

**FEDERAL HOUSING FINANCE BOARD****12 CFR Part 951****[No. 2006-17]****RIN 3069-AB26****Affordable Housing Program Amendments****AGENCY:** Federal Housing Finance Board.**ACTION:** Final rule.

**SUMMARY:** The Federal Housing Finance Board (Finance Board) is amending its Affordable Housing Program regulation to remove prescriptive requirements, clarify certain operational requirements, provide additional discretionary authority in certain areas, remove certain authorities, and otherwise streamline and reorganize the regulation.

**DATES:** The final rule is effective on January 1, 2007.

**FOR FURTHER INFORMATION CONTACT:**

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**SUPPLEMENTARY INFORMATION:****I. Background**

Section 10(j)(1) of the Federal Home Loan Bank Act (Bank Act) requires each Federal Home Loan Bank (Bank) to establish an affordable housing program (AHP), the purpose of which is to enable Bank members to provide subsidized financing for long-term, low- and moderate-income, owner-occupied and affordable rental housing. See 12 U.S.C. 1430(j)(1). The AHP has played an important role in facilitating Bank support of their members' efforts to meet the housing needs of their communities. The strength of the AHP lies in its capacity to leverage additional public and private resources for housing. Since the inception of the program in 1990, the Banks have awarded more than \$2.5 billion in AHP subsidies to assist nearly 472,000 housing units. Seventy percent of the units receiving AHP subsidies were for very low-income households. AHP subsidies have proven effective in

financing projects that present underwriting challenges, such as projects for the homeless and special needs populations, which may include persons with disabilities and the elderly. The AHP also has been used effectively in conjunction with Low-Income Housing Tax Credits (LIHTC or tax credits), which are important funding sources for rental housing for very-low income households.

The AHP also serves as an important resource for low- or moderate-income homeowners and first-time homebuyers. From 1990 through 2005, the program assisted in the financing of over 126,000 owner-occupied units under the Banks' competitive application programs, and over 47,000 units under their homeownership set-aside programs. Some of the units address specific housing needs, such as expanding homeownership opportunities for underserved households.

**II. Proposed Rule**

The Finance Board's regulation implementing the AHP provisions of the Bank Act is codified at 12 CFR part 951. The regulation generally has reflected a prescriptive approach, which was appropriate for rules implementing a newly created program. As the program has matured, the Finance Board periodically has revised the AHP regulation, to provide greater authority to the Banks in managing their individual programs and codify lessons learned through oversight of the Banks' operation of their programs. The Finance Board believes, based in part on its review of the AHP on a System-wide level, *Report of the Horizontal Review of the Affordable Housing Programs of the Federal Home Loan Banks* (March 15, 2005) (Horizontal Review), that there are a number of areas in which it can revise the regulation to provide for additional enhancement of the program.<sup>1</sup> Accordingly, on December 28, 2005, the Finance Board published proposed amendments to the AHP in the **Federal Register** for a 120-day comment period, which closed on April 27, 2006. See 70 FR 76938 (Dec. 28, 2005). The Finance Board received a total of 59 comment letters on the proposed rule, representing 61 commenters.<sup>2</sup> Commenters included: All 12 Banks; 4 Bank Affordable Housing Advisory Councils; 3 Bank members; 13 trade associations; 9 not-for-profit housing developers; 5 housing advocacy and

assistance organizations; 3 State housing finance agencies; 3 for-profit housing developers; 3 community development financial institutions; 3 individuals; 2 wholesale financial intermediary and assistance organizations; and 1 secondary market entity for home purchase and rehabilitation mortgages. The Finance Board has considered all of the comments it received on the proposed rule, and has determined to adopt a final rule amending the AHP, with a number of revisions to the proposed rule, as further discussed below. Comments received that were relevant to the issues raised in the proposed rule are discussed below. Comments that raised issues beyond the scope of the proposed rule are not addressed in this final rule, but may be considered by the Finance Board at a future date.

**III. Analysis of the Final Rule**

As discussed in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, the amendments to the AHP regulation are intended to address the following principal changes.

1. The final rule incorporates additional definitions into the regulation at § 951.1. These definitions establish the precise meaning of key terms that are used in the regulation.

2. The final rule reorganizes the regulatory text so that operational provisions relating to the competitive application program and the homeownership set-aside program, respectively, are fully contained within separate sections of the regulation. Section 951.5 addresses the competitive application program, while § 951.6 addresses the homeownership set-aside program. The reorganization is intended to make it easier for program sponsors and other interested parties to understand the individual operation of the competitive application and homeownership set-aside programs.

3. The final rule authorizes the Banks, in their discretion, to provide AHP direct subsidies under the competitive application program for eligible projects and households involving both the lending of the subsidy and subsequent re-lending of subsidy principal and interest repayments by a revolving loan fund. This change is intended to expand the eligible means of supporting affordable housing through the program.

4. The final rule specifies the conditions under which a Bank, in its discretion, may provide AHP subsidy under the competitive application program to loan pools. This change is intended to provide additional clarity for Banks that may wish to use such

<sup>1</sup> The Horizontal Review is available on the Housing Programs page of the Finance Board's Web site: <http://www.fhfb.gov/Default.aspx?Page=47>.

<sup>2</sup> Letters from 2 of the Banks also incorporate the comments of those Banks' respective Affordable Housing Advisory Councils.

funding vehicles to support affordable housing through the program.

5. The final rule eliminates the existing discretionary authority for a Bank to prohibit applications for AHP subsidy for projects located outside a Bank's district. This change is in response to the expansion of interstate banking, which has resulted in many Bank members operating in markets outside a Bank's district boundaries. However, in response to comments received, the final rule retains the current discretionary scoring preference for in-district projects under the First District Priority, and continues to allow a Bank to adopt such a scoring preference under its Second District Priority.

6. In response to comments received, the final rule retains the Banks' current authority to draw on AHP funds from the subsequent year to fund the current year's AHP, but limits the amount that may be drawn to an amount up to the greater of \$2 million or 20 percent of the Bank's annual required AHP contribution for the current year, which the Bank would deduct from the annual required AHP contribution for the subsequent year. This change responds to the fact that Banks have, at times, found this authority to be useful for addressing housing needs in their districts.

7. The final rule removes provisions in the regulation that would increase annually the maximum allowable dollar amount of a Bank's allocation to its homeownership set-aside program, and maximum allowable dollar amount drawn on the subsequent year's allocation under a Bank's homeownership set-aside and competitive application program, based on the annual inflation rate. This change addresses the potential for inflation to increase the allocation of AHP contributions to the homeownership set-aside program relative to the competitive application program.

8. The final rule replaces certain prescriptive monitoring requirements in the current regulation, which detail specific monitoring and control processes with which a Bank must comply, with broadly stated monitoring objectives to be accomplished through the Bank's adoption and implementation of written monitoring policies for its competitive application and homeownership set-aside programs.

These principal changes relative to the current rule, and other provisions of the final rule, including significant changes from the proposed rule, are discussed in greater detail below.

#### *A. Definitions: § 951.1*

Consistent with the proposed rule, the final rule revises certain of the existing AHP definitions and defines a number of other terms that are used throughout the regulation. See 12 CFR 951.1. New definitions are discussed below in the context of specific regulatory requirements. The more substantive changes are described below.

*Affordable.* Consistent with the proposed rule, the final rule revises the existing definition of "affordable" by adding a reference, consistent with the AHP statutory term, to "rent charged to a household," which is defined to mean the rent that is actually paid by the household occupying the unit. See 12 U.S.C. 1430(j)(13)(D). The change clarifies the existing regulatory language, which could be read to mean the amount of rent charged by the owner for the unit, which would be greater than the rent actually paid by the occupants if the occupants receive financial assistance for rent payments from other sources. One commenter supported the proposed revision, noting that the change acknowledges an important distinction between unit rent and the household's rent payment.

The final rule also adds a new paragraph (2) to address rents charged for units that are subsidized with low-income housing assistance under the Department of Housing and Urban Development (HUD) Section 8 program, see 42 U.S.C. 1437f, as well as rents under other assistance programs that are charged in the same way as under the Section 8 program. This provision is intended to clarify that rents charged to a household under such programs will be deemed to be "affordable" for AHP purposes, even if the rent increases after initial occupancy, if the rent complied with the AHP definition of "affordable" upon initial household occupancy and thereafter the household continues to be assisted through the program. This provision is applicable for purposes of the annual adjustment of targeting commitments after initial occupancy under § 951.7(a)(5) of the final rule (which is re-designated from current §§ 951.10(d) and 951.11(b)).

The proposed rule would have applied this paragraph (2) only to the Section 8 program. Several commenters supported the change, with 1 commenter adding that the United States Department of Agriculture (USDA) Rural Rental Assistance Program, at 7 CFR part 3560, charges rents in the same way as Section 8, and recommending that rents under that program be included in the AHP provision. The Finance Board believes

that the commenter's suggestion has merit, and that the provision should include not only rents under the USDA program, but rents under any other assistance program that are charged in the same way as under the Section 8 program. Accordingly, the final rule adopts the proposed language as expanded to include rents under other assistance programs that are charged in the same way as under the Section 8 program.

*AHP project.* Consistent with the proposed rule, the final rule adds a new definition—"AHP project"—that applies to both owner-occupied and rental projects that have been awarded or have received AHP subsidy through the competitive application program. This is intended to codify existing practice and clarify that the term "project" does not apply to direct subsidies, *i.e.*, grants, to households made pursuant to the homeownership set-aside program. The term applies to both single-family and multifamily projects. Consistent with the proposed rule, the final rule also makes conforming changes to the definitions of "owner-occupied project" and "rental project." Several commenters supported the proposed changes.

*Low- or moderate-income household and very low-income household.* Consistent with the proposed rule, the final rule amends the household-size adjustment provisions in paragraph (3) of the existing definition of "low- or moderate-income household" (and similarly for the definition of "very low-income household") by changing the household-size adjustment from an optional to a mandatory requirement, provided that if the source for the area median income data has no methodology to adjust the household income limit for household size, the Bank is not required to make such an adjustment. The existing regulation defines "low- or moderate-income household" to mean a household that has an income of 80 percent or less of the median income for the area, with the income limit adjusted for family (*i.e.*, household) size, in a Bank's discretion, in accordance with the methodology of the applicable median income standard. The change in the final rule is intended to bring the AHP into conformance with other federal programs that adjust for household size. Several commenters supported the proposed change, stating that it would ensure consistency when the AHP is used with other federal programs.

As discussed below, the final rule, consistent with the proposed rule, also relocates certain provisions of the existing definitions relating to when a

household's income must be determined, to §§ 951.5(c)(1)(i) and (ii) and 951.6(c)(2)(i) for the competitive application program and the homeownership set-aside program, respectively.

*Median income for the area.*

Consistent with the proposed rule, the final rule removes the language "for purposes of that entity's housing programs" in the existing definition of "median income for the area," which will enable the Finance Board to approve, upon a Bank's request, median income standards from sources, such as the U.S. Census Bureau, that publish median income data but do not have their own housing programs. The existing definition lists a number of median income standards that a Bank may adopt for purposes of determining household income eligibility. See 12 CFR 951.1. The regulation also provides that a Bank may request Finance Board approval for use of a median income for any definable geographic area, as published by a federal, state, or local government entity for purposes of that entity's housing programs. One commenter supported the change, citing the additional flexibility it would provide.

*Owner-occupied project and rental project.* The final rule adopts the proposed amendments to the existing definitions of "owner-occupied project" and "rental project" by clarifying that they apply only to the competitive application program, and by deleting language requiring the project to involve "the purchase, construction, or rehabilitation" of owner-occupied housing or rental housing, respectively. That requirement is relocated to the provisions addressing the eligibility requirements for the use of AHP subsidy, at § 951.5(c)(1)(i) and (ii). No commenters addressed these technical changes.

The proposed rule also would have added manufactured housing to the types of owner-occupied housing, and emergency shelters and single-room occupancy (SRO) housing as types of rental housing, which are explicitly referenced in the rule. In all cases, these types of housing have been eligible under the AHP since its inception, and the proposed rule sought to clarify this fact in the proposed language. However, some commenters misunderstood the proposed changes as indicating that these types of housing currently are not eligible for AHP funding. Based on the comments, the Finance Board has determined that the eligibility of manufactured housing should be further clarified as eligible for all AHP funding, including owner-occupied and rental

projects under the competitive application program and owner-occupied units under the homeownership set-aside programs. Accordingly, the final rule adds the term "manufactured housing" not only to the definition of "owner-occupied project" but also to the definition of "rental project" and to the provision on eligible uses of AHP direct subsidy under the homeownership set-aside program (§ 951.6(c)(4)). However, as noted by 1 commenter, whether manufactured housing is treated as an owner-occupied unit or a rental project depends on the actual use of the AHP subsidy.<sup>3</sup>

Several commenters suggested that the Finance Board restrict the types of manufactured housing that would be eligible housing under the AHP, for example, by requiring that the housing be on a permanent foundation. The Finance Board recognizes the benefits of placing a manufactured home on a permanent foundation. However, the Finance Board is not adopting such a requirement, because the various types of manufactured housing provide different and significant sources of affordable housing stock, including temporary shelters during an emergency following a natural disaster.

*Retention period.* The final rule revises the proposed definition of "retention period" to provide that, in the case of rehabilitated units that currently are occupied by the owner and do not involve a closing, the retention period shall commence on the date established by the Bank in its AHP Implementation Plan.

The proposed rule would have provided that the retention period commenced on the date of completion of the rehabilitation. One commenter supported the proposal, while a number of commenters opposed it, pointing out that it can be difficult to determine with specificity the date that rehabilitation of an already owner-occupied unit is complete. The comments indicated that Banks have adopted different dates for the commencement of the retention period, based on local rehabilitation and real estate practices, and suggested that the Banks be given the discretion to establish the date. The Finance Board finds merit in the commenters' suggestions and, consequently, has revised the language in the final rule to require a Bank to specify in its AHP Implementation Plan the date that the

retention period commences for rehabilitated units that are currently occupied by the owner and do not involve a closing.

*Sponsor.* Consistent with the proposed rule, the final rule amends the existing definition of "sponsor" by requiring a Bank to define in its AHP Implementation Plan the terms "ownership interest" and "integrally involved," which are part of the definition of "sponsor." Under the existing definition, a Bank must consider a "sponsor" to include any entity that has an ownership interest in a rental project, regardless of how small or temporary such ownership interest is. Requiring a Bank to define "ownership interest" in its AHP Implementation Plan would allow the Bank to address concerns that some rental project sponsors may manipulate ownership interests in order to receive points as not-for-profit sponsors under the competitive application program's scoring system. Several commenters agreed that the proposal would address concerns about sponsors that are only nominally or initially involved in a project. Commenters concurred with the Finance Board that the proposal would allow the Banks to address projects that attempt to "game" the scoring system by using minimally involved not-for-profit sponsors to get points under the scoring criterion for sponsorship by a not-for-profit or government entity.

Consistent with the proposed rule, the final rule also expands the definition of "sponsor" to include revolving loan funds or entities that operate loan pools. Those terms are used for purposes of implementing amendments to the competitive application program rules that address revolving loan funds and loan pools, respectively.

*Subsidy.* The final rule adopts the proposed revisions to the existing definition of "subsidy." Specifically, the provisions specifying the dates as of which the amount of the subsidy is to be determined are deleted, and the substance of those provisions is incorporated into § 951.5(c)(12), which sets forth the eligibility requirements relating to the competitive application program. In addition, the term "homeownership set-aside funds" is removed from the definition of "subsidy" because homeownership set-aside funds are direct subsidies, which are included within the definition of "subsidy." No commenters addressed these technical changes.

*B. Required Annual AHP Contributions; Allocation of Contributions: § 951.2*

*Required annual contribution: § 951.2(a).* Under the Bank Act, each

<sup>3</sup> See, e.g., Finance Board Regulatory Interpretation 2000-RI-04 (May 26, 2000) (available in the FOIA Reading Room on the Finance Board Web site at <http://www.fhfb.gov/Default.aspx?Page=59&ListYear=2000&ListCategory=8#8\2000>).

Bank annually must contribute to its AHP an amount equal to the greater of 10 percent of the Bank's previous year's net income or such prorated amount as is required to assure that the aggregate contribution of the 12 Banks is no less than \$100 million. 12 U.S.C. 1430(j)(5)(C); 12 CFR 951.2. The pro rata allocation method has not been needed since the Banks' annual contributions based on the 10 percent of income formula have exceeded \$100 million. Nonetheless, consistent with the proposed rule, § 951.2(a)(2) of the final rule revises the existing provision to clarify that if the pro rata allocation method is used in any future year, the required annual contribution for any Bank shall not exceed its net earnings for the previous year. This primarily is intended as a safety and soundness measure to avoid the possibility that a Bank might otherwise be required to contribute an amount in excess of its income, thereby reducing its regulatory capital. Several commenters supported the change.

*Net earnings of a Bank: § 951.1.* Consistent with the proposed rule, § 951.1 of the final rule revises the existing definition of "net earnings of a Bank" to clarify existing practice with respect to how a Bank's earnings are defined for purposes of calculating its required AHP contribution. See 12 CFR 951.1. Each Bank must present its financial statements in accordance with Generally Accepted Accounting Principles in the United States (GAAP). The application of Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* (SFAS 150), requires the Banks to classify capital stock subject to a mandatory redemption request as a liability on the statement of condition and requires that they treat the dividends on capital stock subject to a mandatory redemption request as interest expense on the statement of income. The Bank Act provisions related to the AHP provide that each Bank shall make an annual contribution equal to 10 percent of its net earnings for the previous year after reduction for any payment required under 12 U.S.C. 1441b (the Resolution Funding Corporation obligations) and before declaring any dividend. 12 U.S.C. 1430(j)(8). Because the Bank Act requires that the AHP contribution be calculated before the declaration of dividends, net earnings for purposes of calculating the AHP contribution should not be reduced by any dividend declaration, including those associated with mandatorily redeemable stock,

even though those dividends are treated as interest expense in the calculation of GAAP net income. One commenter supported the change.

*Allocation of contributions: § 951.2(b).* Consistent with the proposed rule, the final rule relocates the allocation of contributions provisions for the competitive application program and homeownership set-aside program in existing § 951.3(a) to § 951.2(b), as they relate to the requirements for AHP contributions, which are set forth in § 951.2. No comments addressed this technical change.

AHP subsidies are disbursed through a Bank's competitive application program and its homeownership set-aside program. Under the existing regulation, a Bank may set aside annually up to the greater of \$3 million or 25 percent of its annual required AHP contribution to provide funds to members through its homeownership set-aside programs. See 12 CFR 951.3(a)(1)(i). If member demand in a given year exceeds the AHP subsidy amount available for that year, a Bank may allot (or accelerate) additional amounts from the subsequent year's AHP contribution, up to the greater of \$3 million or 25 percent of the Bank's annual required AHP contribution for the following year, to the current year's homeownership set-aside program.

In addition to those amounts, under the current regulation, a Bank may set aside annually up to the greater of \$1.5 million or 10 percent of its annual required AHP contribution to fund a homeownership set-aside program to be used solely to provide financial assistance to first-time homebuyers. See 12 CFR 951.3(a)(1)(ii). If member demand for that homeownership set-aside program exceeds the amount of available AHP subsidy for a particular year, a Bank may allot an additional amount from the subsequent year's AHP contribution, up to the greater of \$1.5 million or 10 percent of the Bank's annual required AHP contribution for the subsequent year, to the current year's first-time homebuyer set-aside program. Under the competitive application program, a Bank currently may allot up to the greater of \$3 million or 25 percent of its annual required AHP contribution for the subsequent year, to the current year's competitive application program. These maximum allowable dollar amounts are adjusted annually by the Finance Board to reflect any percentage increase in the preceding year's Consumer Price Index (CPI). See 12 CFR 951.3(a)(1)(iii), (a)(2).

*Removal of CPI adjustment provisions.* Consistent with the proposed rule, the final rule removes

the existing provision authorizing an annual CPI adjustment of the caps on the dollar amounts, including amounts allotted from the subsequent year, that may be allocated to the homeownership set-aside programs, principally because it has the potential over time to increase disproportionately the amounts allocated to the homeownership set-aside programs versus the competitive application program. See 12 CFR 951.3(a)(1)(iii). In addition, the provision authorizing a CPI adjustment of any amount allotted from the subsequent year under the competitive application program, as provided under existing § 951.3(a)(2), is eliminated. Several commenters supported the changes, with 1 commenter stating that the changes are needed to ensure some parity between the homeownership set-aside and competitive application programs.

