

# Banking On Communities

FEDERAL HOME LOAN BANK OF SAN FRANCISCO

Issue One — Volume Six — Fall 2005

## GSE Reform Legislation Passed by the House, Poised to Move Through Congress

By Dwight Alexander, Vice President

Legislation to change oversight and regulation of the housing Government Sponsored Enterprises (GSEs) moved slower than expected on Capitol Hill this year, but remains a possibility to be enacted sometime in the 109th Congress.

A GSE reform measure passed in the House of Representatives, while the Senate Banking Committee approved its version of GSE reform. The full Senate is expected to consider the bill in 2006. The legislation

would establish a new regulator for the Federal Home Loan Banks (FHLBanks), as well as Fannie Mae and Freddie Mac.

Momentum for enacting legislation, which was fueled by accounting problems at Fannie Mae and Freddie Mac a year ago, seemed to slow as Congress dealt with other issues, such as rebuilding in the Gulf Coast after Hurricane Katrina, the war in Iraq, and filling two Supreme Court vacancies. Moreover, it also became clearer that the

two current regulating bodies—the Federal Housing Finance Board and the Office of Federal Housing Enterprise Oversight—were capable of responding to the new challenges.

“We certainly think that our current regulator has stepped up to the plate and done its job efficiently,” said Dean Schultz, President and Chief Executive Officer of the Federal Home Loan Bank of San Francisco (FHLBank San Francisco). “It will be up to the Congress and the

administration to decide if, and when, change is required. The fact that the GSEs are registering with the Securities and Exchange Commission (SEC) has also given more confidence to the investors and the regulators that government oversight of the GSEs is adequate.”

Brian Riedl, a senior fellow at The Heritage Foundation, a conservative Washington think tank, said that “the legislative agenda was clearly different after Katrina than it was before.” He said that many

issues high on the legislative agenda in June and July were postponed while others, like reform of the GSEs, had more time to be debated.

Throughout debate of the legislation, supporters of the FHLBanks have maintained that the FHLBanks need to be regulated differently than the other GSEs because of their structure and mission. The FHLBanks, for instance, are private rather than publicly held companies. Moreover, the main business activity of the

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## FHLBanks Meeting the Needs of Community Lenders

Dean Schultz, President and CEO



Dean Schultz

For more than 70 years, the Federal Home Loan Banks (FHLBanks) have helped families and individuals of all income levels enjoy the American dream of homeownership by providing their member financial institutions with low-cost funding that enables them to serve their communities more effectively.

Some question whether the FHLBanks are still relevant today, when homebuyers have so many mortgage financing options available to them. But there is resounding

evidence that the FHLBanks are needed now, more than ever, to help community lenders, both large and small, meet the challenges confronted by their customers.

Consider that advances from the FHLBanks to their member institutions increased from \$161 billion in 1996 to \$564 billion by the end of 2004. Once savings institutions, community banks, and credit unions obtain our advances, they are in a better position to provide mortgage, small business, and economic development loans to the communities they serve. These figures represent far more than numbers to the families, individuals, and businesses that obtain credit from FHLBank member institutions.

What separates the FHLBanks from the rest of the mortgage finance industry is our unique ability to enable local lenders the flexibility to shape loan products that will meet the credit needs of their communities. The FHLBanks bring

real meaning to the term “community lenders” because our advances empower lenders to provide the right products and services to their communities.

How do we accomplish this?

Our member institutions pledge mortgage loans and other eligible loans as collateral to support advance borrowings from the FHLBanks. This allows the lenders to use the funds advanced from the FHLBanks to make more mortgages and other loans, which in turn can be used as collateral to borrow more advances. This cycle creates liquidity for the lenders. As a result, FHLBank member institutions can operate as portfolio lenders, meaning that they keep the loans they originate on their books, rather than selling them all into the secondary market.

