



REGULATORY INTERPRETATION 1999-RI-07

Date: March 3, 1999

Subject: Federal Home Loan Bank Authority to Issue Standby Letters of Credit In Conjunction With Tax-Exempt Bonds or Notes, Including School Construction Bonds

Request Summary:

A Federal Home Loan Bank (FHLBank) has requested that the Federal Housing Finance Board (Finance Board) determine whether an FHLBank has the authority under recently promulgated Finance Board regulations, to issue standby letters of credit (SLOCs) in conjunction with tax-exempt bonds or notes. Specifically, the FHLBank has requested confirmation that under the recently adopted Finance Board Regulation on SLOCs, the FHLBank would have authority to issue SLOCs in conjunction with tax-exempt bonds or notes when the issues are designed to promote housing or the financing of commercial and economic development activities that benefit low- and moderate-income families, or that are located in low- and moderate-income neighborhoods. In addition, the FHLBank requests confirmation that it could issue a confirming letter of credit on behalf of a member that provides a letter of credit for the benefit of bondholders in conjunction with a tax-exempt school construction bond issuance. According to the FHLBank, issuance of the confirming letter of credit would enable bond rating agencies to issue a triple "A" rating on the bond, as well as provide an additional guarantee of payment to the bondholders.

Analysis and Interpretation:

The Finance Board's former Interim Policy Guidelines For FHLBank Standby Letters Of Credit (SLOC Guidelines), Resolution Number 93-63, dated July 28, 1993, provided that the FHLBanks could issue or confirm SLOCs, on behalf of member institutions, "in conjunction with tax-exempt bonds or notes, only when the issues are designed to promote housing or the financing of commercial and economic development activities that benefit low- and moderate-income families, or that are located in low- and moderate-income neighborhoods." That is, the purpose of the tax-exempt bonds or notes had to be the financing of housing or commercial and economic development activities eligible for funding under the Banks' Community Investment Program (CIP). *See* 12 U.S.C. § 1430(i).

On November 23, 1998, the Finance Board adopted a final regulation (SLOC Regulation), that codified and amended the SLOC Guidelines to allow for broader use of SLOCs by members and eligible nonmember mortgagees and eliminated or modified some of the restrictions that had been imposed on the SLOCs issued or confirmed by the FHLBanks. *See* 68 Fed. Reg. 65693 (Nov. 30, 1998). The Finance Board rescinded the SLOC Guidelines after the SLOC Regulation was adopted. *See* Resolution No. 98-50 (Nov. 23, 1998).

Section 938.2(a) of the SLOC Regulation provides that:

Each [FHL]Bank is authorized to issue or confirm on behalf of members standby letters of credit that comply with the requirements of this part, for any of the following purposes:

- (1) To assist members in facilitating residential housing finance;
- (2) To assist members in facilitating community lending that is eligible for any of the [FHL]Banks' CICA programs under part 970 of this chapter;
- (3) To assist members with asset/liability management; or
- (4) To provide members with liquidity or other funding.

See 63 Fed. Reg. 65693, at 65699-65700 (*to be codified at* 12 C.F.R. § 938.2(a)). Where a member issues an SLOC to support a tax-exempt bond or note issuance, a FHLBank's issuance on behalf of the member of a confirming SLOC enables the transaction to receive a triple "A" rating from the bond rating agencies, lowering the interest rate paid on the bonds or notes and reducing the cost of the bond issuance. Therefore, the FHLBank's issuance of a confirming SLOC assists the member in facilitating the financing purpose for which the bond or note was issued. Moreover, the preamble to the SLOC Regulation states that "a [FHLBank] LOC may be issued to support the issuance of bonds." *See* 63 Fed. Reg. 65693, at 65696. Accordingly, under section 938.2(a)(1) and (2), a FHLBank may issue a confirming SLOC on behalf of members in conjunction with tax-exempt bonds or notes, provided the bonds or notes are issued for the purpose of "residential housing finance" or "community lending."

The Community Investment Cash Advance Programs Regulation (CICA Regulation) provides the FHLBanks with an array of specific standards for projects, targeted beneficiaries, and targeted income levels that the Finance Board has determined support "community lending" under all CICA programs, including the CIP. *See* 63 Fed. Reg. 65536 (Nov. 27, 1998). Specifically, section 970.3 of the CICA Regulation defines "community lending" to mean "providing financing for economic development projects for targeted beneficiaries." *See* 63 Fed. Reg. 65536, at 65546. "Economic development projects" are defined in section 970.3 as:

- (1) Commercial, industrial, manufacturing, social service, and public facility projects and activities; and
- (2) Public or private infrastructure projects, such as roads, utilities, and sewers.

"Targeted beneficiaries" are defined in section 970.3 as beneficiaries determined by the geographical area in which a project is located, by the individuals who benefit from a project as employees or service recipients, or by the nature of the project itself, as further set forth in the CICA Regulation. *See* 63 Fed. Reg. 65536, at 65547.

Thus, economic development activities that are financed by tax-exempt bonds or notes and that benefit low- or moderate-income families would have to be one of the types of eligible "targeted beneficiaries" set forth in section 970.3 of the CICA Regulation in order to qualify as "community lending" for purposes of the SLOC Regulation. Economic development activities located in low- and moderate-income neighborhoods (*i.e.*, neighborhoods with an area median income of 80 percent or less) would be targeted beneficiaries for purposes of the CICA Regulation.¹

¹ Under section 970.3 of the CICA Regulation, a "targeted beneficiary" includes projects "located in a neighborhood with a median income at or below the targeted income level," and "targeted income level" is defined to include neighborhoods with an area median income of 80 percent or less. *See* 63 Fed. Reg. 65536, at 65547.

School construction would qualify as an “economic development project” under section 970.3 of the CICA Regulation since it is a public facility project. Therefore, if the school construction project being financed by the tax-exempt bond qualifies as a “targeted beneficiary” for purposes of the CICA Regulation as discussed above, it would qualify as “community lending” for purposes of the SLOC Regulation. Accordingly, the FHLBank would have the authority, under the Finance Board’s regulations, to issue, on behalf of a member, a confirming SLOC in conjunction with a tax-exempt bond financing such school construction.

If you have any further questions, please call Deborah F. Silberman, General Counsel, at (202) 408-2570.

This is a Finance Board regulatory interpretation within the meaning of the Procedures for Requests and Applications adopted by the Board of Directors of the Finance Board pursuant to Resolution Number 98-51, dated October 28, 1998. The regulatory guidance set forth herein may be relied upon subject to modification or rescission by action of the Board of Directors of the Finance Board.