*Consolidation of separate homeownership set-aside program authorities: § 951.2(b)(2).* Consistent with the proposed rule, § 951.2(b)(2) of the final rule retains the maximum allowable aggregate allocation of AHP dollars to the homeownership set-aside programs, *i.e.*, the greater of \$4.5 million or 35 percent of a Bank's annual required AHP contribution, but eliminates the first-time homebuyer set-aside program authority as a separate and distinct authority. See 12 CFR 951.3(a)(1). The final rule replaces the existing separate first-time homebuyer set-aside program provision with a requirement that at least one-third of a Bank's aggregate annual homeownership set-aside allocation be targeted for first-time homebuyers, which reflects a comparable commitment to first-time homebuyers. The Finance Board understands that most of the Banks currently dedicate a substantial portion of their general homeownership set-aside allocation to first-time homebuyers before allocating funds under the separate homeownership set-aside authority that specifically targets first-time homebuyers. Therefore, the Finance Board believes the change will simplify the regulation without causing a material change in the allocation of homeownership set-aside funds to first-time homebuyers.

A number of commenters supported the change. One commenter requested clarification on whether one-third of any amount allocated and not actually disbursed by a Bank for its homeownership set-aside programs in a given year must be targeted to first-time homebuyers. Consistent with current practice, the "allocation" language in the rule makes clear that the one-third

requirement applies to the amount allocated and not to the amount actually disbursed.

Several commenters suggested that the one-third allocation include households displaced by natural disasters, rather than be limited to first-time homebuyers. The Banks may use their remaining allocation of homeownership set-aside funding to assist households displaced by natural disasters. In addition, a Bank may request a waiver from the Finance Board to use its first-time homebuyer allocation for other purposes.

**Additional funding authority:** § 951.2(b)(3). Section 951.2(b)(3) of the final rule revises the proposal by providing that a Bank may draw on AHP funds from the subsequent year to fund the current year's AHP, up to an amount equal to the greater of \$2 million or 20 percent of the Bank's annual required AHP contribution for the current year. The Bank would deduct the amount from the annual required AHP contribution for the subsequent year. The proposed rule would have removed the 2 existing provisions authorizing such allotment for the competitive application and homeownership set-aside programs. *See* 12 CFR 951.3(a)(1)(i) and (ii) and (a)(2). The Banks have not often used this authority, although 1 or 2 Banks may do so in a year. The existing authority may present operational difficulties because it may require the Banks to project future earnings in order to determine how much they may allot to the current year, and these projections may fall short. Basing the authority on the known amount of the current year's contribution eliminates uncertainty about the maximum permissible amount that the Bank may allot from the subsequent year's required AHP contribution to the current year's AHP funding levels.

A number of commenters supported eliminating this authority from the homeownership set-aside and competitive application programs, citing operational difficulties. However, a Bank and its Advisory Council stated that the Bank has not found the authority to be difficult to administer. A number of other commenters favored retaining the authority, stating that it has been an important tool for the Banks to meet housing demand and to respond to the need for emergency owner-occupied housing and rehabilitation following natural disasters. Commenters also noted that some Banks have used the authority to ensure some minimum availability of AHP funding when reduced Bank earnings cause a significant decrease in AHP

contributions in a given year. Several commenters suggested that the Finance Board retain the authority provision but further limit the amount of AHP funds that may be allotted from the subsequent year.

Based on the comments, the Finance Board recognizes that the authority may be helpful for Banks in responding to housing needs in their districts and the need for emergency housing and rehabilitation following natural disasters, but believes that the authority should be limited in scope and calculated based on the current year's required AHP contribution to minimize potential operational and compliance difficulties with the subsequent year's allocation requirement. A Bank could request a waiver from the Finance Board of the funding limits in the event that those limits are not sufficient to address specific housing needs in the Bank's district. Consequently, the final rule allows a Bank to allot AHP funds from the subsequent year to fund the current year's AHP, up to an amount equal to the greater of \$2 million or 20 percent of its annual required AHP contribution for the current year, which the Bank would deduct from its annual required AHP contribution for the subsequent year.

#### *C. AHP Implementation Plan: § 951.3*

##### *Adoption of Plan: § 951.3(a).*

Consistent with the proposed rule, § 951.3(a) of the final rule reorganizes and streamlines requirements for a Bank's AHP Implementation Plan to conform them to amendments to other parts of the AHP regulation. *See* 12 CFR 951.3(b). The changes to the specific program operating requirements for AHP Implementation Plans are discussed elsewhere in this preamble in the context of the particular operating requirements. The final rule also adopts the proposed requirement that the AHP Implementation Plan include the Banks' retention agreement requirements.

A number of commenters supported the changes to the requirements for the AHP Implementation Plan, but expressed concern that they would require a Bank to include all of its policies and procedures in its Plan, which would make for a cumbersome document and complicate the Bank's process for amending the policies and procedures. The Finance Board intends that a Bank's program requirements, such as its scoring guidelines, but not its implementing operating procedures, be included in the Plan. A Bank may reference its operating procedures in the Plan so that AHP participants will be aware of their existence and make them available upon request.

**Notification of Plan amendments:** § 951.3(c). Section 951.3(c) of the final rule adopts the proposed requirement that a Bank notify the Finance Board within 30 days of amending its AHP Implementation Plan. Several commenters supported the change.

**Public access:** § 951.3(d). Section 951.3(d) of the final rule adopts the proposed requirement that a Bank make the amended AHP Implementation Plan publicly available through its Web site within 30 days after adoption of the amendments. Under the current rule, the Bank must submit all amendments to the Finance Board and make its AHP Implementation Plan available to members of the public upon request. *See* 12 CFR 951.3(b)(4), (b)(5). Making the AHP Implementation Plan available through the Banks' Web sites is intended to provide the public with easy access to important information about the AHP, as well as to promote greater transparency and accountability in the program. A number of commenters supported the change as increasing transparency and accountability and noted that most of the Banks have now placed their AHP Implementation Plans on their Web sites.

#### *D. Advisory Councils: § 951.4*

The final rule makes a number of revisions to the existing provisions addressing the Advisory Councils of the Banks, many of which are intended to clarify, but not change the substance of, the existing rule. *See* 12 CFR 951.4. The provisions that have a substantive effect are described below.

**Terms of Advisory Council members:** § 951.4(b). Section 951.4(b) of the final rule adopts the proposed requirement that each Bank adopt policies governing the appointment process for Advisory Council members. In addition, the final rule requires each Bank to appoint Advisory Council members to terms of 3 years, except that a Bank may appoint members for terms of 1 or 2 years as a transitional measure solely for purposes of achieving the necessary staggering of the 3-year terms.

Proposed § 951.4(b) would have required each Bank to appoint members to terms of "up to" 3 years. This proposal was intended to enhance the effectiveness of the Advisory Councils by lessening the likelihood that the terms of more than one-third of the Advisory Council members will expire in any 1 year, by allowing the Banks to appoint as a transitional measure some individuals to terms of 1 or 2 years as a means of ensuring an appropriate balance of experience and service among members of the Advisory

Council as a whole while achieving appropriate staggering of terms. Under the current rule, the Banks must appoint members of the Advisory Council to 3-year terms. *See* 12 CFR 951.4(d).

A number of commenters supported the proposal, stating that it would allow for better balance of expiring terms and provide greater continuity of the Advisory Council membership. Other commenters raised concerns that the proposal would allow the Banks as a routine matter to appoint Advisory Council members to terms of 1 year and 2 years in addition to 3 years, creating positions of unequal power and resulting in greater turnover and loss of members with AHP knowledge and expertise. The Finance Board's intent in proposing the change was to allow the Banks the flexibility to appoint members to shorter terms when necessary as a transitional measure to reconfigure the staggering of the 3-year terms on the Advisory Councils. Although the Banks originally set staggering of the 3-year terms beginning in January 1998, when the current AHP regulation became effective, the Banks have found it necessary to reset the staggering from time to time. The Finance Board has acted on a number of Bank requests, through waivers or no-action letters, to allow the Banks to readjust staggering by appointing some members to terms of less than 3 years. The Finance Board recognizes the concerns of the commenters, but also recognizes the need of the Banks for flexibility to stagger the Advisory Council member terms. Consequently, the language is revised in the final rule to provide that Advisory Council terms shall be for 3 years, except that a Bank may appoint members for terms of 1 or 2 years as a transitional measure solely for purposes of achieving the necessary staggering of the 3-year terms.

**Election of officers: § 951.4(c).** Consistent with the proposed rule, § 951.4(c) of the final rule imposes on the Advisory Council an affirmative obligation to elect certain officers, which is intended to ensure that each Advisory Council has in place a chairman and vice chairman. The current rule permits, but does not require, election of such officers. *See* 12 CFR 951.4(e). Several commenters supported the change.

**Duties: Meetings with the Banks: § 951.4(d)(1)(ii).** Consistent with the proposed rule, § 951.4(d)(1)(ii) of the final rule revises the duties of the Advisory Council principally by adding a list of specific matters on which the Advisory Council must provide recommendations to the Bank's board of directors. *See* 12 CFR 951.4(f)(1). Those

matters include: The relative allocation of AHP subsidies between the competitive application and homeownership set-aside programs; the AHP Implementation Plan; eligibility criteria for each program; scoring criteria and related definitions for the competitive application program; and any priority criteria for the homeownership set-aside program. A number of commenters supported the changes, stating they would strengthen communication among the Bank's board, the Advisory Council, and the public.

**Annual Advisory Council analysis; public access: § 951.4(d)(3).** Section 951.4(d)(3)(i) of the final rule adopts the proposed extension of the deadline by which the Advisory Council must submit its annual analysis of the Bank's low- and moderate-income housing and community lending activity to the Finance Board from March 1 to May 1. *See* 12 CFR 951.4(f)(3). The proposed change in the due date was intended to respond to requests received from some of the Advisory Councils, which meet at least quarterly, for additional time after the end of each calendar year to prepare, review, and approve their report. A number of commenters supported the change in the due date, with 1 commenter stating that it would offer the Advisory Council a better opportunity to summarize the accomplishments of the year.

Section 951.4(d)(3)(ii) of the final rule adopts the proposed requirement that each Bank publish the Advisory Council analysis on its publicly available Web site within 30 days of its submission to the Finance Board. Making the Advisory Councils' analyses available to the public through the Banks' Web sites is intended to promote greater transparency and accountability in the Banks' AHP and in the work of the Banks' Advisory Councils. A number of commenters supported the change, stating that it would increase transparency and accountability.

**No delegation: § 951.4(f).** Section 951.4(f) of the final rule prohibits a Bank's board of directors from delegating to Bank officers or other Bank employees its responsibility for appointing Advisory Council members and meeting with the Advisory Council at the quarterly meetings required by the Bank Act. *See* 12 U.S.C. 1430(j)(11). This provision is intended to ensure that each board of directors fulfills its statutory obligations with regard to its interaction with the Advisory Council and is consistent with findings of the Finance Board's Horizontal Review, which indicated that in general the Bank boards could improve their

interactions with their Advisory Councils. *See* 12 U.S.C. 1430(j)(11); *Horizontal Review* at 23.

Several commenters supported the proposal, stating that it would improve the Bank board's understanding of affordable housing issues. A Bank and its Advisory Council opposed the proposal, believing it would add to the duties and responsibilities of the Bank's board and apply to Advisory Council meetings beyond the quarterly meetings with the Bank's board that are required by the Bank Act. It was not the Finance Board's intent to prohibit Bank staff from meeting with the Advisory Councils at times other than the Bank boards' quarterly meetings with the Advisory Councils. Consequently, the language is revised in the final rule to clarify that the prohibited delegation applies only to the statutorily-required quarterly meetings between the Banks' boards and their Advisory Councils.

#### **E. Competitive Application Program: § 951.5**

Consistent with the proposed rule, the final rule consolidates existing regulatory provisions governing the operation of the competitive application program into a single section of the AHP rule—§ 951.5. Under the current regulation, some of those provisions are located in different sections of the regulation. A number of commenters supported the proposed reorganization, streamlining, and consolidation of the regulatory provisions. Commenters stated that these technical revisions would be helpful for the Banks, members, and sponsors in understanding the specific requirements of the competitive application and homeownership set-aside programs. The principal revisions to the existing regulatory structure are described below.

**Removal of optional nonmember applicants provision: § 951.5(b)(2).** Consistent with the proposed rule, § 951.5(b)(2) of the final rule eliminates the current discretionary authority for a Bank to accept AHP applications from institutions that are not members of the Bank, but that have applied for membership. *See* 12 CFR 951.6(b)(1). A trade association opposed the proposed change, stating that the AHP offers an incentive for nonmember institutions to join the Banks and the current regulatory provision remains an important membership recruitment tool for the Banks. The Finance Board notes that the AHP would remain a membership recruitment tool under the final rule as the institution can apply for AHP funds once it is a member.

A Bank opposed the proposal, stating that where a member that intends to submit AHP applications on behalf of sponsors is merged into a nonmember, and the nonmember intends to apply for Bank membership, the proposal would prohibit the nonmember from continuing the process of submitting to the Bank the AHP applications for those sponsors for an imminent funding round. The Bank noted that this would result in the AHP activities of the nonmember being prohibited for as much as 180 days. *See* 12 CFR 925.24(b). The Finance Board believes that such an event would be rare, and the Bank has alternatives to address the matter so that the sponsors could compete for funding at that time, such as by assisting the sponsors in identifying another member to submit the application.

*Eligibility requirements: § 951.5(c).* Consistent with the proposed rule, § 951.5(c) of the final rule sets out the eligibility requirements that apply in connection with the receipt of AHP subsidies under the competitive application program.

*Timing of household income-eligibility determination: § 951.5(c)(1).* Consistent with the proposed rule, the final rule relocates the current provisions on timing of household income eligibility from the definitions of “low- or moderate-income household” and “very low-income household” in § 951.1 to § 951.5(c)(1). In addition, consistent with the proposed rule, the final rule incorporates into this section, without change, the requirements in the existing definitions of “owner-occupied project” and “rental project” that the AHP subsidy be used for the purchase, construction, or rehabilitation of owner-occupied or rental housing.

*Need for subsidy: § 951.5(c)(2).* The final rule permits a Bank, in its discretion, to permit a project’s sources of funds to include or exclude the estimated market value of in-kind donations and voluntary professional labor or services (excluding the value of sweat equity), provided that the project’s uses of funds also include or exclude, respectively, the value of such estimates. The existing regulation requires that, for purposes of determining a project’s eligibility, the project must demonstrate a need for the subsidy, based on its estimated total sources and uses of funds. *See* 12 CFR 951.5(b)(2). The proposed rule would have maintained this requirement, but would have eliminated a related requirement that the estimated sources and uses of funds analysis include estimates of the market value of in-kind

donations and volunteer professional labor or services (excluding the value of sweat equity) as sources of funds. *See* 12 CFR 951.5(b)(2)(i)(B). By focusing the analysis on cash sources and uses, the sponsor can streamline the analysis, as non-cash contributions are exactly offset by the amount of non-cash expenses they cover and, therefore, cancel out of the comprehensive sources and uses of funds analysis. For example, a contribution of materials (in-kind) is a source that reduces the need for cash payments by exactly its value. The Finance Board stated in the **SUPPLEMENTARY INFORMATION** section of the proposed rule that experience since 1998 indicated that estimates of non-cash costs generally do not affect the amount of subsidy needed for a project, and that eliminating this requirement also would obviate the need for Regulatory Interpretation 1999–RI–03 (Jan. 26, 1999),<sup>4</sup> which already had eliminated this requirement for self-help homeownership projects involving such non-cash costs.

One commenter opposed the proposal, stating that if estimates of non-cash costs generally do not affect the amount of subsidy needed for a project, then it should not matter whether or not a project includes non-cash sources and uses in its development budget, and the rule should leave it to the Bank’s discretion whether the development budget may include such items. This commenter stated that sponsors must make these estimates as line items in their budgets for funding from certain federal programs such as Low-Income Housing Tax Credits and Community Development Block Grants, and the regulation should not require them to do separate budgets for the AHP. The Finance Board finds the comment persuasive. Accordingly, the final rule provides a Bank with the discretion to determine whether estimates of market value of in-kind donations and voluntary professional labor or services (excluding the value of sweat equity) may be a required component in determining a project’s source of funds along with the identical value included as a use of funds.

Section 951.5(c)(2)(ii) of the final regulation also includes a requirement for how a self-help homeownership sponsor that provides permanent financing must account for the value of cash payments that it will receive from the purchaser of the home when

determining the sponsor’s cash sources of funds. Several commenters were concerned that rescinding 1999–RI–03 also would remove a provision relating to the determination of cash sources of funds for such sponsors. The Regulatory Interpretation provides that, in performing the cash sources and uses of funds analysis, the sponsor’s cash contribution must include the present value, rather than the face value, of any payments the sponsor is to receive from the homebuyer, *i.e.*, any cash down payment from the buyer plus the present value of any below-market purchase note the sponsor holds on the unit. If such a note carries a market interest rate commensurate with the credit quality of the borrower (market rate), the present value of the note equals the face value of the note. If the note carries an interest rate below the market rate, the present value of the note can be determined using the market rate to discount the cash flows.

The commenters stated that, without the provision in 1999–RI–03, such sponsors would be required to include the face value of the mortgage payments received rather than the discounted amount, which would result in the development budget for these types of projects showing cash sources of funds in excess of cash uses, *i.e.*, no need for AHP subsidy, thereby making such projects ineligible to receive AHP subsidy. The Finance Board concurs that the provision related to the use of the net present value should continue to apply to sponsor-financed self-help housing, and the final rule codifies the 1999–RI–03 provision in § 951.5(c)(2)(ii).

The final rule also adopts the proposal that would make the need for subsidy requirement independent of the project developmental and operational feasibility requirements. These feasibility requirements are separate assessments and, therefore, should not be linked to the need for subsidy requirement. The Finance Board stated in the **SUPPLEMENTARY INFORMATION** section of the proposed rule that this change also may have the effect of more competition by smaller projects and projects with higher production or operating costs, such as projects with services or more common space, and several commenters agreed that this could be a result of the proposed change.

*Project costs: § 951.5(c)(3).* Section 951.5(c)(3)(i) of the final rule adopts the proposed clarification that the determination of project costs is a separate eligibility requirement, and removes an existing requirement that project costs be “customary” and

<sup>4</sup> 1999–RI–03 is available in the FOIA Reading Room on the Finance Board Web site at <http://www.fhfb.gov/Default.aspx?Page=59&ListCategory=8#8>.



determined according to “industry standards” in accordance with the Bank’s project feasibility guidelines. See 12 CFR 951.5(b)(2)(ii). In lieu of that requirement, a Bank is still required to establish feasibility and cost guidelines as a basis for evaluating project costs, but must determine whether an individual project’s costs are reasonable by taking into account the geographic location of the project, development conditions, and other non-financial household or project characteristics, such as housing for the elderly or for persons with disabilities, which affect the project’s costs. The changes are intended to make the eligibility review process more adaptive to projects such as those serving special needs populations, and other projects that may require special architectural features or other amenities appropriate to their location.

Several commenters supported the proposal as providing additional flexibility for a Bank to assess project costs based on the characteristics of individual projects, taking into consideration factors that could increase costs in determining whether a project’s costs are reasonable. Some commenters stated, however, that the proposed language could be read to require a Bank’s feasibility guidelines to reflect a variety of characteristics for different project types. This was not the intent of the proposal. Accordingly, the language in the final rule is reworded to state that the Bank’s feasibility guidelines themselves need not include characteristics for different project types.

As discussed above under Need for Subsidy, the proposed rule would have eliminated the existing provision in § 951.5(b)(2)(i)(B) that requires, for purposes of a Bank’s sources and uses of funds analysis, that the Bank include as sources of funds estimates of the market value of in-kind donations and volunteer professional labor or services (excluding the value of sweat equity) committed to the project. See 12 CFR 951.5(b)(2)(i)(B). Several commenters objected that removal of this provision would result in payment of a lower developer’s fee where the fee is calculated as a percentage of the project’s total development costs, as the total development costs amount would be lower. One commenter stated that this consequence would be particularly difficult for small, not-for-profit housing producers, especially in rural areas, that rely on income from the developer’s fee for their continuing operations. Commenters stated that the Banks should be given discretion to include in-kind donations and volunteer

professional labor or services as part of total development costs in the budget. The Finance Board believes the comments have merit. Accordingly, § 951.5(c)(3)(i)(B) of the final rule allows a Bank to include estimates of the market value of in-kind donations and volunteer professional labor or services (excluding the value of sweat equity) in total development costs for purposes of calculating the developer’s fee. The Bank would continue to be required to determine, after calculating the fee, that it is a reasonable fee pursuant to the Bank’s project cost guidelines, as required by § 951.5(c)(3)(i)(A) of the final rule.