This process is the foundation of the FHLBank System. By holding loans

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## Congressional Corner Q&A with U.S. Representative Jim Gibbons

*This is another in a series of interviews with senators, representatives, and other public officials who play significant roles in helping to keep housing affordable for the constituents of the Federal Home Loan Bank of San Francisco.*

Rep. Jim Gibbons (R-NV) was first elected to Congress in 1996; he is now serving his fifth term representing Nevada's 2nd Congressional District. His district encompasses 100,000 square miles, or about 97% of the state. A decorated Air Force combat pilot, Rep. Gibbons is a veteran of the Vietnam and Persian Gulf wars. He serves on the House Resource Committee, where he is Chairman of the Energy and Mineral Resources Subcommittee, the Armed Services Committee, and the Committee on Homeland Security.

**Q** What is the most important housing issue in the United States today?

**A** One of the most important housing issues facing our country is the affordability of purchasing a home today.



Representative Jim Gibbons

While growth rates in the U.S. economy have been consistently stable, prices for housing have increased due to a higher demand. As a result, prices for homes in many parts of the country have been rising—making it more difficult for first-time homebuyers to afford the American Dream, their own home.

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# FHLBank San Francisco Helps Communities



Senator Dianne Feinstein cuts the ribbon with state and local officials at the new International Hotel grand opening.

## Checking into the International Hotel

The Federal Home Loan Bank of San Francisco (FHLBank San Francisco) joined U.S. Senator Dianne Feinstein (D-CA) for the grand opening, ribbon-cutting ceremony of the International Hotel in San Francisco on August 26. The hotel is located in a 10-block corridor once known as Manilatown, home to 20,000 Filipino immigrants.

The Bank contributed \$829,000 through an Affordable Housing Program grant to assist in the construction financing of this new building. Bank of America California was the sponsoring member for the award.

The International Hotel was last open for business 28 years ago. More than 50 Filipino immigrants were evicted from the hotel in 1977. It remained vacant for years and was then demolished as part of a city redevelopment plan. The new hotel, home to a Filipino Cultural Center and a community center, pays homage to those evicted from the hotel with etchings on the interior glass throughout the building depicting the immigrants' strife.

Gordon Chin, Executive Director of the Chinatown Community Development Center in San Francisco, was a community activist and part of the public protest that took

place when the International Hotel was closed. He spoke at the ribbon-cutting to a



View of the new International Hotel from Portsmouth Square in San Francisco's Chinatown.

crowd of 300 people, proclaiming a long-awaited victory, "I waited 26 years to say these six words: Welcome to the new International Hotel!"

The new \$28 million, 15-story building has 104 studio and one-bedroom apartments for low-income seniors. Each apartment is handicapped-accessible and has roomy bathrooms and kitchenettes. The building also has meeting rooms for educational programs and a rooftop garden with scenic views of the bay.

Occupants, who began moving into the building in October, are selected by lottery from more than 7,500 people seeking housing. Twelve people who lived in the original International Hotel will be among the first occupants.

## Homebuyer Fairs

The FHLBank San Francisco held a series of homebuyer fairs in California with Rep. Brad Sherman (CA-27th) in Woodland Hills, Rep. Barbara Lee (CA-9th) in Oakland, Rep. Jim Costa (CA-20th) in Fresno, and Rep. Adam Schiff (CA-29th) in Alhambra.

Passport to Homeownership: A First-Time Homebuyer Fair helps prospective homebuyers understand the many

facets involved in buying their own home. Homebuyers have numerous financing options, and their choices can significantly influence the cost of their mortgages.



The fairs are part of the FHLBank San Francisco's continuing interest in promoting financial literacy so that individuals can make well-informed financing decisions when they buy or refinance a home.

## Realtor Education

Working with the Fresno Association of Realtors, the FHLBank San Francisco hosted a Realtor Education Breakfast prior to the Fresno Passport to Homeownership. The focus of the seminar was to provide realtors with the latest information on programs geared toward first-time homebuyers. Participants included Citibank, Washington Mutual, California State Housing Finance Agency, The City and County of Fresno, Acorn Housing, and ByDesign Financial Solutions.

## GSE Reform Legislation

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FHLBanks is to advance funds to their member financial institutions, which use the mortgage loans they originate as collateral. This allows members to set loan requirements to meet the needs of their communities because these mortgages are held in portfolio rather than sold to the secondary market. As a result, FHLBank members originate a higher percentage of loans to minorities, low-income communities, and households headed by women. By contrast, Fannie Mae and Freddie Mac purchase mortgages from lenders, and those loans have to fit standardized secondary market guidelines.

