers. It also has met Congress's intention that it be used as a flexible source of funding for affordable owner-occupied and rental housing. Funds have been used to lower the interest rates on mortgages financing rental and owner-occupied housing, to reduce a property's purchase price, and to help with down-payments and closing costs. The report also highlights some of the issues already identified by the Housing Finance Board through its examination activities and the steps that are being taken, including the proposed revision to the Affordable Housing Program regulations, to address those issues.

See comment 1.

See comment 2.

While in general, the Housing Finance Board agrees with GAO's conclusions, in discussing the subsidy calculation issue, the report does not adequately communicate the technical complexity involved in the determination of the appropriate amount of subsidy required for an Affordable Housing Program subsidized advance, particularly in light of how the FHLBank System traditionally finances advances. The Housing Finance Board recognizes that the regulation governing this issue has ambiguities and is in the process of developing revised regulations that will provide greater clarity for the FHLBanks.

Finally, while we agree that modification to the Affordable Housing Program regulation is not possible due to the absence of a quorum at the Housing Finance Board, we do not believe that lack of a quorum has caused a delay in enforcement of the program's existing regulations.

Again, we appreciate the opportunity to provide written comments on your report.

Sincerely,

Nicolas P. Retsinas
Nicolas P. Retsinas
HUD Secretary's Designee
to the Board

Lawrence U. Costiglio
Lawrence U. Costiglio
Board Member

The following are GAO's comments on the Federal Housing Finance Board's letter dated May 1, 1995.

GAO's Comments

1. We agree with the Finance Board that determining the appropriate amount of the AHP subsidy is technically complex. Specifically, our discussion in chapter 3 acknowledges the technical complexities by referring to comments made by both the FHLBanks and the Finance Board's examiners. The report further acknowledges certain legal issues concerning whether the terms and conditions of an AHP contract can be modified. Finally, our report offers an alternative for minimizing the technical problems associated with funded projects.

2. We believe our discussion in chapter 3 addresses the constraints placed upon the Board of Directors without full statutory authority imposed by the lack of a quorum. Specifically, for both systemwide and individual FHLBank compliance issues, we describe the limits of the Board of Directors to clarify current policy, formulate new policy, or finalize proposed changes to current regulations without a quorum.

Major Contributors to This Report

Resources, Community, and Economic Development Division, Washington, D.C.	Jim Wells, Associate Director Dennis W. Fricke, Assistant Director William F. Bley, Assignment Manager Alice G. Feldesman, Assistant Director Carolyn M. Boyce, Senior Social Science Analyst Patrick B. Doerning, Senior Operations Research Analyst Sara Ann Moessbauer, Senior Operations Research Analyst
New York Field Office	Alice L. London, Senior Evaluator-in-Charge
Los Angeles Field Office	Gary N. Hammond, Site Senior Evaluator Marco F. Gomez, Staff Evaluator James C. Geibel, Social Science Analyst
Office of the General Counsel	John T. McGrail, Senior Attorney

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