**Project feasibility: § 951.5(c)(4).** Consistent with the proposed rule, § 951.5(c)(4) of the final rule separates the 2 aspects of project feasibility—developmental feasibility of a project and, in the case of rental housing, operational feasibility of the project over time—and defines the terms. These 2 types of project feasibility are not differentiated in the existing rule. Section 951.5(c)(4)(i) requires that a project be developmentally feasible, which is defined as the likelihood that the project will be completed and occupied, based on relevant factors contained in the Bank’s project feasibility guidelines, including the project’s development budget, market analysis, and the sponsor’s experience in providing the requested assistance to households. Section 951.5(c)(4)(ii) requires that a rental project be operationally feasible, which is defined as the ability of the project to operate in a financially sound manner, in accordance with the Bank’s project feasibility guidelines, as projected in the project’s operating *pro forma*.

A Bank and its Advisory Council supported the proposal, stating that it would allow the Banks more flexibility in addressing project needs based on a variety of factors that can influence development costs and operational budgets.

**Financing costs: § 951.5(c)(5).** Consistent with the proposed rule, the final rule makes a technical change by relocating the provision regarding interest rates, points, fees, and other charges for loans financing the project from existing § 951.5(b)(2)(iii) to § 951.5(c)(5) of the final rule. See 12 CFR 951.5(b)(2)(iii). The final rule also clarifies that this provision applies to loans made for the project in conjunction with the AHP subsidy.

**Refinancing: § 951.5(c)(8).** Section 951.5(c)(8) of the final rule adopts a proposed technical change regarding the use of AHP subsidies in connection with a refinancing of a project. See 12

CFR 951.5(b)(6). The change clarifies that refinancing is permitted only if it generated equity proceeds and if the proceeds are used to purchase, construct, or rehabilitate eligible housing units. The change also clarifies that the requirement regarding use of the equity proceeds applies only to an amount of equity proceeds that is at least equal to the amount of AHP subsidy in the project. No comments addressed this technical change.

**Project sponsor qualifications: § 951.5(c)(10).** Consistent with the proposed rule, § 951.5(c)(10)(ii) and (iii) of the final rule revises existing § 951.5(b)(8) by requiring a Bank to adopt written policies regarding the project sponsor qualifications for revolving loan funds and loan pools. See 12 CFR 951.5(b)(8). These issues are discussed separately below under the sections addressing use of the AHP subsidy by revolving loan funds and loan pools.

**Calculation of AHP subsidy: § 951.5(c)(12).** Consistent with the proposed rule, § 951.5(c)(12) of the final rule, which relates to the calculation of the AHP subsidy, incorporates, without change, the existing provisions regarding the time at which the calculation of subsidy is to be made, which currently is included as part of the definition of “subsidy” in § 951.1. No comments addressed this technical change.

**Lending and re-lending of AHP direct subsidy by revolving loan funds: § 951.5(c)(13).** General requirements: Consistent with the proposed rule, the final rule authorizes a Bank, in its discretion, to provide AHP direct subsidy under its competitive application program for eligible projects and households involving both the lending of the subsidy and subsequent lending of subsidy principal and interest repayments by a revolving loan fund. The final rule further provides that both the initial loans made by the revolving loan fund, as well as any subsequent loans made with amounts received from repayments of the initial loans, would have to meet AHP eligibility requirements, as applicable depending on whether the subsidy is used for initial lending or for subsequent lending, as discussed below. The revolving loan fund also would have to assure that the initial loans are made to projects and households that meet the commitments made in the approved AHP application, and that they will be met for the full AHP retention period. In order to exercise this authority, a Bank would have to consult with its Advisory Council and then adopt written policies governing



the disbursement of the AHP direct subsidy through this type of entity.

A number of commenters supported allowing the Banks to provide AHP direct subsidy to revolving loan funds as proposed, stating that it could maximize the impact of the direct subsidy because using loans rather than grants allows the financial benefit of the subsidy to be leveraged many times over. One commenter stated that it would meet a need for small, flexible-term loans for a broad range of purposes. Another commenter stated that it would benefit rural areas that are losing affordable housing, as revolving loan funds are better able to match the capital needs of smaller scale, scattered-site development efforts typical in rural areas.

Other commenters opposed the proposal, stating that it would be unworkable because of difficulties with scoring, monitoring and compliance. A commenter stated that lending the AHP direct subsidy would erode the value of the AHP grants. Several commenters stated that revolving loan funds charge interest or fees that increase project costs, thereby effectively reducing the amount of AHP subsidy passing through to the project, and projects that cannot support debt service would not be able to benefit from revolving loan funds using direct subsidy as loan principal instead of grants. The Finance Board acknowledges these potential concerns, but notes that under the regulation no Bank would be obligated to accept applications from a revolving loan fund. The authority in the rule is permissive, not mandatory. The Finance Board believes that revolving loan funds can provide opportunities for the benefits of the AHP to reach harder-to-serve populations, such as those in rural areas or those with special needs. By allowing revolving loan funds to lend and re-lend direct subsidy, the regulation will enable entities specializing in community development lending to leverage additional funds for low-income borrowers, or bring added value to the services provided by not-for-profit corporations and local governments, and provide technical assistance that can contribute to project success and help develop capacity of small, not-for-profit housing producers.

As noted previously, § 951.1 of the final rule expands the definition of "sponsor" to specify revolving loan funds in the list of eligible sponsors. Section 951.1 of the final rule defines a "revolving loan fund" as a capital fund established to make mortgage or other loans whereby loan principal is repaid into the fund and re-lent to other borrowers. Commenters questioned

whether members would qualify as revolving loan funds under the rule, noting that if members could not qualify, the rule would give revolving loan funds an unfair competitive advantage over members in access to AHP funds. Members are eligible to apply for AHP subsidy as revolving loan funds if they meet the definition of "revolving loan fund" and the project sponsor qualifications requirement in the final rule.

The Finance Board notes that revolving loan funds currently can and do apply as sponsors under the competitive application program for AHP subsidy for funding specified projects. Under § 951.5(c)(13)(i) of the final rule, in a Bank's discretion, a revolving loan fund would be able to apply for direct subsidy to lend to a specified or an unspecified project (or projects) meeting the requirements of the competitive application program and to re-lend repayments of that subsidy to subsequent projects that meet certain minimum eligibility requirements. A number of commenters stated that it was not clear how an application for an unspecified project could meet the eligibility requirements for project feasibility and project costs. To address these issues, § 951.5(c)(13)(i) and (ii) of the final rule provides that an application for an unspecified project to be funded through a revolving loan fund must include the revolving loan fund's criteria for lending of the subsidy, including its project cost and project feasibility guidelines, which the Bank will evaluate according to the AHP eligibility requirements, including the Bank's project cost and project feasibility guidelines. See § 951.5(c)(3) and (c)(4) of final rule. Pursuant to § 951.7(a)(1) of the final rule, upon initial monitoring of the actual project(s) funded with the initial lending of subsidy, the Bank will have to determine that the actual project costs were reasonable in accordance with the Bank's project cost guidelines, and that the subsidy was needed in accordance with § 951.5(c)(2).

Section 951.5(c)(13)(ii) of the final rule provides that a Bank shall review an application from a revolving loan fund to evaluate the project or criteria for the initial lending of the subsidy, as applicable, pursuant to the Bank's scoring guidelines. Some commenters questioned how an application for an unspecified project(s) could be scored against other applications for projects. Under § 951.5(c)(13)(i), an application with nonspecific project(s) would have to propose how the project(s) will meet various applicable scoring criteria and, if approved, the revolving loan fund

would have to ensure that the actual project or projects eventually funded with the initial lending of subsidy would meet those scoring criteria. If, upon initial monitoring of the project, the Bank found that the project did not meet the scoring criteria and could not be modified under § 951.5(f), then the revolving loan fund would have to repay the AHP subsidy to the Bank. Many revolving loan funds operating for the purpose of financing housing for very low- and low- or moderate-income households either restrict their funding to projects with certain requirements, such as housing for the elderly, or have a pipeline of potential projects. Consequently, the Finance Board believes that an application can be scored based on the proposed characteristics of an unspecified project.

An application with unspecified project(s) must still meet the eligibility requirement in § 951.5(c)(6) that the project must be likely to begin drawing down some or all of the AHP subsidy or use it to procure other financing commitments within 12 months of the date of the application's approval. The Finance Board does not intend that approved AHP subsidy lay idle for significant periods of time.

Section 951.5(c)(13)(iv) of the final rule also provides that payments of interest on the lending of the AHP direct subsidy must be used by the revolving loan fund in accordance with the requirements for subsequent lending of AHP direct subsidy in that section. Some commenters opposed allowing interest earned on the lending of the AHP subsidy to be used for general operating support of the revolving loan fund or the sponsor, and the Finance Board concurs. Under § 951.13(d)(3) of the current AHP regulation, a member or sponsor that lends AHP direct subsidy to a project must pay any repayments of principal and payments of interest forthwith to the Bank for use by other AHP-eligible projects. See 12 CFR 951.13(d)(3). Requiring a revolving loan fund to return interest payments to its lending fund and use them for AHP-eligible purposes in accordance with the subsequent lending provisions is consistent with this existing requirement. In addition, § 951.9(a)(9) of the final rule revises existing § 951.13(d)(3) to provide for an exception to the requirement that repayments of principal and payments of interest must be paid to the Bank in the case of lending and re-lending of direct subsidy by a revolving loan fund.

*Initial lending of AHP direct subsidy:* § 951.5(c)(13)(iii): Section 951.5(c)(13)(iii)(A) of the final rule provides that, once its application is

approved, a revolving loan fund may lend direct AHP subsidy to 1 or more projects or households, as needed to use the full amount of subsidy approved, that meet the eligibility criteria of § 951.5(c) and the commitments made in the approved AHP application. Like all other approved projects, the project or projects funded as part of the revolving loan fund's initial lending of the AHP direct subsidy are subject to AHP retention agreements, and to initial and long-term monitoring, as applicable according to whether the housing is owner-occupied or rental. The revolving loan fund may re-lend subsidy principal and interest repayments received in accordance with the "subsequent lending" requirements described below.

Section 951.5(c)(13)(iii)(B) of the final rule provides that if an initial-lending project or owner-occupied unit is not in compliance with the commitments in the approved AHP application, or is sold or refinanced prior to the end of the applicable AHP retention period, the required amount of AHP subsidy must be repaid to the revolving loan fund in accordance with §§ 951.8 and 951.9 of the final rule. The revolving loan fund must re-lend such repaid subsidy, excluding the amounts of AHP subsidy principal already repaid to the revolving loan fund, to another project or owner-occupied unit meeting the initial lending requirements for the remainder of the retention period. For example, if an initial-lending rental project is sold after 8 years and the buyer does not commit to maintain the AHP income-targeting and affordability commitments, then the revolving loan fund must re-lend the repaid subsidy to another eligible project meeting the initial lending requirements that will have a retention period of 7 years in order to complete the full 15-year retention period required for an initial-lending rental project. In this case, the amount of subsidy that must be used for another initial-lending project does not include the amounts of AHP subsidy principal already repaid to the revolving loan fund.

*Subsequent lending of AHP subsidy principal and interest repayments:* § 951.5(c)(13)(iv): Section 951.5(c)(13)(iv)(B) of the final rule provides that subsequent lending of AHP subsidy principal and interest repayments must be for the purchase, construction, or rehabilitation of owner-occupied units for households with incomes at or below 80 percent of the median income for the area, or of rental projects where at least 20 percent of the units are occupied by and affordable for households with incomes at or below 50 percent of the median income for the

area, and must meet all other eligibility requirements in § 951.5(c). Section 951.5(c)(13)(iv)(C) provides that a Bank may, in its discretion, require the revolving loan fund's subsequent lending of AHP subsidy principal and interest repayments to be subject to retention period, monitoring, and recapture requirements as defined by the Bank in its AHP Implementation Plan. A number of commenters expressed concerns about the revolving loan fund sponsor having to monitor revolved payments of AHP subsidy over the long-term retention period. Some commenters stated that the monitoring requirements would be extremely difficult or unworkable, and would be different than those applicable under the final rule for projects that do not involve revolving loan funds.

Commenters recommended various approaches to the monitoring of the revolved subsidy, including that: The Bank have flexibility to determine whether to require monitoring over a long-term period (as proposed); the sponsor be allowed to commingle the AHP funds with its other funds but be required to separately account for the AHP funds through an annual A-133 type audit; the Bank be allowed to monitor the performance of the revolving loan fund rather than the individual households or properties; and the monitoring period be limited to 5 years or until the AHP direct subsidy is rolled over twice. The Finance Board recognizes the potential problems that monitoring for subsequent lending of the repaid subsidy could entail. As discussed above, only projects funded with the revolving loan fund's initial lending of subsidy would be subject to the monitoring requirements applicable to all projects under the competitive application program. The Bank, in its discretion, may decide what, if any, monitoring, retention, or recapture requirements should apply to subsequent lending of the repaid AHP subsidy.

Section 951.5(c)(13)(iv)(A) of the final rule also provides that a revolving loan fund, in its discretion, may provide part or all of the AHP subsidy principal and interest repayments as nonrepayable grants to eligible projects under the "subsequent lending" requirements. Under § 951.5(c)(13)(v), the revolving loan fund must return to the Bank any AHP subsidy that will not be used for AHP-eligible purposes.

Several commenters wanted to ensure that the Finance Board or the Banks would not set the interest rate that a revolving loan fund could charge for lending the AHP direct subsidy. The final rule does not set the interest rates

that a revolving loan fund can charge; however, a revolving loan fund's interest rates must be reasonable and comply with the financing costs requirement of § 951.5(c)(5).

*Revolving loan fund sponsor qualifications:* § 951.5(c)(10)(ii): Consistent with the proposed rule, § 951.5(c)(10)(ii) of the final rule provides that, pursuant to written policies adopted by a Bank's board, a revolving loan fund sponsor that intends to use the AHP subsidy in accordance with this section must: (i) Provide audited financial statements that its operations are consistent with sound business practices; and (ii) demonstrate the ability to re-lend AHP subsidy repayments on a timely basis and track the use of the AHP subsidy. Several commenters recommended that the regulation give priority to community development financial institutions as qualified revolving loan fund sponsors, because of their experience and controls and reporting systems for the lending of funds. Another commenter suggested that a revolving loan fund sponsor should have to have a minimum of 2 years' experience successfully operating a revolving loan fund in order to be considered an eligible sponsor. The Finance Board does not believe it is appropriate to give preference in the regulation to any particular type of sponsor or indicator of experience. The AHP is a competitive application process and, during the application review process, a Bank must evaluate a sponsor's experience in determining whether the sponsor has the qualifications to be eligible to participate in the competitive application process. Those sponsors that can demonstrate such qualifications will be eligible to participate in the competitive application process.

*Other issues:* Several commenters also recommended that the Banks be allowed to fund revolving loan funds as a separate set-aside, rather than under the competitive application program, and that the Banks be allowed to establish the governing policies for their revolving loan fund programs. The Finance Board does not believe that it is appropriate to set aside AHP funds for specific types of sponsors. The AHP is primarily a competitive program that awards funds based on the merits of the application, regardless of sponsorship.

Under the final rule, AHP funds disbursed through a revolving loan fund may not be used for purposes, such as to pay for operating costs, that are unrelated to the purchase, construction, or rehabilitation of housing. Several commenters stated that AHP subsidy

should be able to be used for operating costs, citing the more intensive servicing needed for higher-risk, low-income loans. A commenter proposed that revolving loan funds be able to use interest earned on lending the AHP direct subsidy and on short-term investment of the AHP subsidy for servicing and related functions and investments. The Finance Board believes that use of AHP subsidy for operating costs and investment of the subsidy would not be consistent with the requirement in the Bank Act that AHP subsidy only be used for the financing of purchase, construction, or rehabilitation of affordable housing and, as discussed above, that interest earned on the lending of the subsidy should also be used for AHP-eligible purposes. See 12 U.S.C. 1430(j)(2).

Some commenters also stated that revolving loan funds should be allowed to lend AHP subsidy to fund predevelopment costs for rental housing, or short-term construction loans. The Finance Board notes that lending for short-term construction loans is an eligible use of AHP subsidy, provided that the resulting housing complies with the AHP retention requirements. The Finance Board has determined that predevelopment costs are not an eligible use of AHP subsidy if no eligible housing is produced as a result. Under the AHP, a project that meets the eligibility requirements, including developmental and operational feasibility requirements, may include previously incurred predevelopment costs in its uses of funds.

Three years after promulgation of the new revolving loan fund authority, the Finance Board intends to conduct a program review of the use of the authority to determine how the program is working and to address any issues that have arisen.

*Use of AHP subsidy in loan pools:* § 951.5(c)(14). *General requirements:* Consistent with the proposed rule, § 951.5(c)(14) of the final rule specifies the conditions under which a Bank, in its discretion, may provide AHP subsidies under its competitive application program for the origination of first mortgage loans or rehabilitation loans with subsidized interest rates to AHP-eligible households through a purchase commitment by an entity that will purchase and pool the loans. The final rule also allows a loan pool sponsor to use repaid AHP subsidy resulting from prepayments of a loan in the pool for the origination of another AHP-assisted loan as substitution for the prepaid loan in the pool, rather than requiring the return of the AHP subsidy

to the Bank, as is required under the current regulation. Because of this new reuse authority, the Finance Board has determined that each Bank should have the discretion to determine whether to fund AHP applications for loan pools under its competitive application program. The Bank would determine whether there is a market need for such funding in its district as part of its determination whether to permit funding of applications for loan pool sponsors. In order to make available the loan pool authority under its competitive application program, a Bank would have to consult with its Advisory Council and then adopt written policies governing the disbursement of the AHP subsidy through this type of funding arrangement.

A number of commenters generally supported the use of AHP subsidy by loan pool sponsors, stating that greater use of secondary market operations could help sponsors provide homeownership to more low-or moderate-income households in their communities. Commenters also supported the discretionary nature of the proposal. Other commenters opposed the proposal, citing a number of reasons, including that loan pools may not be addressing a specific market need. The Finance Board notes that loan pool entities are already eligible sponsors for AHP-assisted projects provided that the loan originations through the purchase commitments meet the requirements of the current AHP regulation. However, prepayments of loans prior to the end of the retention period required that AHP subsidy be returned to the Bank in accordance with the retention agreements. One Bank stated that it has received applications for AHP subsidy from a loan pool sponsor in its district, but was unsure how loan pool operations could meet the AHP requirements, especially when loans in the pool prepaid. The Finance Board believes that loan pools can facilitate the origination of AHP-subsidized home purchase mortgage loans, owner-occupied rehabilitation loans, and rental property loans for eligible households. Consequently, consistent with the proposed rule, the final rule specifies the criteria that the Finance Board has determined meet the requirements of the AHP, especially in the areas of retention, eligible uses, need for subsidy, pass through of the subsidy to the ultimate borrower, and substitution of prepaid loans.

*Loan pool sponsor qualifications:* § 951.5(c)(10)(iii): As noted previously, § 951.1 of the final rule specifically includes in the definition of "sponsor"

entities that operate loan pools in the list of eligible sponsors. Consistent with the proposed rule, § 951.1 of the final rule defines a "loan pool" as a group of AHP-eligible loans that are purchased, pooled, and held in trust. Consistent with the proposed rule, and in light of the new authority to reuse repaid subsidy for new AHP-assisted loans to substitute in the loan pools, § 951.5(c)(10)(iii) of the final rule provides that, pursuant to written policies adopted by a Bank's board, a project sponsor that operates a loan pool must: (i) Provide evidence of sound asset/liability management practices; (ii) provide audited financial statements that its operations are consistent with sound business practices; and (iii) demonstrate the ability to track the use of the AHP subsidy. Several commenters recommended that only loan pool sponsors that have previously received AHP funds should be considered eligible sponsors. For the same reasons discussed above under Revolving Loan Funds, the Finance Board does not believe it is appropriate to give preference in the regulation to particular types of sponsors or indicators of experience. However, a Bank may take into consideration a sponsor's experience in determining its qualifications and the eligibility of the project to participate in the AHP competitive application process.

Commenters also questioned whether members could qualify as loan pool sponsors under the rule, noting that if members could not qualify, the proposed rule could give secondary market entities an unfair competitive advantage over members that are engaged in originating loans for their portfolios or for sale. The Finance Board believes that members, like any other entity, should be eligible to apply for AHP subsidy as loan pool sponsors if they meet the definition of "loan pool" sponsor and the project sponsor qualifications requirement in the final rule.

*Eligibility requirements; forward commitment:* § 951.5(c)(14)(i), (ii)(A): The final rule adopts a number of proposed provisions intended to ensure that AHP subsidies disbursed through a loan pool sponsor actually benefit AHP-eligible households. Specifically, § 951.5(c)(14)(i) provides that the loan pool's use of the AHP subsidy must meet the requirements of § 951.5(c)(14), and shall not be used for the purpose of providing liquidity to the originator or holder of the purchased loans, or paying the loan pool's operating or secondary market transaction costs. The loan pool sponsor must purchase the loans pursuant to a forward commitment that

conforms to the approved AHP application. Subsequent purchases of loans to substitute for repaid loans in the pool also must be made pursuant to the terms of the approved AHP application. The use of a forward commitment ensures that the loan originators will originate the end loans in accordance with the requirements of the sponsor's approved AHP application and the requirements of the AHP, such that each end loan will have the prescribed interest rate and term and be subject to a retention agreement and that each household will meet the income-eligibility commitments in the approved AHP application.