The GSE reform bills making their way through Congress reflect the FHLBanks' unique characteristics and mission. The House-passed and Senate Banking Committee-approved bills both maintain

the FHLBanks' status as cooperative organizations that provide low-cost funds for their members because of the FHLBanks' relationship to the federal government. Both bills also include one of the FHLBanks' highest priorities—making sure there are separate supervisory divisions for the FHLBanks and the other housing GSEs. This will ensure that regulators are not distracted by the needs of the other housing GSEs, which, because of their size and structure, often face more challenging problems. Separate supervisory divisions will make that possible and allow the FHLBanks to continue to serve their members appropriately.

Another priority—separate assessment funds—is also still very much in play. Funds obtained from the FHLBanks should be used for regulating the FHLBank System, and not the other GSEs. Anything less would short-change the

FHLBanks and their members. The House Financial Services Committee report on the House legislation said assessments from the FHLBanks and other GSEs should be kept separate to the maximum extent possible.

A third priority—required information-sharing among the FHLBanks—is contained in the bill the House passed and continues to be discussed seriously by the Senate. It is important that each FHLBank within the FHLBank cooperative have an accurate picture of the financial status of the other FHLBanks. This seemingly technical issue is important to ensure proper transparency within the FHLBank System. The FHLBanks are legally tied to each other by their joint and several liability for FHLBank System debt. Their ability to operate soundly and to provide uniformly available low-cost mortgage credit depends in part on each FHLBank

having some access to the financial information of the other FHLBanks.

In keeping with the requirements imposed on public companies by the Sarbanes-Oxley Act, the FHLBank San Francisco supports the current requirement that independent directors should be a part of the board of directors of each FHLBank. After a floor amendment from Rep. Paul Kanjorski (D-PA), the House bill generally maintains the current status and number of independent directors, and the

Senate bill provides for fewer independent directors.

"Independent directors have the appropriate expertise and experience in housing and community development that allow them to represent the Banks' interest and the communities each member institution serves," said Lawrence Parks, Senior Vice President of External and Legislative Affairs at FHLBank San Francisco. "This will help us continue to achieve our mission and meet the legal requirements imposed on the Banks' activities."

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# Member Profile: Community Commerce Bank

By Jim Yacenda, Vice President

Community Commerce Bank (CCB) is a Federal Home Loan Bank of San Francisco (FHLBank San Francisco) member institution with a deep commitment to improving the lives of the people it serves. It specializes in rebuilding the inner cities of Southern California while meeting the credit needs of historically underserved communities.

As a state-chartered industrial loan company with six branches throughout Southern California and two in Northern California, CCB specializes in real estate loans, auto loans/contracts, and other asset-based financing, such as non-conforming and mixed-use property loans. By offering FDIC-insured Statement and Term accounts, CCB uses these deposit accounts and FHLBank

San Francisco financing to make loans to families and small business owners who typically do not meet the requirements of larger commercial institutions.

Founded in 1976 and headquartered in Los Angeles, CCB serves as an integral part of its 36 year-old parent company, TELACU Industries, Inc. TELACU is an organization that directly supports the creation of sustainable and self-sufficient, for-profit enterprises throughout Southern California. CCB serves as an important source of financial strength for TELACU's mission to provide greater business and educational opportunities through the creation of new jobs, responsive financial institutions, expanding businesses, quality affordable housing, and educational

opportunities for young people and veterans.

After joining FHLBank San Francisco in 1997, CCB's access to a lower cost of funds increased its ability to provide lower rates to borrowers and higher returns to investors. As of September 30, 2005, the amount of advances outstanding from FHLBank San Francisco was equivalent to approximately 20% of CCB's assets.

Since its inception, CCB has funded nearly \$1.5 billion in loans and is a model of a successful, community-based lender. Nearly half of its lending volume has been generated in low- to moderate-income and minority neighborhoods.

"It's been a very good relationship with the Federal Home Loan Bank," said Bill Lasher, President of CCB.

"Since joining the Bank, we've been able to further assist businesses and investors who are dedicated to improving inner city communities."

CCB's success as a model for inner city lending is attributed to its award-winning Purchase/Rehabilitation Loan program, which provides affordable housing opportunities while rebuilding disadvantaged neighborhoods. Recently awarded the California Reinvestment Excellence Award for its significant impact on rebuilding urban communities, CCB's Purchase/Rehabilitation program ensures that adequate funds are provided to borrowers not only for the purchase of residential property in low-income neighborhoods, but also for necessary structural renovations. Under this program, CCB typically

lends up to 70% of the estimated post-construction value of the property.

"In communities, when a property becomes abandoned, it often becomes a threat to the quality of life for an entire neighborhood as a haven for the homeless and drug dealers. Our program allows investors to purchase and rehab these properties, and thus eliminate these threats," said Mr. Lasher.

Mr. Lasher also noted that CCB's success is due to relationships with its investors, the FHLBank San Francisco, and perhaps most importantly, the customers served.

"As a committed community partner," he said, "we know our borrowers well. It's a win-win situation for the neighborhood, our investors, and the institution."

## FHLBanks Meeting Needs

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in portfolio, lenders retain and expand their long-term relationships with customers and directly invest in their communities. Portfolio lenders also have greater flexibility and control over underwriting decisions; they can adjust their lending criteria to meet the needs of the communities they serve.

For example, California's Central Valley is an area dominated by agriculture, family farmers, farm workers, and small businesses. This community needed a bank that could understand and meet the diverse credit needs of its agriculture-dependent economy, which was characterized by cyclical incomes and large new immigrant populations. So in 1981, local farmers and business leaders founded Valley Independent Bank to be responsive to the needs of Central Valley residents.

Since joining the Federal Home Loan Bank of San Francisco in 1998, Valley Independent Bank has relied on the flexible, low-cost funding we provide to meet the needs of its diverse service region. According to founding President Dennis Kern, membership in the Federal Home Loan Bank of San Francisco allowed Valley Independent Bank to fund mortgage and business loans for new immigrants, family farmers, and seasonal workers, as well as

for housing developments, shopping and retail centers, leisure facilities, and commercial and industrial properties. Valley Independent Bank (now Rabobank) has grown to over \$2 billion in assets, and its service area stretches from the U.S.-Mexico border to Fresno, California, 500 miles to the north. This growth, which reflects the institution's ability to meet the unique credit needs of the communities it serves, was made possible, in part, by the Federal Home Loan Bank of San Francisco.

The advances that Rabobank borrows from the Federal Home Loan Bank of San Francisco today enable it to continue to make these loans at attractive rates, encouraging economic growth and development in surrounding communities. Many of these loans are considered non-conforming because they do not conform to standardized underwriting criteria that would make them eligible for sale in the secondary market

Often it is not the size of a loan that makes it non-conforming, but other characteristics, such as the use of non-standard underwriting criteria like "character lending." The ability of a financial institution to consider intangibles, or "character lending," can mean the difference between loan approval and rejection for many individuals, families, and businesses. This is a critical factor enabling many new immigrants with short credit

histories and self-employed workers to obtain mortgages. From the lender's perspective, the questions of character are: Who are you? How do you pay your bills? What do your employer, customers, suppliers, employees, community leaders, and/or friends say about you when called on as references? Flexible lending strategies may also include pre-loan financial and home-buyer education programs, use of specialized underwriting teams familiar with the local economy, use of joint-liability models, and individual loan structures designed to minimize risk.

Portfolio lenders lend to creditworthy borrowers who may not qualify for credit under the restrictive guidelines dictated by the secondary market. In many cases, these loans can only be made because the FHLBanks provide liquidity for them and other loans in their members' portfolios. Lending that allows the consideration of intangible factors is made possible by what we do at the FHLBanks—provide advances and credit products collateralized by the loans held in our members institutions' portfolios, allowing them to meet the credit needs of their communities by retaining control over their underwriting decisions.

This is the core business of the FHLBanks; providing liquidity for member financial institutions so they can, in

turn, address the unique credit needs of their communities.

The FHLBanks are the critical liquidity link that supports portfolio lending for mortgages, farm loans, business, and community development loans.