The Finance Board requested comment in the proposed rule on whether it is preferable to establish by regulation a time limit, to be specified in the forward commitment, within which a project sponsor would have to expend the full amount of the AHP subsidy and, if so, the duration of that time limit, or whether to allow a Bank to establish the time limit as part of its AHP Implementation Plan, as proposed. Several commenters stated that the Bank should have the discretion to establish the time limit, noting that different time limits may be appropriate depending on the type, complexity, and specific funding needs of the loan pool, as well as legal and regulatory factors that may affect the pool. The Finance Board recognizes the need for some flexibility in this regard. The time limit should reflect the loan pool sponsor's market volume, considering the size and capacity of the network of originators that the loan pool sponsor uses to produce the AHP-assisted loans. However, the Finance Board believes that the time period should be no longer than 1 year because the use of the subsidy is interest-rate sensitive. Accordingly, the final rule allows a Bank to determine the time limit, to be specified in the forward commitment, for use of the AHP subsidy, provided that such limit may not exceed 1 year from the date of approval of the AHP application.

Section 951.5(c)(14)(ii)(B) of the final rule provides that, as an alternative to using a forward commitment, a loan pool sponsor may purchase an initial round of loans that were not originated pursuant to an AHP-specific forward commitment, provided that the entities from which the loans were purchased are required to use the proceeds from these purchases within the time limits specified in the Bank's AHP Implementation Plan, which shall not exceed 1 year from the date of approval of the AHP application. The proceeds must be used by such entities for loans

with terms in the approved AHP application and subject to AHP retention agreements.

*Retention agreements and other requirements: § 951.5(c)(14)(iii):* Section 951.5(c)(14)(iii) of the final rule requires that each AHP-assisted owner-occupied unit and rental property receiving AHP direct subsidy or a subsidized advance shall be subject to the requirements for monitoring and remedial action for noncompliance in the final rule, as well as the requirement for an AHP 5-year or 15-year retention agreement, respectively. The proposed rule inadvertently omitted the requirement for such a retention agreement in the case of loans financed with the proceeds of a subsidized advance. Consistent with the proposed rule, § 951.9(a)(7)(ii)(A) of the final rule eliminates current § 951.13(c)(4)(i)(B), such that households receiving permanent mortgage loans through the use of a subsidized advance would not have to repay any AHP subsidy in the case of a refinancing of the owner-occupied unit prior to the end of the retention period. However, the final rule continues to require such households to have retention agreements in place, because the retention agreement contains the requirements for notice to the Bank of any sale or refinancing of the unit. Several commenters favored not requiring a retention agreement for owner-occupied units assisted with subsidized advances, and recommended that a retention agreement also not be required where owner-occupied units are assisted with direct subsidies. The Finance Board believes that households funded with AHP-assisted mortgage loans and rehabilitation loans whose origination was funded by a loan pool sponsor should be subject to the same requirements as households receiving AHP-assisted loans or direct subsidies from other sponsors.

*Use of AHP subsidy as interest-rate buy down: § 951.5(c)(14)(iv):* Section 951.5(c)(14)(iv) of the final rule provides that where AHP direct subsidy is being used to buy down the interest rate of a loan or loans from a member or other lender, the loan pool sponsor must use the full amount of the AHP direct subsidy to buy down the interest rate at the time of closing on such loan or loans to achieve the permanent below-market interest rate on the loan as specified in the approved AHP application.

*Other issues:* A number of commenters recommended that the Banks be allowed to fund loan pools as a separate set-aside, rather than under the competitive application program, and that the Banks be allowed to establish the governing policies for their

loan pool programs. As discussed above under Revolving Loan Funds, the Finance Board does not believe that it is appropriate to set aside AHP funds for specific types of sponsors such as loan pool sponsors. The AHP is primarily a competitive program that funds projects based on their individual merits, regardless of sponsorship.

The Finance Board requested comment in the proposed rule on whether, in addition to loans for AHP-assisted owner-occupied units, rental housing loans should be eligible under the AHP loan pool authority, and if so, what kinds of loans and activities, consistent with the AHP requirements, should be eligible. Several commenters stated generally that rental housing loans should be eligible under the loan pool authority, with 1 commenter stating that this would help maximize the Bank's ability to meet housing needs in its district. The Finance Board recognizes that there may not be a sizable market at the current time for purchase and pooling of rental housing loans. Nevertheless, the Finance Board does not want to foreclose the potential use of AHP subsidy for this purpose should such opportunities arise. Accordingly, the final rule allows rental housing loans to be eligible under the AHP loan pool authority.

*Out-of-district projects eligibility requirement: § 951.5(c)(15):* Consistent with the proposed rule, § 951.5(c)(15) of the final rule removes the existing provision that allows a Bank, in its discretion, to require as an eligibility requirement that a project receiving AHP subsidy must be located in the Bank's district. See 12 CFR 951.5(b)(10)(i)(B). In addition, proposed § 951.5(c)(17) would have prohibited a Bank from establishing an eligibility requirement that a project receiving AHP subsidy must be located in the Bank's district. This provision is unnecessary and is omitted from the final rule, as a Bank in any case may not adopt additional eligibility requirements not specifically authorized under the AHP regulation. See the further discussion of the out-of-district projects issue below, under AHP Projects Outside the District.

*Removal of discretionary minimum Bank credit product usage requirement.* Consistent with the proposed rule, the final rule removes the existing provision that authorizes a Bank, in its discretion, to require its members to have used a minimum amount of the Bank's other credit products within the previous 12 months as a condition to applying for additional amounts of AHP subsidy. See 12 CFR 951.5(b)(10)(i)(C). A number of commenters opposed elimination of this

discretionary authority, stating that members who use a Bank's credit products contribute to the Bank's earnings, thereby generating more funds for the AHP, and a credit product usage requirement can be an incentive to encourage borrowing by members. The Finance Board believes that AHP funding should be provided, without restriction, to projects that score highest under a Bank's competitive application scoring criteria without regard to a member's Bank credit product usage. Accordingly, the final rule eliminates the authority.

*Discretionary homebuyer or homeowner counseling requirement:* § 951.5(c)(15)(ii). Section 951.5(c)(15)(ii) of the final rule adopts the proposed provision authorizing a Bank, in its discretion, to require homebuyer or homeowner counseling as an eligibility requirement for owner-occupied projects under the competitive application program. Under such a requirement, a Bank could limit AHP subsidies to owner-occupied projects that provide this resource for low- or moderate-income households. Such counseling, particularly for first-time homebuyers, can contribute to successful long-term homeownership, which the Finance Board has recognized in supporting such counseling for low- or moderate-income households receiving home purchase assistance under the AHP homeownership set-aside program. See 12 CFR 951.5(a)(2)(ii); see also discussion of counseling below under Homeownership Set-Aside Program.

A number of commenters supported allowing the Banks to require homeownership counseling as an eligibility requirement for homeownership projects under the competitive application program, with some commenters stating that the Finance Board should go further by making homeownership counseling mandatory under the competitive application program. However, several commenters pointed out that there are situations, such as rehabilitation of currently owner-occupied units or homeownership for households that are not first-time homebuyers, such as disaster victims, in which it is unnecessary or impractical to require counseling. It is for this reason that the Finance Board also proposed to make the currently mandatory counseling requirement under the homeownership set-aside program discretionary for households that are not first-time homebuyers (see § 951.6(c)(2)(iii)). The Finance Board does not believe that it is appropriate to mandate counseling for all projects under the competitive

application program, nor was such a proposal noticed for comment in the proposed rule. Nevertheless, the Banks, in their discretion, may require homebuyer or homeownership counseling, such as counseling for first-time homebuyers.

Several commenters also suggested that the Finance Board set minimum standards for homeownership counseling. The Finance Board believes that the Banks have better knowledge of what counseling is available in their districts and, under the final rule, the Banks have the discretion to set minimum counseling requirements. The Finance Board does not believe that it is appropriate to set national requirements in the rule that may create challenges in delivery for some local jurisdictions.

Several commenters also recommended that the Finance Board permit the use of AHP funds for counseling even when the counseled household does not purchase an AHP-assisted unit. The Finance Board believes that allowing this would not be consistent with the statutory requirement that AHP funds be used for the purchase, construction, or rehabilitation of eligible housing. See 12 U.S.C. 1430(j)(2).

*Prohibited use of AHP subsidy: prepayment fees:* § 951.5(c)(16)(i). Section 951.5(c)(16)(i) of the final rule revises the current provision by allowing a project to use AHP subsidy to pay prepayment fees imposed by a Bank on a member if the member prepays a subsidized advance, provided that: (i) The project is in financial distress that cannot be remedied through a project modification pursuant to § 951.5(f); (ii) the prepayment of the subsidized advance is necessary to retain the project's affordability and income targeting commitments; (iii) subsequent to such prepayment, the project will continue to comply with the terms of the approved AHP application and the requirements of the AHP regulation for the duration of the original retention period; (iv) any unused AHP subsidy is returned to the Bank and made available for other AHP projects; and (v) the amount of AHP subsidy used for the prepayment fee may not exceed the amount of the member's prepayment fee to the Bank. The existing provision does not include the restrictions in (i), (ii), and (v) above. See 12 CFR 951.5(b)(4)(i). The proposed rule would have prohibited AHP subsidy from being used for prepayment fees under all circumstances.

One commenter supported elimination of the authority, stating that AHP subsidy should be used only for

purchase, construction, or rehabilitation of housing, as required by the Bank Act. A number of other commenters opposed elimination of the authority, citing potential adverse consequences for ongoing project retention and affordability. A Bank stated that when a project is in financial distress and cannot maintain the AHP debt service, sale of the project or injection of additional equity or grant funds and subsequent repayment of the outstanding AHP subsidized advance may be its only recourse, with prepayment of the AHP subsidy allowing the project to be feasible provided it agrees to continue to meet the AHP requirements. The Bank asserted that such use of the AHP subsidy constitutes use of the subsidy for purchase, construction, or rehabilitation, as required by the Bank Act. Other commenters stated that the proposal appears to place members using AHP subsidized advances at a disadvantage over members using direct subsidies, by placing a greater burden on members that would likely pass some or all of the burden on to homeowners, project owners, and sponsors, thereby having a potentially chilling effect on member participation in the AHP. A Bank stated that the proposal would limit members' use of AHP subsidized advances because of the increased exposure to prepayment fees, and noted that subsidized advances provide long-term benefits to members and projects. The commenters also stated that prepayment fees are a customary part of financing costs for the purchase, construction, or rehabilitation of housing and, therefore, should be allowed as an eligible use of AHP subsidy.

Based on the comments, the Finance Board believes that in the limited circumstances where a project is in financial distress that cannot be remedied through a project modification pursuant to § 951.5(f), and prepayment of the AHP subsidized advance is necessary to retain the project's affordability and income targeting commitments, the AHP subsidy should be able to be used to pay the prepayment fee. Subsequent to prepayment, the project would have to continue to comply with the terms of the approved AHP application and the requirements of the AHP regulation for the duration of the original retention period, and any unused AHP subsidy would have to be returned to the Bank and made available for other AHP projects. In addition, the amount of AHP subsidy used for the prepayment fee may not exceed the amount of the

member's prepayment fee to the Bank. Accordingly, the final rule allows AHP subsidy to be used for prepayment fees under these limited circumstances.

*Changes to the scoring system:*

§ 951.5(d). Section 951.5(d)(1) and (2) of the final rule retains the current provisions that require each Bank to adopt written scoring guidelines for its competitive application program, and to allocate 100 points among 9 scoring criteria. See 12 CFR 951.6(b)(4). The proposal would not have made any substantive changes to those criteria, except for those relating to disaster areas and out-of-district projects, but proposed a number of technical revisions to the current rules and codification of certain staff interpretations.

*Variable-point scoring:*

§ 951.5(d)(3)(ii): Section 951.5(d)(3)(ii) of the final rule adopts the proposal to retain the provisions relating to fixed-point and variable-point scoring criteria, but makes technical changes to the latter, the effect of which is to codify a current staff interpretation that allows a Bank to implement variable-point scoring criteria either through a fixed scale or on a scale relative to the other applications that are to be scored in the same funding round. See 12 CFR 951.6(b)(4)(iii). Several commenters supported the proposal, with 1 commenter stating that the flexibility ensures that a Bank can meet effectively the housing needs in its district.

*Removal of optional income-targeting scoring provision for projects receiving government funds or tax credits:*

§ 951.5(d)(5)(iii)(A): Consistent with the proposed rule, § 951.5(d)(5)(iii)(A) of the final rule removes a provision of the existing regulation that allows a Bank, in its discretion, to score rental projects according to the targeting commitments made by the project to a government or tax credit allocating entity that provides funds or tax credits, respectively, to the project. See 12 CFR 951.6(b)(4)(iv)(C)(1). That provision is no longer necessary because of the changes to the rule, located at § 951.7(a)(2) and (a)(3), discussed further below, that allow a Bank, in its discretion, to rely for AHP long-term monitoring purposes on monitoring by government or tax credit monitoring entities, and the new risk-based monitoring authority that will enable a Bank to adopt risk-based monitoring requirements for such projects even if the projects' targeting commitments differ from those of the government or tax credit allocating entity. This does not preclude a project from using the targeting commitments of another housing program when applying for AHP subsidy, even when

the project intends to exceed such targeting commitments in practice. No comments addressed elimination of this scoring provision.

*Owner-occupied project income-targeting scoring:* § 951.5(d)(5)(iii)(B): Section 951.5(d)(5)(iii)(B) of the final rule adopts the proposed language clarifying regulatory practice relating to the scoring criterion for income targeting in owner-occupied projects. The provision clarifies that a Bank may determine in its AHP Implementation Plan how to award scoring points on a declining scale, taking into consideration the percentages of units and targeted income levels. One commenter supported the change.

*Disaster areas and displaced households scoring criterion:*

§ 951.5(d)(5)(vi)(E). Section 951.5(d)(5)(vi)(E) of the final rule adopts the proposed language permitting a Bank to award scoring points for applications that would finance housing located in a federally declared disaster area, as well as for applications that would finance housing for low-or moderate-income households that have been displaced from a federally declared disaster area due to a disaster, irrespective of the household's current residential location. The current regulatory provision on disaster area scoring permits the Banks to award scoring points only to the financing of housing located in federally declared disaster areas. See 12 CFR 951.6(b)(4)(iv)(F)(5). Because disasters may displace families from their homes, as in the case of Hurricane Katrina in 2005, the Finance Board believes that this scoring criterion should be expanded to address such situations. A number of commenters supported the change, stating that it would be consistent with other federal initiatives. One Bank recommended that the Finance Board eliminate income-eligibility requirements for displaced households, or codify in the regulation its No-Action Letter 2005–NAL–01 (Sept. 9, 2005),<sup>5</sup> which temporarily suspended income-eligibility requirements for existing AHP rental projects that provide vacant units for households displaced by Hurricane Katrina. However, the AHP income-eligibility limits are required by the Bank Act, and suspension of these limits only should be done on a case-by-case basis in extraordinary circumstances.

<sup>5</sup> 2005–NAL–01 is available in the FOIA Reading Room on the Finance Board Web site at <http://www.fhfb.gov/Default.aspx?Page=59&ListYear=2005&ListCategory=7#72005>.

*AHP projects outside the district:*  
§§ 951.5(d)(5)(vi)(L), 951.5(d)(5)(vii).

Consistent with the proposed rule, the final rule rescinds the Bank's existing discretionary authority to prohibit applications to fund projects located outside a Bank's district. However, in contrast to the proposed rule, the final rule retains, at § 951.5(d)(5)(vi)(L), the Bank's current discretionary authority to give a scoring preference under the First District Priority to applications to fund projects located in the Bank's district. In addition, under § 951.5(d)(5)(vii) of the final rule, a Bank continues to have the discretion to adopt a Second District Priority for in-district projects.

Under the current regulation, a Bank, in its discretion, may deny consideration of applications to the AHP competitive application program from members proposing to fund projects located outside a Bank's district. See 12 CFR 951.5(b)(10)(i)(B). Another provision of the current regulation permits a Bank to give scoring point preference to applications proposing to finance housing located within the Bank's district. See 12 CFR 951.6(b)(4)(iv)(F)(12). The proposed rule would have eliminated both provisions. In addition, proposed § 951.5(d)(5)(vii) would have prohibited a Bank from adopting as its Second District Priority a scoring preference for projects located in the Bank's district. See 12 CFR 951.6(b)(4)(iv)(G).

The Bank Act does not set up the AHP as a geographically targeted program. Rather, it requires each Bank to establish a program to provide subsidized funding to its members. See 12 U.S.C. 1430(j)(1). The existing discretionary authority to prohibit applications for out-of-district projects was adopted at a time when all Bank members generally conducted business only within the boundaries of a state within the Bank's district. As a result of interstate branching, however, many members now do business in communities outside their Bank district. The authority to restrict AHP projects to the Bank's district, if exercised, would limit a member's ability to support otherwise eligible AHP projects in certain of the communities that it serves solely because those communities are located outside the Bank's district boundaries. This restriction also could disadvantage communities served by financial institutions that move their headquarters to a state located in a different Bank district. The Finance Board believes that a Bank should not prohibit applications for AHP projects simply because the projects are located outside the Bank's district, so long as

they are in communities in which a member does business.

In addition, the existing authority in the current AHP regulation has not been extensively invoked by the Banks. In 2004, only 1 Bank prohibited the use of AHP funds for out-of-district projects, and only 2 Banks elected to give scoring preference to in-district projects. Nor has there been a significant outflow of AHP funds as a result of member financing of projects outside the district. Of over 10,000 AHP projects funded since the beginning of the program in 1990, approximately 300 projects, or 3.0 percent, have been located outside a Bank's district.

A number of commenters supported elimination of the 2 provisions, stating that the proposal recognized the changing nature of member operations resulting from interstate mergers and acquisitions, and would allow members to obtain the benefits of the AHP for their entire market areas. Some commenters pointed out that the proposal would enable developers and communities to continue established relationships with financial institutions even when mergers and acquisitions result in a change in the Bank district of which the institution is a member. Other commenters opposed elimination of the 2 provisions, citing a number of reasons, including increased monitoring costs, less familiarity with out-of-district projects and their market areas, and the concern that large, multi-regional members would have access to more projects outside of the district that could compete for funds more effectively than projects in the district, putting local, state-chartered members at a disadvantage. Several Banks stated that their Advisory Councils and members preferred to keep the district's resources within the district where they can help meet local needs, especially when other resources for affordable housing may be less available to local projects.

The remaining commenters on the proposal stated that they would not object to requiring the Banks to permit applications for out-of-district projects, provided the regulation retained the current discretionary scoring preference for in-district projects under the First District Priority. These commenters stated that this discretionary scoring priority preserves a geographic balance by spreading projects across and among the different Bank districts, and eliminating the priority may eventually divert projects from districts with fewer or smaller members to districts with large, multibillion dollar members. A trade association representing local member institutions encouraged the Finance Board to continue to permit the

Banks to provide some scoring points for in-district projects for at least a portion of their AHP funds, to ensure that those members that do not operate out-of-district have access to some share of AHP funds.

The Finance Board continues to believe that the Banks should not be authorized to prohibit applications for AHP funding for out-of-district projects, because the AHP should be available to all members and each Bank has members with branches located outside the district boundaries. However, the Finance Board is persuaded by the comments that there is merit in retaining the current discretionary authority for the Banks to give scoring preference to in-district projects. Consequently, the final rule eliminates the existing discretionary authority to prohibit out-of-district projects, but retains the existing discretionary scoring criterion for in-district projects under the First District Priority. The final rule also retains the existing language in the Second District Priority, thereby allowing a Bank, in its discretion, to adopt a scoring preference for in-district projects under that scoring category. However, the Finance Board intends that a Bank should not use the scoring criteria as a way to exclude out-of-district projects from the competitive application program.

*Modifications of approved AHP applications: § 951.5(f).* Section 951.5(f) of the final rule adopts the proposed codification of current practice by adding a requirement that a Bank must document in writing its analysis and justification for any modification of a previously approved project. See 12 CFR 951.7(a). One commenter supported the proposed language.

*Progress towards use of AHP subsidies: § 951.5(g)(2).* Section 951.5(g)(2) of the final rule requires each Bank to establish and implement policies, including time limits, for determining whether progress is being made towards draw-down and use of AHP subsidies by approved projects, and whether to cancel an AHP application approval for lack of such progress. Progress requirements must be included in the Bank's AHP Implementation Plan.

Affordable housing projects often may encounter delays due to changes in funding, legal requirements, community challenges, or other events. These delays may affect the ability of a project to progress towards its scheduled draw-down and use of the AHP subsidy. The current regulation requires a Bank to specify a time period in its AHP Implementation Plan for the draw-down and use of the AHP subsidy. If a project

does not do so within such period, the Bank must cancel its approval of the application. See 12 CFR 951.8(c)(1). The rigidity of this requirement sometimes has impaired the ability of the Banks to determine whether the delays are significant enough to affect a particular project's ability to draw down and use the subsidy. While the Banks have extended the time period for certain projects in an effort to take into account such delays, the current cancellation requirement limits a Bank's ability to manage this process.

The final rule gives the Banks greater capacity to manage this process by requiring them to adopt policies that address how they will make such determinations. Several commenters supported the change as providing increased flexibility.

*Compliance upon disbursement: § 951.5(g)(3).* Section 951.5(g)(3) of the final rule adopts the proposed requirement that a Bank establish and implement policies for determining, prior to initial disbursement of AHP subsidy, and prior to each subsequent disbursement if the need for AHP subsidy has changed, that the project meets the applicable eligibility requirements and all obligations committed to in the approved AHP application. The final rule also states that if a Bank cancels any AHP application approvals due to failure to meet the eligibility requirements, the Bank shall make the AHP subsidies available for other AHP-eligible projects. The Bank's requirements must be included in its AHP Implementation Plan.

Under the current regulation, a Bank must verify compliance with eligibility requirements and application commitments prior to each disbursement of AHP subsidy. See 12 CFR 951.8(c)(2). The requirement to repeatedly verify project compliance during every stage of the disbursement process may be more than is necessary to ensure compliance with the rules, and effectively precludes a Bank from using its best judgment to determine whether the circumstances of a particular AHP project warrant repeated verification of compliance with the rules. The change gives the Banks greater latitude in determining when it is appropriate to verify compliance prior to disbursing AHP funds. Several commenters supported the change as providing additional Bank discretion to establish appropriate compliance procedures.

*Bank board of directors duties and delegation: § 951.5(h).* The final rule consolidates provisions of the current and proposed rules addressing the Bank



board of directors" various duties regarding establishment and implementation of the competitive application program requirements in one section, § 951.5(h). Specifically, § 951.5(h)(1) states that a Bank's board, after consultation with its Advisory Council, shall be responsible for adoption of the AHP Implementation Plan, and for approving or disapproving the applications for AHP subsidy. Section 951.5(h)(2) reiterates that the Bank's board may not delegate these responsibilities to Bank officers or other Bank employees. No comments addressed these changes.

*F. Homeownership Set-Aside Program: § 951.6*

The final rule adopts the proposed reorganization of the existing regulation, generally by combining various homeownership set-aside program provisions into one section, located at § 951.6. A number of commenters supported these technical changes, stating that they would be helpful for the Banks, members, and sponsors in understanding the different requirements of the competitive application and homeownership set-aside programs.

*Removal of optional nonmember applicants provision: § 951.6(b).* Consistent with the proposed rule, § 951.6(b) of the final rule eliminates the existing provision permitting a Bank, in its discretion, to accept applications for homeownership set-aside program subsidies from an institution that is not a member of the Bank, but which has pending an application for membership. See 12 CFR 951.6(a). Thus, an applicant would have to be a member of the Bank at the time that it submits an AHP application. The rationale for this revision was discussed above in connection with a similar amendment for the competitive application program.

*Timing of household income-eligibility determination; reservation of set-aside funds; qualification of students: § 951.6(c)(2)(i), (e)(2).* Timing of household enrollment: § 951.6(c)(2)(i): Section 951.6(c)(2)(i) of the final rule provides that a household's income eligibility is to be determined at the time the member enrolls the household in the Bank's homeownership set-aside program, with the time of enrollment by the member to be defined by the Bank in its AHP Implementation Plan. The existing regulation has been interpreted by some Banks as requiring that the household's income qualification for purposes of the AHP be determined at the time that the household is qualified for a mortgage loan. See 12 CFR 951.1 (definition of

"low- or moderate-income household"); 951.5(a)(2)(i). Such an interpretation has posed problems for certain households participating in empowerment programs, such as multi-year job training or savings or welfare-to-work programs, that are designed to assist very low- and low- or moderate-income households accumulate assets over a number of years, including households that might not otherwise qualify for a mortgage loan. The problem has been that by the time the household completes such a program and can qualify for a mortgage loan, the household may no longer qualify as low- or moderate-income as required under the AHP homeownership set-aside program.

In response to the concern that participants in empowerment programs be able to depend on receipt of anticipated closing cost or down payment assistance when they are ready to purchase a home, such as offered by homeownership set-aside funding, § 951.6(c)(2) of the proposed rule would have provided that the household's income eligibility be determined at the time the household is enrolled by the member and the Bank in the homeownership set-aside program. This was intended to clarify that once a household is enrolled in an empowerment program, the household's income eligibility for the homeownership set-aside program is assured. This clarification was intended to be consistent with the belief that such assurance is important to achieving the purpose of such programs to prepare households for homeownership.

This provision in the proposed rule, however, caused some confusion among commenters, because the process of "enrollment" was not described in the rule. Several commenters pointed out that under some existing Bank homeownership set-aside programs, members and Banks enroll households at different times; e.g., a member may enroll a household for participation in the homeownership set-aside program at the member level, but not notify the Bank of the household's participation until the household has met the requirements of the Bank's homeownership set-aside program, such as saving for a specified period or receiving homeownership counseling. This process recognizes that any number of households enrolled by the member will not complete the program before completing program requirements, and minimizes the administrative requirements of processing them at the Bank level.

The Finance Board wants to ensure that a Bank may allow a household to

enroll with a member, even though the household may not meet the requirements of the Bank's homeownership set-aside program for a number of years because the household is participating in an empowerment program. The Finance Board believes the individual Bank should establish the policies for enrollment of households by members in the Bank's homeownership set-aside program. Accordingly, the final rule provides that income eligibility is to be determined as of the date the household is enrolled by the member in the Bank's homeownership set-aside program, with the time of enrollment by the member defined by the Bank in its AHP Implementation Plan.

*Reservation of set-aside subsidies: § 951.6(e)(2).* In the past, the Finance Board generally has considered a household to be enrolled in the AHP homeownership set-aside program at the time the member or the Bank reserves the set-aside funds for the household so that the funds will be available when the household closes on its home purchase. While such a process might ensure that the set-aside funds will be available when all program requirements have been met for households participating in job-training or other empowerment programs, such a process could result in many years elapsing between the time of enrollment of the households in the homeownership set-aside program and the disbursement of the set-aside funds to that household. Such a delay is inconsistent with the intent of § 951.6(e)(3), which requires progress to be made towards draw-down and use of the AHP direct subsidies by eligible households pursuant to the requirements in the Bank's policies.

The homeownership set-aside program requires careful administration by a Bank and the participating member and should be subject to reasonable Bank policies on the reservation and timely use of AHP subsidy. In those cases in which members enroll households that may take a number of years to complete the program requirements, the Bank should not reserve funds for these households at the time of enrollment by the member in the homeownership set-aside program, but should anticipate the timing of disbursement and manage future set-aside allocations based on that. The Finance Board believes that, in managing future set-aside allocations, it would be reasonable for a Bank to reserve set-aside funds up to 2 years in advance of the Bank's time limit for the draw-down and use of the funds by the household. The Bank should reserve

such funds from the set-aside allocation of the year in which the Bank makes the reservation. For example, a household enrolling with a member at the same time it enrolls in the Family Self Sufficiency (FSS) Program has 5 years in which to complete the requirements of the FSS. In this case, a member may enroll a household in 2006, but the Bank should not reserve 2006 set-aside funds for the household. Rather, the Bank should anticipate funding that household from a future year's set-aside allocation, with such future reservation of funds being no more than 2 years prior to the expected disbursement to the household. In this case, the Bank could reserve funds from its 2009 set-aside allocation for a household that has until 2011 to complete its FSS requirements and purchase its home. It is expected that the Bank will work with members that enroll such households in order to determine whether households are likely to meet the FSS requirements in fewer than 5 years and to manage the reservation of funds to accommodate such households. This provision will not affect the operations of the current homeownership set-aside programs of most of the Banks, which already require a household to draw down the AHP subsidy within 24 months or less of enrollment in their homeownership set-aside programs.

Accordingly, § 951.6(e)(2) of the final rule provides that a Bank must establish and implement policies for reservation of set-aside subsidies for households enrolled in the Bank's homeownership set-aside program. These must provide that set-aside subsidies be reserved no more than 2 years in advance of the Bank's time limit in its AHP Implementation Plan for draw-down and use of the funds by the households and the reservation of subsidies be made from the set-aside allocation of the year in which the Bank makes the reservation.

**Qualification of students:** It is the Finance Board's expectation that Bank policies for the homeownership set-aside program will be designed to assist AHP income-eligible households who, but for receipt of the AHP subsidy, would not be able to afford to purchase or rehabilitate a home. This would preclude qualification of students with part-time or no income while in school who ordinarily would have a reasonable prospect for a substantial increase in income exceeding the AHP income-eligibility limit upon entering the workforce full-time.

Several commenters appeared to misunderstand the manner in which this principle was expressed in the **SUPPLEMENTARY INFORMATION** section of

the proposed rule, believing that it was intended to address households already in the workforce with low- or moderate-incomes that a Bank would have to determine were "temporary." Rather, this principle refers to a potential misuse of AHP funds available through the homeownership set-aside program, in which member institutions qualify students as income-eligible based on part-time or no income, but who have a reasonable expectation or knowledge that, upon graduation, the student will have income substantially above the AHP income limit. For example, a member should not qualify a full-time law school student with little or no income, knowing that the student already has secured a position with a law firm upon graduation that will pay considerably more than the AHP income limit of 80 percent of the area median income. This principle is not intended to apply to households participating in empowerment programs, such as multi-year job training or savings or welfare-to-work programs, that are designed to assist very low- and low- or moderate-income households accumulate assets over a number of years.

**Homebuyer or homeowner counseling:** § 951.6(c)(2)(ii), (c)(2)(iii). Section 951.6(c)(2)(ii) of the final rule retains the existing requirement that first-time homebuyers must complete a homebuyer or homeowner counseling program in order to be eligible for homeownership set-aside assistance, but § 951.6(c)(2)(iii) revises the existing requirement by authorizing a Bank to decide, in its discretion, whether to require households that are not first-time homebuyers to complete a homebuyer or homeowner counseling program in order to be eligible for homeownership set-aside assistance.

Under the existing regulation, all households receiving AHP homeownership set-aside funds must complete a homeowner or homebuyer counseling program. See 12 CFR 951.5(a)(2)(ii). At its inception, the homeownership set-aside program was a home-purchase program for first-time homebuyers only. As a result, the Finance Board required each assisted household to obtain homebuyer counseling in order to obtain AHP assistance. The Finance Board later amended the homeownership set-aside authority to permit the Banks to use homeownership set-aside funds to finance housing other than for first-time homebuyers, such as rehabilitation of already owner-occupied units or homeownership for disaster victims, and required that each assisted household obtain homebuyer or homeowner counseling. As a practical

matter, not all households will require such counseling. Moreover, there are some areas of the country in which counseling may not be readily available, and the quality of the counseling also may vary. Accordingly, the proposed rule would have made counseling for all households receiving set-aside funds under the homeownership set-aside program an optional requirement for the Bank.

A number of commenters concurred with the Finance Board that it is unnecessary or impractical to require counseling for households that are not first-time homebuyers. Other commenters generally opposed the proposal, emphasizing that homeownership counseling is critical to a household's short-term and long-term success in avoiding foreclosure. While the Finance Board continues to believe that it is not appropriate to mandate homebuyer or homeowner counseling for all households under the homeownership set-aside program, the Finance Board concurs with commenters that counseling is important for first-time homebuyers. Accordingly, § 951.6(c)(2)(ii) of the final rule retains the existing requirement that first-time homebuyers must complete a homebuyer or homeowner counseling program in order to be eligible for homeownership set-aside assistance, but § 951.6(c)(2)(iii) allows a Bank to determine, in its discretion, whether to require households that are not first-time homebuyers to complete a homebuyer or homeowner counseling program in order to be eligible for homeownership set-aside assistance.

**Financial or other concessions:** § 951.6(c)(6). **Bank discretionary authority:** Section 951.6(c)(6) of the final rule provides that a Bank may, in its discretion, require members and other lenders to provide financial or other concessions, as defined by the Bank in its AHP Implementation Plan, to households in connection with providing the AHP direct subsidy or financing to the household.

Under existing § 951.5(a)(6), a member that provides mortgage financing to a participating household under the homeownership set-aside program also must provide financial or other incentives to that household in connection with the mortgage financing. See 12 CFR 951.5(a)(6). The existing requirement may place small members, such as those located in rural areas, at a disadvantage compared with larger members, which may have more financial and market resources, and may place a number of members at a disadvantage compared with nonmember lenders, which do not have

to provide any financial or other concessions to the borrowing household. The Finance Board requested comment in the proposed rule on whether the authority to require member financial or other concessions to households should be mandatory or discretionary for the Banks. Most commenters addressing this issue preferred that the Banks have discretionary authority, stating that a mandatory requirement could place smaller, community, and rural members at a disadvantage vis-à-vis larger members with the resources to provide concessions and with nonmembers that do not have to provide concessions to the household. The Finance Board agrees that a mandatory requirement could disadvantage smaller, community, and rural members, and that each Bank is in the best position to determine whether such a requirement is appropriate for the members in its district. Accordingly, in contrast to the proposed rule, the final rule makes the authority to require member financial or other concessions discretionary for the Banks.

*Bank establishment of concessions:* The current regulation does not prescribe or define the types of financial or other concessions the member must provide, leaving it to the member's discretion to determine what kind of concessions meet the requirement. Under the proposed rule, each Bank, rather than the member, would establish the specific types of financial incentives or other assistance that the member would have to provide in order to meet the requirement for providing financial or other concessions to the households. The Finance Board requested comment in the proposed rule on whether the regulation itself should specify particular financial or other concessions that a member must provide to households, such as matching funds or member-provided financing. Several commenters generally supported having the Bank establish the specific types of eligible financial or other concessions that the member must provide to the homebuyers. Accordingly, consistent with the proposed rule, the final rule provides for the Bank to establish the specific types of financial or other concessions that members must provide to households.

Some commenters also stated that the wording of the proposal could be interpreted to mean that the Banks must provide financial concessions to the members to participate in the homeownership set-aside program. As discussed above, this was not the intent of the proposed language. The language is reworded in the final rule to clarify

that the concessions are to be provided by the members to the households, not by the Bank to the members.

In reviewing the comments, the Finance Board concluded that the word "incentives" used in the proposed rule in connection with the member requirements created confusion, because these are not intended to encourage households to use the homeownership set-aside program. Access to AHP down payment and closing cost assistance is the incentive for household participation in the program. The term "concessions" more accurately describes the types of reduced costs or fee waivers provided by the member in order to meet the requirements of this provision. Accordingly, the final rule uses the word "concessions" rather than the word "incentives."

The proposed rule also would have removed the existing requirement that a member provide financial or other concessions if it is providing mortgage financing to a participating household. This proposal was intended to level the playing field among members offering homeownership set-aside assistance, and to help avoid situations in which the member might require the household to obtain a mortgage loan from another lender in order to avoid having to provide financial or other concessions to the household. The proposal also was intended to provide the homebuyers additional opportunities to benefit from financial concessions, whether or not they are getting their mortgage loans from the member. As discussed above, commenters generally supported allowing Bank discretion in the establishment of member financial or other concessions. The Finance Board believes that the Banks are in the best position to determine whether the existing requirement would be appropriate in their respective districts. Accordingly, consistent with the proposed rule, the final rule does not require a member providing mortgage financing to a participating household to also provide financial or other concessions to the household in connection with the mortgage financing.

*Bank discretionary authority to require concessions from nonmembers:* The Finance Board also requested comment in the proposed rule on whether the regulation should require all originators of mortgage loans to households receiving homeownership set-aside funding to provide financial or other concessions in connection with their mortgage financing, irrespective of whether the originator is a member or nonmember. The proposed rule would have applied this requirement only to

members. Several commenters stated generally that requiring nonmembers, as well as members, to provide financial or other concessions would level the playing field. Other commenters objected to putting members in the position of having to monitor nonmembers and their concessions for adherence to Bank guidelines, which they stated could discourage members from participating in the AHP, and raises issues regarding how to enforce such requirements again nonmembers. The Finance Board believes that households would benefit from additional opportunities to receive financial or other concessions from nonmember lenders, and that the Banks are in the best position to determine whether such a requirement would be appropriate in their respective districts. Accordingly, the final rule provides the Banks with discretionary authority to require lenders other than members to provide financial or other concessions in conjunction with their lending to households receiving AHP assistance under the homeownership set-aside program.

*Bank discretionary authority to establish member preferences.* In addition, the Finance Board requested comment in the proposed rule on whether the Banks should have to establish preferences for member priority access to homeownership set-aside funds, such as a preference for a member working in partnership with a not-for-profit sponsor assisting first-time homebuyers to qualify for a mortgage loan. One commenter supported requiring the Banks to give priority to members that provide financial assistance to not-for-profit sponsors for program development, especially for homeownership counseling assisting first-time homebuyers, stating that not-for-profit participation in homeownership programs is key to households' long-term success in keeping their homes. Another commenter supported a preference for members working with not-for-profit sponsors that have a long-term commitment to the creation of affordable housing. The Finance Board believes that the Banks are in the best position to determine whether such preferences for members would be appropriate in their respective districts. Accordingly, the final rule does not require the Banks to establish particular preferences for members.

*Financing costs: § 951.6(c)(7).* Consistent with the proposed rule, § 951.6(c)(7) of the final rule provides that the rate of interest, points, fees, and any other charges for all loans made in conjunction with the AHP direct

subsidy shall not exceed a reasonable market rate of interest, points, fees and other charges for loans of similar maturity, terms, and risk.

Under the existing regulation, the requirement applies only to situations in which the member provides the financing, but not if a third party does so. See 12 CFR 951.5(a)(6). The existing language has the potential to create opportunities for using AHP funds in conjunction with the origination of loans with interest rates, points, fees, and other charges that exceed a reasonable market rate, if the loans are originated by a nonmember. In order to avoid that possibility, § 951.6(c)(7) of the proposed rule would have revised the regulation to state that charges that are used directly or indirectly in conjunction with the AHP direct subsidy must not exceed a reasonable market rate. That revision is consistent with the statutory requirement that Finance Board regulations must “ensure that subsidies provided by Banks to member institutions under this program are passed on to the ultimate borrower.” See 12 U.S.C. 1430(j)(9)(E).

The majority of commenters on this issue supported extending application of the provision to nonmembers, stating that this would help guard against the imposition of excessive financing costs on low- or moderate-income households by a third-party lender. A Bank and its Advisory Council opposed the proposal on the basis that it would require members to regulate other lenders even though the members are not making the loans. The Finance Board believes that any member that receives AHP subsidy and passes it through to another lender has a responsibility to assure that the lender is not imposing excessive financing costs on the household receiving the AHP subsidy. Under § 951.8(b)(1) of the final rule, the member would be liable to the Bank for repayment of the amount of any excessive financing costs imposed by the lender if imposition of these costs resulted from the member's actions or omissions.

*Cash back to household: § 951.6(c)(9).* Section 951.6(c)(9) of the final rule provides that a member may provide cash back to a household at closing on the mortgage loan in an amount not exceeding \$250, as determined by the Bank in its AHP Implementation Plan, and a member must use any AHP subsidy exceeding such amount that is beyond what is needed at closing for closing costs and the approved mortgage amount as a credit to reduce the principal of the mortgage loan or as a credit toward the household's monthly payments on the mortgage loan.

The Finance Board's Horizontal Review identified problems in the operations of the homeownership set-aside programs at some of the Banks. Although those problems were limited to a few situations, the proposed rule sought to address them by clearly identifying ineligible uses of AHP set-aside funds. A number of commenters supported the proposal, but pointed out that implementing the prohibition on cash backs to households could pose an unnecessary administrative burden if the terms of the loan and the loan documents would need to be changed at closing. These commenters recommended that the final rule allow a *de minimis* amount of cash back at closing to the household. The Finance Board believes that the comments have merit, and accordingly, the final rule provides for a *de minimis* amount of cash back of up to \$250 per household, as determined by the Bank in its AHP Implementation Plan.