Portfolio lenders come in all sizes. Today, the FHLBank System's members—both large and small—serve their communities and customers in a variety of different ways—and we believe it should stay that way. We strongly believe that financial institutions of all sizes should continue to have access to membership in the FHLBank System, and that doing so makes the System more vibrant, efficient, and flexible. Large banks bring enormous economies of scale to the FHLBank System, which enable us to offer all of our member institutions far better credit pricing than would otherwise be available. This pricing advantage is of the greatest benefit to our smaller members, which have limited access to alternative sources of low-cost funds.

In today's rapidly changing financial world, where mergers and acquisitions have become commonplace, working with lending institutions of all sizes is one of the best ways to make certain that each FHLBank continues to serve its community regardless of what changes occur. Today's smaller bank, savings institution, or credit union could easily become part of a larger institution

tomorrow. Artificial rules that put limits on which institutions can be members would mean communities that for decades have had access to lower-cost mortgage and economic development loans through FHLBank members could suddenly, and needlessly, be denied access to that source of credit. Furthermore, without the liquidity provided by the FHLBanks, it is likely that many of these institutions would be forced to increase the pricing of their portfolio loans significantly or cease making them altogether.

As Congress, regulators, and the administration consider changes to the FHLBank System, every effort should be made to keep our structure intact. It is critical that both large and small financial institutions continue to have access to FHLBank System funding. Second, we must ensure that new initiatives do not discourage the use of advances as core funding for lending activities. Finally, the safety and soundness of the System must be secured by continuing to require all FHLBank members to have federal deposit insurance.

For more than seven decades, the FHLBanks have played a vital role in the nation's economy and in the unprecedented rise in homeownership. We will continue to be there for our member institutions and their customers, so that urban, suburban, and rural communities can continue to thrive.



## Congress Takes Key Steps On GSE, FDIC Reform



Lawrence H. Parks

After years of debate, the House approved a reform bill for Government Sponsored Enterprises (GSEs) this fall that creates a new regulator for the Federal Home Loan Banks (FHLBanks), Fannie Mae, and Freddie Mac.

While the fate of reform legislation is a bit more unpredictable in the Senate, it does show that maintaining safety and soundness at the GSEs remains a priority, even as Congress deals with other weighty issues, such as Katrina recovery, the war in Iraq, and filling the remaining Supreme Court vacancy.

The House legislation was a clear victory for House Financial Services Chairman Michael Oxley (R-OH) and Rep. Richard Baker (R-LA), who were able to overcome objections from the conservative members of their party who opposed creating affordable housing

funds for Freddie Mac and Fannie Mae to disburse. Many believe the need to make housing funds available to assist victims of Hurricane Katrina was a major factor in winning House approval for the legislation.

The House legislation also delivered a confidence booster to the new House Majority Leader, Rep. Roy Blunt (R-MO), who is standing in for Rep. Tom DeLay (R-TX), while he awaits trial on possible campaign finance violations. Rep. Blunt needed to show that he could push major legislation through the House, and the GSE reform bill presented him with that opportunity. Most Washington insiders that follow GSE legislation agree that he was instrumental in hammering out a compromise on the affordable housing provision.

Still, the question of whether the reform will be enacted now lies on the shoulders of Sen. Richard Shelby (R-AL), who heads the Senate Committee on Banking, Housing, and Urban Affairs. Sen. Shelby has consistently said that reforming the regulatory structure of the GSEs is a priority. However, he does not embrace some of the provisions in the House bill, including the affordable housing provisions. Sen. Shelby's desire to statutorily limit the portfolios of Fannie Mae and Freddie Mac, coupled with his

opposition of the affordable housing provisions in the House bill, put him at odds with his Democratic colleagues on the Senate Banking Committee. A key issue will be whether Sen. Shelby is willing to compromise or whether he would rather see no legislation.

What Congress and the administration ultimately decide will have a tremendous impact across the country—where the housing market remains a major contributor to the nation's economy and to local economies.

Indeed, members of Congress and economic policymakers recognize that homeownership is more important than ever before. Homeowners are a major force in America's consumer-driven economy

But, just as with GSE reform, legislation to amend regulations for the Federal Deposit Insurance Corporation (FDIC) could threaten the nation's housing finance structure and significantly slow the housing market—and with it the nation's economy.