Some commenters were concerned that the proposal would prevent the use of any of the AHP subsidy to reimburse the household for closing costs paid outside of closing or for rehabilitation work that is part of the closing. The Finance Board has always allowed AHP subsidy to be used to reimburse households that have paid some out-of-pocket closing costs prior to the actual closing, and the final rule does not prevent that. However, the Finance Board does not believe that AHP subsidy should reimburse a household for any down payment, or earnest money or deposit applied to the down payment, especially where the Bank awards AHP subsidy based on a match of the household's own down payment savings. The prohibition on cash back to the household does not apply to cash that is being placed in escrow or paid to a third party for purposes of planned rehabilitation of the property after closing, for example, as would be reflected on a HUD-1A closing statement. However, a Bank could not provide AHP subsidy directly to the household for improvements that are not part of the home purchase.

Some commenters also were concerned that requiring excess AHP subsidy to be used to reduce the loan principal would result in an administrative burden at closing because loan documents including the note and lender's check, and other required consumer disclosures, would have been prepared prior to closing. In requiring that any amount of AHP subsidy in excess of what is needed at closing be applied as a credit to reduce the principal of the mortgage loan, the Finance Board does not intend that the

lender have to recalculate the mortgage amount and terms and generate new consumer disclosures at closing. Rather, the additional AHP subsidy may be applied as a credit to the outstanding principal following execution of the note and thereby increase the household's equity in the home. In this way, the additional AHP subsidy would decrease the amount of principal outstanding on the original note without affecting the monthly payments and, thereby, not creating an administrative burden at closing. This does not preclude the permanent lender from applying the additional AHP subsidy as additional down payment and revising the loan terms and consumer disclosures accordingly, either prior to or at closing. The final rule also provides that, in the alternative, the excess AHP subsidy may be applied as a credit toward the household's monthly payments on the mortgage loan.

*Procedure for funding: § 951.6(e).* *Reservation of homeownership set-aside subsidies: § 951.6(e)(2).* As discussed above under Reservation of Set-Aside Subsidies, § 951.6(e)(2) of the final rule addresses requirements for Bank reservation of homeownership set-aside subsidies for households enrolled in the Bank's homeownership set-aside program.

*Progress towards use of AHP direct subsidy: § 951.6(e)(3).* For reasons similar to those discussed above under the competitive application program, § 951.6(e)(3) of the final rule, consistent with the proposed rule, requires a Bank to establish and implement policies, including time limits, for determining whether progress is being made towards draw-down and use of homeownership set-aside funds by eligible households, and whether to cancel AHP application approvals for lack of such progress. See 12 CFR 951.8(b)(1). The Bank's requirements adopted pursuant to this paragraph (e)(3) shall be included in its AHP Implementation Plan. One Bank expressed concern that this proposal could require the Bank to track homebuyers' progress toward closing on a home between the time of the household's enrollment and the end of the time period for draw-down and use of the subsidy, and that doing so would create unnecessary administrative costs of reporting each homebuyer's status. The Finance Board's intent in proposing the change was not to require tracking of a household's progress in meeting the requirements of the homeownership set-aside program during the period prior to the end of the Bank's time limit specified in its AHP Implementation Plan, but to allow the Banks greater flexibility for dealing with a household

that has not used the assistance by the end of the time period, rather than having to cancel the commitment of homeownership set-aside funds to the household at that time. Another Bank stated that, in the case of a homeownership set-aside program in which the Bank reserves a portion of homeownership set-aside funds for use by an individual member, the provision should apply to the member's progress in drawing down its homeownership set-aside allocation. The Finance Board believes that a Bank's method for members' access to the homeownership set-aside funds, either through lump-sum allocation or first-come, first-serve according to its qualified household customers, is irrelevant to the underlying purpose of this provision, which is the household's draw-down and use of the subsidy.

#### *G. Monitoring: § 951.7*

Consistent with the proposed rule, the final rule replaces prescriptive monitoring provisions in the existing regulation with more broadly stated monitoring objectives that are intended to allow the Banks more latitude in determining the type and frequency of reports and certifications that are best suited for monitoring a particular project's compliance with its AHP application commitments and the AHP regulation. The final rule also reorganizes the proposed monitoring provisions to provide greater clarity.

*Monitoring Requirements for the Competitive Application Program: § 951.7(a). Initial monitoring policies: § 951.7(a)(1): Adoption and implementation: § 951.7(a)(1)(i):* Section 951.7(a)(1)(i) of the final rule adopts the proposed requirement that a Bank adopt and implement written policies for monitoring of each AHP owner-occupied and rental project under its competitive application program prior to, and within a reasonable period of time after, project completion. The Bank's requirements for initial monitoring shall be included in its AHP Implementation Plan. Specifically, a Bank's monitoring policies must enable it to determine, at a minimum, whether: the project is making satisfactory progress toward completion; the completed project is making satisfactory progress towards occupancy by eligible households; and the completed project meets the commitments made in the approved AHP application and is otherwise in compliance with applicable AHP requirements within a reasonable period of time after project completion. Consistent with the proposed rule, the final rule removes the existing requirement that the Banks

must monitor project habitability, and also removes the definition of "habitable" from the existing definitions. See 12 CFR 951.1; 951.10(a)(2)(ii)(B)(2), (c)(2).

A number of commenters supported the monitoring proposal, citing its increased flexibility and the likelihood that it would result in streamlined procedures. Several commenters specifically supported removing the existing requirement to monitor "project habitability." Some commenters recommended that the regulation define "reasonable period of time" in order to avoid differing interpretations. The Finance Board believes that such determinations are best made by the Banks based on the types of projects to be monitored. Some commenters also requested that the Finance Board review and approve the Banks' policies for initial monitoring. The Finance Board intends to review the Banks' initial monitoring policies as a part of its examination program.

*Back-up and other project documentation; sampling plan: § 951.7(a)(1)(ii), (a)(1)(iii):* Section 951.7(a)(1)(ii) of the final rule adopts the proposed requirement that a Bank's monitoring policies include requirements for Bank review of back-up project documentation regarding household incomes and rents maintained by the project sponsor or owner, and requirements for maintenance and Bank review of other project documentation in the Bank's discretion. Several commenters supported the proposal, provided the regulation allows the Banks to use project sampling for initial monitoring, rather than having to conduct initial monitoring of each project. Section 951.7(a)(1)(iii) of the final rule prohibits a Bank from using a sampling plan to select the projects to be monitored, but allows a Bank to use a reasonable risk-based sampling plan to review the back-up project documentation. Section 951.7(a)(1)(iii) reflects the importance of determining that all completed projects are starting out on a solid basis and in compliance with the commitments made in their approved AHP applications and the AHP regulation.

*Reliance on long-term tax credit monitoring for rental projects: § 951.7(a)(2):* Consistent with the proposed rule, § 951.7(a)(2) of the final rule provides that for completed AHP rental projects that have been allocated tax credits, a Bank may, in its discretion, for purposes of long-term AHP monitoring, rely on the monitoring by the state-designated housing credit agency administering the tax credits of the income targeting and rent

requirements applicable under the LIHTC program. The Bank would not need to obtain and review reports from such agency or otherwise monitor the projects' long-term AHP compliance.

Under the existing regulation, in the case of AHP rental projects that receive tax credits, a Bank may rely on the monitoring conducted by the government entity providing the tax credits, provided that: (i) The income targeting, rent, and retention period requirements monitored by such entity for its own program are the same as, or more restrictive than, those committed to in the approved AHP application; (ii) the entity agrees to provide monitoring reports to the Bank on any rent, income and project habitability noncompliance; and (iii) the entity demonstrates its ability to carry out monitoring under its own program and the Bank does not have information that such monitoring is not occurring or is inadequate. See 12 CFR 951.11(a)(1). The existing regulation also provides that if the income targeting, rent, and retention period requirements monitored by such entity for its own program are less restrictive than those committed to in the approved AHP application, a Bank may rely on the monitoring conducted by such entity only if the entity agrees to monitor the project for compliance with the AHP standards and provide monitoring reports to the Bank on any rent, income and project habitability noncompliance. See 12 CFR 951.11(a)(2).

The LIHTC, which often is used by projects that receive some form of AHP subsidy, has 2 elective eligibility standards related to the units in the project and the income of the households occupying the units: (1) 20 percent of the units must be occupied by households with incomes at or below 50 percent of the area median income; or (2) 40 percent of the units must be occupied by households with incomes at or below 60 percent of the area median income. See 26 U.S.C. 42(g)(1). The Bank Act imposes similar limits on the use of AHP subsidies for rental housing, *i.e.*, eligible rental projects must have at least 20 percent of the units occupied by households with incomes at or below 50 percent of the area median income. See 12 U.S.C. 1430(j)(2)(B). Because this AHP income-eligibility standard is identical to the first tax credit income-eligibility standard, for AHP-assisted tax credit projects that employ the first standard, the current AHP regulation permits a Bank to accept the project monitoring that is conducted by the government agencies providing the tax credits for their own programs.

With respect to AHP-assisted tax credit projects that employ the second standard, under which 40 percent of the units must be occupied by households with incomes at or below 60 percent of the area median income, the current AHP regulation allows a Bank to rely on monitoring conducted by the government entity administering the tax credits only if the entity also monitors the project for compliance with the AHP income-eligibility standard. *See* 12 CFR 951.11(a)(2). Because this tax credit income-eligibility standard differs from the AHP income-eligibility standard, under the existing AHP regulation a Bank must have an agreement with the government entity to conduct its monitoring of the AHP project for compliance with the AHP standard. Such additional monitoring entails additional costs to the Bank, which a number of the Banks have contended is not an effective means of monitoring the project, as it is largely duplicative of existing monitoring conducted by other parties. A number of AHP users also have contended that this level of monitoring is superfluous and adds unnecessary burdens to the project.

As discussed in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, after reviewing several studies on the performance of the LIHTC, the Finance Board has concluded that the overwhelming majority of these tax credit projects—irrespective of their income eligibility standard—meet the AHP income-eligibility standard in a substantively equivalent manner. A 1997 General Accounting Office study found that 75 percent of households in tax credit projects had incomes under 50 percent of the area median income, which would be well within the AHP requirement that 20 percent of units be occupied by households with incomes at or below 50 percent of the area median income. Other subsequent studies, such as those prepared by Abt Associates for HUD, and one by Ernst and Young, have reached similar conclusions regarding the targeting of tax credit projects to very low-income households. Noncompliance with the income-eligibility requirements by tax credit projects is relatively rare, as it would lead to adverse tax consequences for investors in such projects. In addition, the length of the retention periods for AHP rental projects and tax credit projects is the same, and the affordability standard for tax credit projects, *i.e.*, the rent requirement, is substantively equivalent to the AHP rent requirement that the rents charged may not exceed 30 percent of the targeted household income. *See* 12 U.S.C.

1430(j)(2)(B), (j)(13)(D); 26 U.S.C. 42(g)(2).

All commenters on this proposal strongly supported allowing a Bank to rely on the long-term monitoring performed by the tax credit agency, usually a state housing finance agency, and thereby exclude these rental projects from the Bank's long-term monitoring plan. Commenters supported the reduction in duplicative monitoring as easing the administrative burdens on project owners, members, and Banks, without sacrificing project accountability and quality. Commenters noted that other funding sources often are involved in AHP projects at a much higher funding level, and that state agencies are more than capable of providing high quality monitoring. Other commenters stated that the proposal would make the AHP more compatible with the LIHTC program. Some commenters suggested that the Finance Board clarify whether each Bank must make a determination that the compliance profiles for income targeting, affordability, and retention under the LIHTC program are substantively equivalent to those under the AHP. Commenters interpreted the conditional language "provided that the compliance profiles of the AHP and the LIHTC program continue to be substantively equivalent" in the proposed rule as requiring the Banks to make a determination whether the standards are satisfied before the Bank could rely on LIHTC monitoring. As discussed above, in the **SUPPLEMENTARY INFORMATION** section of the proposed rule, the Finance Board has made the determination, based on studies of the occupancy and rents of LIHTC projects, that these standards currently are being met. The Banks, therefore, will not need to make such a determination with respect to AHP-assisted LIHTC projects. The final rule clarifies this point by eliminating the conditional language "provided that the compliance profiles of the AHP and the LIHTC program continue to be substantively equivalent."

Some commenters also requested clarification whether any initial monitoring requirements continue to apply to AHP-assisted LIHTC projects. Under the final rule, all of the initial monitoring requirements continue to apply to AHP-assisted LIHTC projects.

*Reliance on other long-term governmental monitoring for rental projects:* § 951.7(a)(3): Section 951.7(a)(3) of the final rule provides that, for completed AHP rental projects that received funds from federal, state, or local government entities other than under the LIHTC, a Bank may, in its

discretion, for purposes of long-term AHP monitoring, rely on the monitoring by such entities of the income targeting and rent requirements applicable under their programs, provided the Bank can show that: (i) The compliance profiles regarding income targeting, rent, and retention period requirements of the AHP and the other programs are substantively equivalent; (ii) the entity has demonstrated and continues to demonstrate its ability to monitor the project; (iii) the entity agrees to provide reports to the Bank on the project's incomes and rents for the full 15-year AHP retention period; and (iv) the Bank reviews the reports from the monitoring entity to confirm that they comply with the Bank's monitoring policies.

In the case of AHP rental projects that receive governmental funds other than tax credits, the existing regulation applies the same requirements for reliance on monitoring by the government entity providing the funds as are applicable for AHP rental projects receiving tax credits under the existing regulation, as discussed above. *See* 12 CFR 951.11(a)(1), (a)(2). The proposed rule would have included requirements similar to the existing requirements for reliance on monitoring by other government entities, and would have provided that the income targeting, rent, and retention period requirements for the other programs be substantively equivalent to those of the AHP. The final rule provides that it is the compliance profiles regarding income targeting, rent, and retention period requirements of the AHP and the other programs that must be substantively equivalent.

A majority of commenters on the proposal supported allowing the Banks to rely on other non-LIHTC governmental monitoring as proposed. Several commenters noted, however, that without determinations by the Finance Board that certain programs, such as those administered by HUD, are substantively equivalent to the AHP, Banks would be reluctant to make the determinations themselves and, therefore, would not take advantage of this provision. At this time, the Finance Board does not have data available to it that would allow it to make determinations that the compliance profiles with respect to income targeting, rent, and retention period requirements of any other government housing programs other than the federal LIHTC program currently are substantively equivalent to those of the AHP. Accordingly, a Bank will need to make such determinations if it wishes to rely on the monitoring by such other government programs.

*Long-term monitoring policies for rental projects: § 951.7(a)(4). Adoption and implementation: § 951.7(a)(4)(i):* Consistent with the proposed rule, § 951.7(a)(4)(i) of the final rule provides that in cases where a Bank does not rely on monitoring by a federal, state, or local government entity pursuant to § 951.7(a)(2) or (a)(3), a Bank must establish and implement written policies for risk-based monitoring of completed AHP rental projects, commencing in the second year after project completion and continuing for the full 15-year retention period. The Bank's requirements for long-term monitoring under this section shall be included in its AHP Implementation Plan. The monitoring policies must enable the Bank to determine, at a minimum, whether household income and rents comply with the respective commitments made in the approved AHP applications.

The current regulation requires the Banks to select from 1 of 3 approved methods for long-term monitoring of rental projects: (1) Monitoring by a federal, state, or local government entity in connection with a project that also is receiving tax credits or funds from that entity, subject to certain other limits stated in the rule; (2) monitoring by the Bank, its members, and project owners; or (3) monitoring by a third party contractor that carries out the Bank's monitoring obligations under the long-term monitoring requirements of existing § 951.11(a)(3)(iii). See 12 CFR 951.11(a). The existing regulation contains prescriptive procedural requirements for projects monitored by the Banks, their members, and project owners under the second and third options. It requires a Bank to review project documentation from various parties and verify compliance with rent, income, and project habitability requirements according to a schedule based on the amount of AHP subsidy received by a project, such that projects receiving greater amounts of subsidy have more stringent and frequent monitoring requirements. See 12 CFR 951.11(a)(3)(iii). Such prescriptive monitoring requirements do not necessarily promote accurate assessments of program effectiveness or take into account the true risks to the Bank's AHP. The existing monitoring requirements may fail to capture adequately the operational risk, location risk, or other relevant performance factors affecting the Bank's AHP project portfolio. The prescriptive nature of the regulation implies that the particular approach to monitoring that is embodied in the regulation is the

optimal approach for such matters, irrespective of the risk characteristics that may be associated with a particular AHP project or the compliance record of the participating member, sponsor, or project owner.

A number of commenters specifically supported the proposal's increased flexibility, risk-based scheme, and sampling authority. Some commenters stated that monitoring costs could be reduced for in-district projects under the proposal, without increasing the Bank's compliance, financial, or reputation risk. A Bank and its Advisory Council opposed the proposal in its entirety, stating that the current regulatory monitoring requirements have served the intended purposes, and changes in those requirements are not necessary or appropriate. The commenters stated that monitoring objectives could vary from Bank to Bank, which could cause confusion among members, sponsors and project owners that use AHP funds in multiple districts. Several commenters objected to the reference in the **SUPPLEMENTARY INFORMATION** section of the proposed rule to "outcome-based" monitoring, stating that it may be inconsistent with the risk-based monitoring requirement and could result in numerous Finance Board examination findings. In order to avoid confusion in this regard, the final rule does not use this term. A Bank suggested that long-term monitoring not be required to commence until the third year after project completion. Another commenter suggested that the rule retain the current monitoring requirement for projects receiving AHP subsidy over \$500,000. Under the monitoring provisions of the final rule, a Bank would have the discretion to include such requirements. Some commenters also requested that the Finance Board review and approve the Banks' long-term monitoring policies. The Finance Board intends to review the Banks' long-term monitoring policies as a part of its examination program.

The final rule does not include the proposed requirement that the Bank monitor the populations served by the project over the long-term retention period. A number of commenters opposed the proposed requirement, pointing out that the annual project owner certification requirement does not include a requirement to certify compliance with targeted population commitments, referring only to incomes and rents of the project households, and targeted populations are not subject to long-term monitoring under the current regulation. The Finance Board finds merit in these comments, and also notes

that inclusion of this requirement would complicate providing housing for households displaced by disasters. Accordingly, the final rule does not require that populations served by the projects be subject to long-term monitoring.

Consistent with the proposed rule, the final rule also removes the existing requirement that the Banks monitor project habitability for the full AHP retention period. See 12 CFR 951.11(a)(3). Several commenters supported removing the requirement to monitor project habitability.

*Annual project owner certifications; backup and other project documentation: § 951.7(a)(4)(ii):* Section 951.7(a)(4)(ii) of the final rule adopts the proposed requirement that the Bank's monitoring policies include requirements for: (i) Bank review of annual certifications by project owners to the Bank that household incomes and rents comply with the commitments made in the approved AHP application; (ii) Bank review of back-up project documentation regarding household incomes and rents maintained by the project owner; and (iii) maintenance and Bank review of other project documentation in the Bank's discretion. Several commenters supported requiring the Banks to establish written requirements for back-up documentation from members and project owners. A Bank and one of its members opposed the annual project owner certification requirement, stating that obtaining the certifications is a labor-intensive process that has little or no positive influence on long-term compliance. The Finance Board believes that the annual project owner certification, which is retained from the current rule, remains an important tool under the new risk-based long-term monitoring for ensuring that the project has regular contact with the Bank. See 12 CFR 951.11(a)(3)(i). The Finance Board notes that the rule only requires that the project owner provide such a certification to the Bank, and this requirement does not involve the member unless the Bank chooses to do so in its monitoring plan.

*Risk factors and other monitoring; risk-based sampling plan: § 951.7(a)(4)(iii):* Consistent with the proposed rule, § 951.7(a)(4)(iii) of the final rule requires a Bank's written policies to take into account risk factors such as the amount of AHP subsidy in the project, type, size, and location of the project, sponsor experience, and any monitoring of the project provided by a federal, state, or local government entity. The final rule further provides that a Bank may use a reasonable, risk-



based sampling plan to select the rental projects to be monitored under this section, and to review the annual project owner certifications, back-up, and any other project documentation. The risk-based sampling plan and its basis shall be in writing.

Several commenters suggested that the Finance Board provide more detailed guidance on the monitoring requirements, including defining "reasonable risk-based sampling plan." One Bank requested clarification whether the Bank must select its sample of rental projects from different types of rental projects, and whether the sample must be statistically valid. The final rule does not specifically require these standards, but Finance Board examiners will review the Bank's sampling plans to ensure that they are reasonable. Several commenters also stated that the Banks should be able to use a risk-based sampling model to select not only the rental projects, but also the specific units in the projects, to be sampled. The language under the proposed and final rules allows for such risk-based sampling of units as well as projects.

*Monitoring Requirements for the Homeownership Set-Aside Program: § 951.7(b). Adoption and implementation: § 951.7(b)(1):* Consistent with the proposed rule, § 951.7(b)(1) of the final rule requires a Bank to adopt and implement written monitoring policies for determining compliance with the requirements of its homeownership set-aside programs. See 12 CFR 951.8(b)(2). The Bank's requirements for monitoring under its homeownership set-aside programs shall be included in its AHP Implementation Plan. A Bank and its Advisory Council supported the proposal.

*Member certifications; back-up and other documentation: § 951.7(b)(2):* Section 951.7(b)(2) of the final rule retains the existing requirement that a Bank review certifications by members to the Bank, prior to disbursement of the AHP subsidy, that the subsidy will be provided in compliance with all applicable eligibility requirements of the homeownership set-aside program. See 12 CFR 951.8(b)(2). The Bank's monitoring policies also must include requirements for the Bank to review back-up documentation regarding household incomes maintained by the member, and maintenance and Bank review of other documentation in the Bank's discretion.

*Sampling plan: § 951.7(b)(3):* Section 951.7(b)(3) of the final rule provides that a Bank may use a reasonable sampling plan to select the households to be monitored, and to review the back-up

and any other documentation, but not the member certifications. One Bank requested clarification whether the Bank's sampling plan may be risk-based, and whether the sample must be statistically valid. Unlike sampling under the competitive application program, sampling under the homeownership set-aside program may not be risk-based, because there is no basis on which to vary risk of noncompliance when grants are provided through members directly to households for home purchase or rehabilitation assistance. The final rule does not specifically require that the sample be statistically valid, but Finance Board examiners will review the Bank's sampling plans to ensure that they are reasonable.

#### *H. Remedial Actions for Noncompliance: § 951.8*

*Reorganization and streamlining.* Consistent with the proposed rule, § 951.8 of the final rule reorganizes and streamlines the language in the existing regulation regarding remedial actions for noncompliance with the commitments made in the approved AHP application and the AHP regulation, in order to eliminate redundancy and provide greater clarity. See 12 CFR 951.12. No commenters addressed these technical revisions.

*Repayment of AHP subsidy by project sponsor or owner: § 951.8(b)(2).* Section 951.8(b)(2) of the final rule adopts the proposed provision allowing a Bank to determine whether a project sponsor or owner must repay AHP subsidies directly to the Bank or to the member, which would then repay the Bank, in the event that the project fails to comply with any AHP requirements. Under the existing regulation, project sponsors or owners are required to repay AHP subsidies to the member, which in turn is required to repay the subsidies to the Bank. See 12 CFR 951.12(b). The change will give the Banks greater flexibility in managing how AHP subsidies are required to be repaid in the event of AHP noncompliance. Several commenters supported the change, with one commenter noting that it would allow for a more efficient repayment process.

*Finance Board approval of settlements: § 951.8(d)(2).* Consistent with the proposed rule, § 951.8(d)(2) of the final rule allows a Bank to obtain approval from "the Finance Board" to settle a disputed claim regarding an AHP subsidy, which will allow Finance Board staff to approve the Bank's proposed settlements relating to the AHP subsidy. The existing regulation requires a Bank to obtain approval from

the Board of Directors of the Finance Board for such settlements. See 12 CFR 951.12(c)(2)(ii). Several commenters supported the proposal, with 1 commenter noting that it would allow AHP claims to be settled more efficiently.

*Bank reimbursement of AHP fund: § 951.8(e)(1).* Section 951.8(e)(1) of the final rule adopts the proposed new provision requiring a Bank to reimburse its AHP fund in the amount of any AHP subsidies (plus interest, if appropriate) misused as a result of the Bank's actions or omissions, even without a Finance Board order to do so. Where noncompliance with AHP requirements is the result of a Bank's actions or omissions, the Bank should reimburse its AHP fund without the Finance Board having to order it to do so as under the existing regulation. See 12 CFR 951.12(c)(3).

One commenter objected to the proposal, stating that even in the case of misuse of funds resulting from Bank error, the Bank should not have to automatically reimburse the AHP fund. Instead, the Bank's board should be required to make an affirmative determination whether or not it must reimburse its AHP fund. If Finance Board examiners objected to the board's decision, then the full Board of Directors of the Finance Board could order the reimbursement after notice and a hearing. The Finance Board believes that the Bank already has ample opportunity to negotiate the amount of reimbursement through the examination process and discussions with the Finance Board.

*Parties to enforcement proceedings.* Consistent with the proposed rule, the final rule removes existing § 951.12(d), which allows a Bank, in its discretion, to enter into a written agreement with a member, project sponsor, or project owner under which such member, sponsor or owner consents to be a party to any Finance Board enforcement proceeding regarding the repayment of AHP subsidies received by such party, or to suspension or debarment of such party, provided that such party has agreed to be bound by the Finance Board's final determination in the enforcement proceeding. See 12 CFR 951.12(d). A Bank opposed removal of the provision, stating that without the provision, third parties would not willingly consent to enter into such an agreement. However, such agreements are voluntary under the existing regulation, and regulatory authorization is not necessary for a Bank to enter into such an agreement.

*Re-use of repaid AHP direct subsidies in same project: § 951.8(f)(2).* Section

951.8(f)(2) of the final rule adopts the proposed language clarifying that a Bank must consult with its Advisory Council in determining whether to allow the re-use of AHP direct subsidies in the same project, as is authorized under this section. *See* 12 CFR 951.12(e)(2). That provision also clarifies that a Bank's board of directors shall not delegate to Bank officers or other Bank employees the responsibility to adopt any Bank policies on re-use of repaid AHP direct subsidies in the same project under this section. No comments addressed these technical revisions.

#### *I. Agreements: § 951.9*

Section 951.9 of the final rule adopts proposed revisions to the existing regulation, which requires each Bank to have in place with each member that receives AHP subsidies a written agreement that includes certain provisions set out in the regulation. *See* 12 CFR 951.13. The revisions are intended to eliminate redundancy and provide greater clarity. No comments addressed these specific technical revisions.

*Notification of member: § 951.9(a)(1).* Consistent with the proposed rule, § 951.9(a)(1) of the final rule adds a provision requiring the AHP agreements to acknowledge that the member has been notified of the AHP requirements and all Bank policies relevant to the member's approved AHP application. Several commenters supported the proposal, but requested clarification that the AHP agreements may include references to the Bank's detailed policies and procedures, as they may be amended from time to time, rather than be required to include the actual policies and procedures themselves. Commenters pointed out that the Banks otherwise would have to change the AHP agreements every time the policies or procedures were modified. The proposal was not intended to require the AHP agreements to include the Bank's detailed policies and procedures. The rule requires only that the agreement include a provision stating that the member has been notified of the Bank's policies.

*Monitoring agreements: § 951.9(a)(5).* Consistent with the proposed rule, § 951.9(a)(5) of the final rule revises the existing provisions relating to monitoring agreements in order to conform them to the changes made elsewhere to the substantive monitoring requirements. *See* 12 CFR 951.13(b)(4). The final rule also revises the proposal that would have required the Banks' agreements with their members to set forth the members' specific monitoring responsibilities, as required under the

Banks' monitoring policies. Instead, the final rule allows the Banks to reference their monitoring policies in the monitoring agreements. A number of commenters opposed requiring inclusion of the Banks' specific monitoring policies and procedures in their monitoring agreements, as the Banks revise their monitoring policies and procedures with some regularity, which could require frequent modifications to the agreements. Commenters suggested that the Banks be allowed to reference the applicable monitoring policies and procedures, as they may be amended from time to time, in the monitoring agreements. The Finance Board agrees that the Banks should not have to modify their monitoring agreements every time they revise their monitoring policies or procedures. Accordingly, the final rule revises the proposal by removing the language "(and set forth in the agreement)."

In addition, the final rule adopts the proposed provision that the agreements shall require the member to have in place an agreement with each project sponsor and project owner setting forth the specific monitoring responsibilities of those sponsors and owners, as required under the Banks' monitoring policies, but with the revision that the Bank's monitoring policies would not have to be included in such agreement. One commenter stated that a member should not be required to maintain a separate monitoring agreement with each project sponsor and owner, as this would increase the cost and administrative burden of participating in the program. The commenter stated that it supports the format currently used at some Banks, where all parties execute a single agreement. The language in the rule is consistent with the language in the current regulation and, as drafted, does not prohibit all parties from executing one agreement.

*Refinancing of owner-occupied units: § 951.9(a)(7)(ii)(A).* Consistent with the proposed rule, § 951.9(a)(7)(ii)(A) of the final rule revises existing § 951.13(c)(4)(i)(B) by providing that, in the case of a refinancing prior to the end of the 5-year retention period of a permanent mortgage loan that was funded by an AHP subsidized advance, the household does not have to repay the AHP subsidy it already used in the unit. *See* 12 CFR 951.13(c)(4)(i)(B). The final rule still requires that such households have retention agreements in place, because of the agreements' requirements for notice to the Bank of any sale or refinancing of the unit.

The existing regulation requires the household to repay the full amount of

the AHP subsidy received (*i.e.*, the value of the interest rate subsidy for the time the household has been paying on the mortgage loan) from any net gain realized upon the refinancing, unless the unit continues to be subject to a retention agreement. The change is consistent with the existing regulatory provision providing that a household subsidized with AHP direct subsidy that refinances an owner-occupied unit must repay only the amount of AHP subsidy that has not been used (*i.e.*, the subsidy required to be repaid is reduced for every year the household owned the unit). *See* 12 CFR 951.13(d)(1)(iii). In addition, the change should help remove a possible deterrent to refinancing by households that seek to make their units more affordable or obtain equity for purposes of their economic betterment. No comments specifically addressed this change.

*Relocation of households in rental projects: § 951.9(a)(8)(iii)(B).* Section 951.9(a)(8)(iii)(B) of the final rule revises the proposal and the existing regulation by providing that, in the case of a sale or refinancing of an AHP-assisted rental project prior to the end of the retention period, a Bank may, in its discretion, determine not to require repayment of the AHP subsidy to the Bank if, due to the exercise of eminent domain, or for expansion of housing or services, the households are relocated to another property that is made subject to a deed restriction or other legally enforceable retention agreement or mechanism incorporating the income-eligibility and affordability restrictions committed to in the approved AHP application for the remainder of the retention period. This new authority is consistent with the current regulatory provision allowing sale of a project to another owner without requiring repayment of the subsidy, where the new owner agrees to maintain the income-eligibility and affordability requirements for the remainder of the retention period. Currently, the AHP regulation treats these situations as a sale that requires the repayment of the entire amount of AHP subsidy, thereby releasing the project from its AHP commitments and making the AHP subsidy available for other AHP-eligible projects, unless the property continues to be subject to a deed restriction or other legally enforceable retention agreement or mechanism incorporating the income-eligibility and affordability restrictions committed to in the approved AHP application for the remainder of the retention period. *See* 12 CFR 951.13(c)(5)(iii), 951.13(d)(2)(iii). Allowing project

sponsors to transfer the AHP subsidies, along with the corresponding income-eligibility and affordability commitments, to another property will result in the retention of the affordable units for the duration of the original retention period and ensure that existing tenants are not adversely affected.

The proposed rule would have required a Bank to allow the relocation of tenants without repayment of AHP subsidy where the retention agreement is maintained. A number of commenters recommended that the relocation authority be at the discretion of a Bank in order to prevent abuse, and that it not be a regulatory authorization for sponsors of rental projects to relocate at their option and in all circumstances. Some commenters were concerned that the proposal could encourage owners to relocate tenants to less desirable properties in order to develop the subject property for market use, or allow a noncompliant owner to delay or escape repayment of misused subsidy. The Finance Board agrees that providing the Banks with discretion on whether to approve a project relocation could prevent abuses of the type raised by the commenters, and the final rule makes the authority discretionary rather than mandatory. In addition, in response to the comments, the final rule specifically includes the exercise of eminent domain and expansion of housing or services as the limited circumstances under which the authority may be used.

*Agreements between Banks and project sponsors or owners: § 951.9(b).* As discussed above, § 951.8(b)(2) of the final rule allows a Bank to determine whether to require a project sponsor or owner to repay AHP subsidies directly to the Bank in the event of noncompliance, in contrast to the existing regulation which requires project sponsors or owners to repay AHP subsidies to the member, which in turn repays the subsidies to the Bank. Under § 951.9(b) of the final rule, consistent with the proposed rule, if a Bank intends to require project sponsors or project owners to repay AHP subsidies directly to the Bank, the Bank first must have in place an agreement with each project sponsor and project owner in which the party agrees to repay the AHP subsidies directly to the Bank. A Bank and its Advisory Council requested clarification whether a tri-party agreement would be permissible under this provision. The language in the rule is consistent with the language in the current regulation and, as drafted, does not prohibit all parties to execute a single agreement.

*Application to existing AHP projects and units: § 951.9(c).* Consistent with the proposed rule, § 951.9(c) of the final rule streamlines the language in existing § 951.16, which addresses the application of the regulation to existing AHP projects, and relocates the provision to this section. See 12 CFR 951.16. A Bank requested clarification whether this provision continues to apply to units funded under the homeownership set-aside program as well as to competitive application projects, as the heading in the proposed rule referred to “projects” and not units. This provision is intended to apply to both projects and units under both programs. Accordingly, the language in the final rule clarifies this by including references to units where appropriate.

#### *J. Conflicts of Interest: § 951.10*

Consistent with the proposed rule, § 951.10 of the final rule relocates the provisions governing the adoption of conflict of interest policies from existing § 951.3(c) to this section. See 12 CFR 951.3(c). The final rule also adds new provisions that prohibit Bank directors or employees, Advisory Council members, and their family members, from engaging in the conflicts of interest prohibited by the Bank’s conflict of interest policies. Section 951.10(c) prohibits a Bank’s board of directors from delegating to Bank officers or other Bank employees its responsibility to adopt the conflict of interest policies. Several commenters supported the changes.

#### *K. Temporary Suspension of AHP Contributions: § 951.11*

Section 951.11 of the final rule adopts the proposal to remove various procedural requirements in existing § 951.14, leaving these decisions to the discretion of the Finance Board in the event an application is received from a Bank for a temporary suspension of its required annual AHP contribution. See 12 CFR 951.14. In addition, certain of the information required to be provided by the Banks is readily obtainable by the Finance Board without the necessity of a regulatory requirement. One commenter supported the changes.

#### *L. Affordable Housing Reserve Fund: § 951.12*

Section 951.12 of the final rule adopts the proposal to remove the requirements in existing § 951.15 that a Bank report by January 15th of each year the amount of any unused and uncommitted AHP funds from the prior year that will be deposited in an Affordable Housing Reserve Fund (Reserve Fund), and that the Finance Board notify the Banks of

the total amount of funds, if any, available in the Reserve Fund. See 12 CFR 951.15. The Finance Board has never had to establish a Reserve Fund and does not expect to do so in the future, given the high demand for AHP funds that has always exceeded the amount of AHP funds available. In addition, information on the amount of any unused and uncommitted AHP funds would be readily obtainable by the Finance Board without such a regulatory mandate. One commenter supported the proposal.

### **IV. Paperwork Reduction Act**

Elsewhere in this issue of the **Federal Register**, the Finance Board is publishing a notice concerning the information collection entitled “Affordable Housing Program (AHP)”. The Finance Board is submitting the information collection to the Office of Management and Budget for review and approval of a 3 year extension of the OMB control number, 3069–0006, which is due to expire on July 31, 2007.

### **V. Regulatory Flexibility Act**

The final rule applies only to the Banks, which do not come within the meaning of small entities for purposes of the Regulatory Flexibility Act (RFA). See 5 U.S.C. 601(6). Therefore, in accordance with section 605(b) of the RFA, 5 U.S.C. 605(b), the Finance Board hereby certifies that the final rule will not have a significant economic impact on a substantial number of small entities.

### **List of Subjects in 12 CFR Part 951**

Community development, Credit, Federal home loan banks, Housing, Reporting and recordkeeping requirements.

■ For the reasons stated in the preamble, the Finance Board hereby revises 12 CFR, chapter IX, part 951, to read as follows:

### **PART 951—AFFORDABLE HOUSING PROGRAM**

#### **Sec.**

- 951.1 Definitions.
- 951.2 Required annual AHP contributions; allocation of contributions.
- 951.3 AHP Implementation Plan.
- 951.4 Advisory Councils.
- 951.5 Competitive application program.
- 951.6 Homeownership set-aside programs.
- 951.7 Monitoring.
- 951.8 Remedial actions for noncompliance.
- 951.9 Agreements.
- 951.10 Conflicts of interest.
- 951.11 Temporary suspension of AHP contributions.
- 951.12 Affordable Housing Reserve Fund.

**Authority:** 12 U.S.C. 1430(j).

**§ 951.1 Definitions.**

As used in this part:

*Affordable* means that:

(1) The rent charged to a household for a unit that is to be reserved for occupancy by a household with an income at or below 80 percent of the median income for the area, does not exceed 30 percent of the income of a household of the maximum income and size expected, under the commitment made in the AHP application, to occupy the unit (assuming occupancy of 1.5 persons per bedroom or 1.0 persons per unit without a separate bedroom); or

(2) The rent charged to a household, for rental units subsidized with Section 8 assistance under 42 U.S.C. 1437f or subsidized under another assistance program where the rents are charged in the same way as under the Section 8 program, if the rent complied with this § 951.1 of this part at the time of the household's initial occupancy and the household continues to be assisted through the Section 8 or another assistance program, respectively.

*AHP project* means a single-family or multifamily housing project for owner-occupied or rental housing that has been awarded or has received AHP subsidy under the competitive application program.

*Competitive application program* means a program established by a Bank under which the Bank awards and disburses AHP subsidy through a competitive application scoring process pursuant to the requirements of § 951.5 of this part.

*Cost of funds* means, for purposes of a subsidized advance, the estimated cost of issuing Bank System consolidated obligations with maturities comparable to that of the subsidized advance.

*Direct subsidy* means an AHP subsidy in the form of a direct cash payment.

*Eligible household* means a household that meets the income limits and other requirements specified by a Bank for its competitive application program and homeownership set-aside programs, provided that:

(1) In the case of owner-occupied housing, the household's income may not exceed 80 percent of the median income for the area; and

(2) In the case of rental housing, the household's income in at least 20 percent of the units may not exceed 50 percent of the median income for the area.

*Eligible project* means a project eligible to receive AHP subsidy pursuant to the requirements of this part.

*Family member* means any individual related to a person by blood, marriage, or adoption.

*Funding period* means a time period, as determined by a Bank, during which the Bank accepts AHP applications for subsidy.

*Homeownership set-aside program* means a program established by a Bank under which the Bank disburses AHP direct subsidy pursuant to the requirements of § 951.6 of this part.

*Loan pool* means a group of mortgage or other loans meeting the requirements of this part that are purchased, pooled, and held in trust.

*Low- or moderate-income household* means a household that has an income of 80 percent or less of the median income for the area, with the income limit adjusted for household size in accordance with the methodology of the applicable median income standard, unless such median income standard has no household size adjustment methodology.

*Low- or moderate-income neighborhood* means any neighborhood in which 51 percent or more of the households have incomes at or below 80 percent of the median income for the area.

*Median income for the area* means one or more of the following median income standards as determined by a Bank, after consultation with its Advisory Council, in its AHP Implementation Plan:

(1) The median income for the area, as published annually by HUD;

(2) The median income for the area obtained from the Federal Financial Institutions Examination Council;

(3) The applicable median family income, as determined under 26 U.S.C. 143(f) (Mortgage Revenue Bonds) and published by a state agency or instrumentality;

(4) The median income for the area, as published by the United States Department of Agriculture; or

(5) The median income for an applicable definable geographic area, as published by a federal, state, or local government entity, and approved by the Finance Board, at the request of a Bank, for use under the AHP.

*Multifamily building* means a structure with 5 or more dwelling units.

*Net earnings of a Bank* means the net earnings of a Bank for a calendar year after deducting the Bank's annual contribution to the Resolution Funding Corporation required under section 21B of the Act (12 U.S.C. 1441b), and before declaring or paying any dividend under section 16 of the Act (12 U.S.C. 1436). For purposes of this part, "dividend" includes any dividends on capital stock subject to a redemption request even if under GAAP those dividends are treated as an "interest expense."

*Owner-occupied project* means, for purposes of the competitive application program, one or more owner-occupied units in a single-family or multifamily building, including condominiums, cooperative housing, and manufactured housing.

*Owner-occupied unit* means a dwelling unit occupied by the owner of the unit. Housing with 2 to 4 dwelling units consisting of one owner-occupied unit and one or more rental units is considered a single owner-occupied unit.

*Program* means the Affordable Housing Program established pursuant to this part.

*Rental project* means, for purposes of the competitive application program, one or more dwelling units for occupancy by households that are not owner-occupants, including overnight and emergency shelters, transitional housing for homeless households, mutual housing, single-room occupancy housing, and manufactured housing.

*Retention period* means:

(1) Five years from closing for an AHP-assisted owner-occupied unit, or in the case of rehabilitation of a unit currently occupied by the owner where there is no closing, 5 years from the date established by the Bank in its AHP Implementation Plan; and

(2) Fifteen years from the date of project completion for a rental project.