Legislation reforming the FDIC was passed by the House in May and later included in the House reconciliation bill. A Senate version is included in a Senate reconciliation bill as well. Both the House and Senate passed reconciliation bills just before Thanksgiving. A conference on the two bills may begin in December.

The FDIC reform portion of the reconciliation bills would generally require that all banks pay a premium to the

structure to increase insurance premiums on banks that hold FHLBank advances on their books. These advances are funds that our member institutions use to help provide home mortgages in the communities that they serve. If premium costs are increased for our members, more likely than not the increase will be reflected in the prices lenders charge for home mortgages.

FHLBank advances have been critical sources of funding for community institutions that do not have direct access to the financial markets. Any burden, such as increased FDIC premiums on advances, particularly for community institutions, would be inconsistent with congressional intent. Fortunately, Rep. Baker and Sen. Tim Johnson (D-SD) have both issued written statements on the floors of their respective chambers of Congress, against the FDIC charging higher premiums on institutions that hold advances.

In both reform measures before Congress, the Federal Home Loan Bank of San Francisco's primary concern is that legislation such as GSE and FDIC reform, must allow the FHLBanks to continue doing what they do best—providing liquidity that enables member institutions to expand homeownership in America. That's what is best for the nation.

*...members of Congress and economic policymakers recognize that homeownership is more important than ever before.*

as they renovate and refurbish homes. New home construction puts people to work, and increases the housing supply. The record level of homeownership in the United States is also providing many families and individuals with increased economic security.

insurance fund based on their risks. The FHLBanks are not opposed to this concept; in general, it seeks to continue the safety and soundness of the country's banking system. But FDIC officials have clearly indicated that they will use the risk-based premium

### Q&A with Representative Jim Gibbons

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**Q** What is the most important housing issue in your district?

**A** The state of Nevada is the fastest growing state in the nation. However, rising housing prices have made it difficult for first-time buyers to purchase a home. According to a 2004 report by the U.S. Census Bureau, the cost of a median-priced home in Nevada was \$202,937—a \$60,000 increase in just four years. And the price continues to increase. Additionally, 85% of our state's land is owned by the federal government which inhibits growth and development. In order to grow, our state has to turn to the federal government and

Congress for some of the public land to be released for sale. The limited amount of land in our state greatly contributes to our rising housing costs.

**Q** What is the role of the Federal Home Loan Banks in today's housing market?

**A** The goal of the Federal Home Loan Banks is to make housing finance more accessible and affordable for millions of families across America. They provide liquidity, stability, and affordability in today's housing market, which makes the American dream of owning a home a reality for many families. I applaud this goal. It is also important that these institutions continue to focus on affordability issues to ensure that hard-working

families have the opportunity to own their own home, especially given the current trend in housing costs.

**Q** How important are financial literacy efforts?

**A** In what has to be seen as a great example of the market responding to consumer needs, lenders have developed a steady series of products and services in recent years so that those who want to borrow money have the ability to do so. Risk-based pricing and interest-only mortgages are two great examples of how, without government interference, the private sector has responded to borrowers' needs.

The additional options provided to consumers by these new products and services mean that the financial world

is more complicated than it used to be, however. It is important that consumers are informed about their options and fully understand the details and requirements of the services available. Fortunately, banks, banking associations, and many consumer groups are currently making financial literacy opportunities more available than ever before. Everyone from long-time homeowners to first-time buyers should take advantage of these educational opportunities.

**Q** How do we continue to make it possible for middle-income workers to afford a home?

**A** First and foremost, it is necessary that the federal government eliminate unnecessary and burdensome taxes

on both consumers and financial institutions. Consumers will then have the opportunity to spend their hard earned money on purchasing a home instead of paying higher tax bills. The federal government should also ensure that lending institutions are not unfairly burdened by regulations that increase their cost of doing business. Prospective homeowners depend on the services of our lending institutions, and unnecessary regulation could hinder the services provided to consumers. In Nevada specifically, we should continue to work to release the public lands that should not be held by the federal government, so that our communities can grow and provide attainable housing options for their residents.