*Revolving loan fund* means a capital fund established to make mortgage or other loans whereby loan principal is repaid into the fund and re-lent to other borrowers.

*Single-family building* means a structure with 1 to 4 dwelling units.

*Sponsor* means a not-for-profit or for-profit organization or public entity that:

(1) Has an ownership interest (including any partnership interest), as defined by the Bank in its AHP Implementation Plan, in a rental project;

(2) Is integrally involved, as defined by the Bank in its AHP Implementation Plan, in an owner-occupied project, such as by exercising control over the planning, development, or management of the project, or by qualifying borrowers and providing or arranging financing for the owners of the units;

(3) Operates a loan pool; or

(4) Is a revolving loan fund.

*Subsidized advance* means an advance to a member at an interest rate reduced below the Bank's cost of funds by use of a subsidy.

*Subsidy* means:

(1) A direct subsidy, provided that if a direct subsidy is used to write down the interest rate on a loan extended by a member, sponsor, or other party to a project, the subsidy must equal the net

present value of the interest foregone from making the loan below the lender's market interest rate; or

(2) The net present value of the interest revenue foregone from making a subsidized advance at a rate below the Bank's cost of funds.

*Very low-income household* means a household that has an income at or below 50 percent of the median income for the area, with the income limit adjusted for household size in accordance with the methodology of the applicable median income standard, unless such median income standard has no household size adjustment methodology.

*Visitable* means, in either owner-occupied or rental housing, at least one entrance is at-grade (no steps) and approached by an accessible route such as a sidewalk, and the entrance door and all interior passage doors are at least 2 feet, 10 inches wide, offering 32 inches of clear passage space.

#### **§ 951.2 Required annual AHP contributions; allocation of contributions.**

(a) *Annual AHP contributions.* Each Bank shall contribute annually to its Program the greater of:

(1) 10 percent of the Bank's net earnings for the previous year; or

(2) That Bank's pro rata share of an aggregate of \$100 million to be contributed in total by the Banks, such proration being made on the basis of the net earnings of the Banks for the previous year, except that the required annual AHP contribution for a Bank shall not exceed its net earnings in the previous year.

(b) *Allocation of contributions.* Each Bank, after consultation with its Advisory Council and pursuant to written policies adopted by the Bank's board of directors, shall allocate its annual required AHP contribution as follows:

(1) *Competitive application program.* Each Bank shall allocate annually that portion of its annual required AHP contribution that is not set aside to fund homeownership set-aside programs under paragraph (b)(2) of this section, to provide funds to members through a competitive application program, pursuant to the requirements of this part.

(2) *Homeownership set-aside programs.* (i) *Allocation amount; first-time homebuyers.* A Bank, in its discretion, may set aside annually, in the aggregate, up to the greater of \$4.5 million or 35 percent of the Bank's annual required AHP contribution to provide funds to members participating in homeownership set-aside programs established by the Bank, provided that

at least one-third of the Bank's aggregate annual set-aside allocation to such programs shall be to assist first-time homebuyers, pursuant to the requirements of this part.

(ii) *No delegation.* A Bank's board of directors shall not delegate to Bank officers or other Bank employees the responsibility for adopting its homeownership set-aside program policies.

(3) *Additional funding.* A Bank may allot to its current year's Program from its annual required AHP contribution for the subsequent year, an amount up to the greater of \$2 million or 20 percent of its annual required AHP contribution for the current year.

#### **§ 951.3 AHP Implementation Plan.**

(a) *Adoption; no delegation.* Each Bank, after consultation with its Advisory Council, shall adopt a written AHP Implementation Plan, and shall not amend the AHP Implementation Plan without first consulting its Advisory Council. The Bank's board of directors shall not delegate to Bank officers or other Bank employees the responsibility to consult with the Advisory Council prior to adopting or amending the AHP Implementation Plan. The AHP Implementation Plan shall set forth, at a minimum:

(1) The applicable median income standard or standards adopted by the Bank consistent with the definition of median income for the area in § 951.1 of this part;

(2) The Bank's requirements for its competitive application program established pursuant to § 951.5 of this part;

(3) The Bank's requirements for its homeownership set-aside programs, if adopted by the Bank pursuant to § 951.6 of this part;

(4) The Bank's requirements for funding revolving loan funds, if adopted by the Bank pursuant to § 951.5(c)(13) of this part;

(5) The Bank's requirements for funding loan pools, if adopted by the Bank pursuant to § 951.5(c)(14) of this part;

(6) The Bank's requirements for monitoring under its competitive application program and any Bank homeownership set-aside programs, pursuant to § 951.7 of this part;

(7) The Bank's requirements, including time limits, for re-use of repaid AHP direct subsidy, if adopted by the Bank pursuant to § 951.8(f)(2) of this part; and

(8) The retention agreement requirements for projects and households under the competitive application program and any Bank

homeownership set-aside programs, pursuant to § 951.9(a)(7) and (a)(8) of this part.

(b) *Advisory Council review.* Prior to the amendment of a Bank's AHP Implementation Plan, the Bank shall provide its Advisory Council an opportunity to review the document, and the Advisory Council shall provide its recommendations to the Bank's board of directors for its consideration.

(c) *Notification of Plan amendments to the Finance Board.* A Bank shall notify the Finance Board of any amendments made to its AHP Implementation Plan within 30 days after the date of their adoption by the Bank's board of directors.

(d) *Public access.* A Bank shall publish its current AHP Implementation Plan on its publicly available Web site, and shall publish any amendments to the AHP Implementation Plan on the Web site within 30 days after the date of their adoption by the Bank's board of directors.

#### **§ 951.4 Advisory Councils.**

(a) *Appointment.* (1) Each Bank's board of directors shall appoint an Advisory Council of 7 to 15 persons who reside in the Bank's District and are drawn from community and not-for-profit organizations that are actively involved in providing or promoting low- and moderate-income housing, and community and not-for-profit organizations that are actively involved in providing or promoting community lending, in the District.

(2) Each Bank shall solicit nominations for membership on the Advisory Council from community and not-for-profit organizations pursuant to a nomination process that is as broad and as participatory as possible, allowing sufficient time for responses.

(3) The Bank's board of directors shall appoint Advisory Council members from a diverse range of organizations so that representatives of no one group constitute an undue proportion of the membership of the Advisory Council, giving consideration to the size of the Bank's District and the diversity of low- and moderate-income housing and community lending needs and activities within the District.

(b) *Terms of Advisory Council members.* Pursuant to policies adopted by the Bank's board of directors, Advisory Council members shall be appointed by the Bank's board of directors to serve for terms of 3 years, which shall be staggered to provide continuity in experience and service to the Advisory Council, except that Advisory Council members may be appointed to serve for terms of 1 or 2

years solely for purposes of reconfiguring the staggering of the 3-year terms. No Advisory Council member may be appointed to serve for more than 3 full consecutive terms. An Advisory Council member appointed to fill a vacancy shall be appointed for the unexpired term of his or her predecessor in office.

(c) *Election of officers.* Each Advisory Council shall elect from among its members a chairperson, a vice chairperson, and any other officers the Advisory Council deems appropriate.

(d) *Duties.* (1) *Meetings with the Banks.* (i) The Advisory Council shall meet with representatives of the Bank's board of directors at least quarterly to provide advice on ways in which the Bank can better carry out its housing finance and community lending mission, including, but not limited to, advice on the low- and moderate-income housing and community lending programs and needs in the Bank's District, and on the use of AHP subsidies, Bank advances, and other Bank credit products for these purposes.

(ii) The Advisory Council's advice shall include recommendations on:

(A) The amount of AHP subsidies to be allocated to the Bank's competitive application program and any Bank homeownership set-aside programs;

(B) The AHP Implementation Plan and any subsequent amendments thereto;

(C) The scoring criteria, related definitions, and any additional optional District eligibility requirements for the competitive application program; and

(D) The eligibility requirements and any priority criteria for any Bank homeownership set-aside programs.

(2) *Summary of AHP applications.* The Bank shall comply with requests from the Advisory Council for summary information regarding AHP applications from prior funding periods.

(3) *Annual analysis; public access.* (i) Each Advisory Council annually shall submit to the Finance Board by May 1 its analysis of the low- and moderate-income housing and community lending activity of the Bank by which it is appointed.

(ii) Within 30 days after the date the Advisory Council's annual analysis is submitted to the Finance Board, the Bank shall publish the analysis on its publicly available Web site.

(e) *Expenses.* The Bank shall pay Advisory Council members' travel expenses, including transportation and subsistence, for each day devoted to attending meetings with representatives of the board of directors of the Bank and meetings requested by the Finance Board.

(f) *No delegation.* A Bank's board of directors shall not delegate to Bank officers or other Bank employees the responsibility to appoint persons as members of the Advisory Council, or to meet with the Advisory Council at the quarterly meetings required by the Act (12 U.S.C. 1430(j)(11)).

#### **§ 951.5 Competitive application program.**

(a) *Establishment of program.* A Bank shall establish a competitive application program pursuant to the requirements of this part.

(b) *Funding periods and application process.* (1) *Funding periods.* A Bank may accept applications for AHP subsidy under its competitive application program during a specified number of funding periods each year, as determined by the Bank.

(2) *Eligible applicants.* A Bank shall accept applications for AHP subsidy under its competitive application program only from institutions that are members of the Bank at the time the application is submitted to the Bank.

(3) *Submission of applications.* Except as provided in paragraph (c)(13)(i) of this section, a Bank shall require applications for AHP subsidy to contain information sufficient for the Bank to:

(i) Determine that the proposed AHP project meets the eligibility requirements of paragraph (c) of this section; and

(ii) Evaluate the application pursuant to the scoring guidelines adopted by the Bank pursuant to paragraph (d) of this section.

(4) *Review of applications submitted.* Except as provided in paragraph (c)(13)(ii) of this section, a Bank shall review the applications for AHP subsidy to determine that the proposed AHP project meets the eligibility requirements of paragraph (c) of this section, and shall evaluate the applications pursuant to the Bank's scoring guidelines adopted pursuant to paragraph (d) of this section.

(c) *Minimum eligibility requirements.* Projects receiving AHP subsidies pursuant to a Bank's competitive application program must meet the following eligibility requirements:

(1) *Owner-occupied or rental housing.* The AHP subsidy shall be used exclusively for:

(i) *Owner-occupied housing.* The purchase, construction, or rehabilitation of an owner-occupied project by or for very low-income or low- or moderate-income households. A household must have an income meeting the income targeting commitments in the approved AHP application at the time it is qualified by the project sponsor for participation in the project.

(ii) *Rental housing.* The purchase, construction, or rehabilitation of a rental project, where at least 20 percent of the units in the project are occupied by and affordable for very low-income households. A household must have an income meeting the income targeting commitments in the approved AHP application upon initial occupancy of the rental unit, or for projects involving the purchase or rehabilitation of rental housing that already is occupied, at the time the application for AHP subsidy is submitted to the Bank for approval.

(2) *Need for subsidy.* (i) The project's estimated sources of funds shall equal its estimated uses of funds, as reflected in the project's development budget. The difference between the project's sources of funds and uses of funds is the project's need for AHP subsidy, which is the maximum amount of AHP subsidy the project may receive. A Bank, in its discretion, may permit a project's sources of funds to include or exclude the estimated market value of in-kind donations and voluntary professional labor or services (excluding the value of sweat equity), provided that the project's uses of funds also include or exclude, respectively, the value of such estimates.

(ii) A project's cash sources of funds shall include any cash contributions by the sponsor, any cash from sources other than the sponsor, and estimates of funds the project sponsor intends to obtain from other sources but which have not yet been committed to the project. In the case of homeownership projects where the sponsor extends permanent financing to the homebuyer, the sponsor's cash contribution shall include the present value of any payments the sponsor is to receive from the buyer, which shall include any cash down payment from the buyer, plus the present value of any purchase note the sponsor holds on the unit. If the note carries a market interest rate commensurate with the credit quality of the buyer, the present value of the note equals the face value of the note. If the note carries an interest rate below the market rate, the present value of the note shall be determined using the market rate to discount the cash flows.

(iii) A project's cash uses are the actual outlay of cash needed to pay for materials, labor, and acquisition or other costs of completing the project. Cash costs do not include in-kind donations, voluntary professional labor or services, or sweat equity.

(3) *Project costs.* (i) *In general.* (A) Taking into consideration the geographic location of the project, development conditions, and other non-financial household or project

characteristics, a Bank shall determine that a project's costs, as reflected in the project's development budget, are reasonable, in accordance with the Bank's project cost guidelines.

(B) For purposes of determining the reasonableness of a developer's fee for a project as a percentage of total development costs, a Bank may, in its discretion, include estimates of the market value of in-kind donations and volunteer professional labor or services (excluding the value of sweat equity) committed to the project as part of the total development costs.

(ii) *Cost of property and services provided by a member.* The purchase price of property or services, as reflected in the project's development budget, sold to the project by a member providing AHP subsidy to the project, or, in the case of property, upon which such member holds a mortgage or lien, may not exceed the market value of such property or services as of the date the purchase price was agreed upon. In the case of real estate owned property sold to a project by a member providing AHP subsidy to the project, or property sold to the project upon which the member holds a mortgage or lien, the market value of such property is deemed to be the "as-is" or "as-rehabilitated" value of the property, whichever is appropriate. That value shall be reflected in an independent appraisal of the property performed by a state certified or licensed appraiser, as defined in 12 CFR 564.2(j) and (k), within 6 months prior to the date the Bank disburses AHP subsidy to the project.

(4) *Project feasibility.* (i) *Developmental feasibility.* The project must be likely to be completed and occupied, based on relevant factors contained in the Bank's project feasibility guidelines, including, but not limited to, the development budget, market analysis, and project sponsor's experience in providing the requested assistance to households.

(ii) *Operational feasibility of rental projects.* A rental project must be able to operate in a financially sound manner, in accordance with the Bank's project feasibility guidelines, as projected in the project's operating *pro forma*.

(5) *Financing costs.* The rate of interest, points, fees, and any other charges for all loans that are made for the project in conjunction with the AHP subsidy shall not exceed a reasonable market rate of interest, points, fees, and other charges for loans of similar maturity, terms, and risk.

(6) *Timing of AHP subsidy use.* Some or all of the AHP subsidy must be likely

to be drawn down by the project or used by the project to procure other financing commitments within 12 months of the date of approval of the application for AHP subsidy funding the project.

(7) *Counseling costs.* AHP subsidies may be used to pay for counseling costs only where:

(i) Such costs are incurred in connection with counseling of homebuyers who actually purchase an AHP-assisted unit; and

(ii) The cost of the counseling has not been covered by another funding source, including the member.

(8) *Refinancing.* The project may use AHP subsidies to refinance an existing single-family or multi-family mortgage loan, provided that the refinancing produces equity proceeds and such equity proceeds up to the amount of the AHP subsidy in the project shall be used only for the purchase, construction, or rehabilitation of housing units meeting the eligibility requirements of this paragraph (c).

(9) *Retention.* (i) *Owner-occupied projects.* Each AHP-assisted unit in an owner-occupied project is, or is committed to be, subject to a 5-year retention agreement described in § 951.9(a)(7) of this part.

(ii) *Rental projects.* AHP-assisted rental projects are, or are committed to be, subject to a 15-year retention agreement described in § 951.9(a)(8) of this part.

(10) *Project sponsor qualifications.* (i) *In general.* A project's sponsor must be qualified and able to perform its responsibilities as committed to in the application for AHP subsidy funding the project.

(ii) *Revolving loan fund.* Pursuant to written policies adopted by a Bank's board of directors, a revolving loan fund sponsor that intends to use AHP direct subsidy in accordance with § 951.5(c)(13) of this part shall:

(A) Provide audited financial statements that its operations are consistent with sound business practices; and

(B) Demonstrate the ability to re-lend AHP subsidy repayments on a timely basis and track the use of the AHP subsidy.

(iii) *Loan pool.* Pursuant to written policies adopted by a Bank's board of directors, a loan pool sponsor that intends to use AHP subsidy in accordance with § 951.5(c)(14) of this part shall:

(A) Provide evidence of sound asset/liability management practices;

(B) Provide audited financial statements that its operations are consistent with sound business practices; and

(C) Demonstrate the ability to track the use of the AHP subsidy.

(11) *Fair housing.* The project, as proposed, must comply with applicable federal and state laws on fair housing and housing accessibility, including, but not limited to, the Fair Housing Act, the Rehabilitation Act of 1973, the Americans with Disabilities Act of 1990, and the Architectural Barriers Act of 1969, and must demonstrate how the project will be affirmatively marketed.

(12) *Calculation of AHP subsidy.* (i) Where an AHP direct subsidy is provided to a project to write down the interest rate on a loan extended by a member, sponsor, or other party to a project, the net present value of the interest foregone from making the loan below the lender's market interest rate shall be calculated as of the date the application for AHP subsidy is submitted to the Bank, and subject to adjustment under paragraph (g)(4) of this section.

(ii) Where an AHP subsidized advance is provided to a project, the net present value of the interest revenue foregone from making a subsidized advance at a rate below the Bank's cost of funds shall be determined as of the earlier of the date of disbursement of the subsidized advance or the date prior to disbursement on which the Bank first manages the funding to support the subsidized advance through its asset/liability management system, or otherwise.

(13) *Lending and re-lending of AHP direct subsidy by revolving loan funds.* Pursuant to written policies established by a Bank's board of directors after consultation with its Advisory Council, a Bank, in its discretion, may provide AHP direct subsidy under its competitive application program for eligible projects and households involving both the lending of the subsidy and subsequent lending of subsidy principal and interest repayments by a revolving loan fund, provided the following requirements are met:

(i) *Submission of application.* (A) An application for AHP subsidy under this paragraph (c)(13) shall include the revolving loan fund's criteria for the initial lending of the subsidy, identification of and information on a specific proposed AHP project if required in the Bank's discretion, the revolving loan fund's criteria for subsequent lending of subsidy principal and interest repayments, and any other information required by the Bank.

(B) The information in the application shall be sufficient for the Bank to:

(1) Determine that the criteria for the initial lending of the subsidy, the



specific proposed project if applicable, and the criteria for subsequent lending of subsidy principal and interest repayments, meet the eligibility requirements of paragraph (c) of this section; and

(2) Evaluate the criteria for the initial lending of the subsidy, and the specific proposed project if applicable, pursuant to the scoring guidelines established by the Bank pursuant to paragraph (d) of this section.

(ii) *Review of application.* A Bank shall review the application for AHP subsidy to determine that the criteria for the initial lending of the subsidy, the specific proposed project if applicable, and the criteria for subsequent lending of subsidy principal and interest repayments, meet the eligibility requirements of paragraph (c) of this section, and shall evaluate the criteria for the initial lending of the subsidy and the specific proposed project, if applicable, pursuant to the scoring guidelines established by the Bank pursuant to paragraph (d) of this section.

(iii) *Initial lending of subsidy.* (A) The revolving loan fund's initial lending of the AHP subsidy shall meet the eligibility requirements of this paragraph (c), shall be to projects or households meeting the commitments in the approved application for AHP subsidy, and shall be subject to the requirements of §§ 951.7(a) and 951.9 of this part, respectively.

(B) If a project or owner-occupied unit funded under this paragraph (c)(13)(iii) is in noncompliance with the commitments in the approved AHP application, or is sold or refinanced prior to the end of the applicable AHP retention period, the required amount of AHP subsidy shall be repaid to the revolving loan fund in accordance with §§ 951.8 and 951.9 of this part, and the revolving loan fund shall re-lend such repaid subsidy, excluding the amounts of AHP subsidy principal already repaid to the revolving loan fund, to another project or owner-occupied unit meeting the initial lending requirements of this paragraph (c)(13)(iii) for the remainder of the retention period.

(iv) *Subsequent lending of AHP subsidy principal and interest repayments.* (A) AHP subsidy principal and interest repayments received by the revolving loan fund from the initial lending of the AHP direct subsidy shall be re-lent by the revolving loan fund in accordance with the requirements of this paragraph (c)(13)(iv), except that the revolving loan fund, in its discretion, may provide part or all of such repayments as nonrepayable grants to eligible projects in accordance with

the requirements of this paragraph (c)(13)(iv).

(B) The revolving loan fund's subsequent lending of AHP subsidy principal and interest repayments shall be for the purchase, construction, or rehabilitation of owner-occupied projects for households with incomes at or below 80 percent of the median income for the area, or of rental projects where at least 20 percent of the units are occupied by and affordable for households with incomes at or below 50 percent of the median income for the area, and shall meet all other eligibility requirements of this paragraph (c).

(C) A Bank may, in its discretion, require the revolving loan fund's subsequent lending of subsidy principal and interest repayments to be subject to retention period, monitoring, and recapture requirements as defined by the Bank in its AHP Implementation Plan.

(v) *Return of unused AHP subsidy.* The revolving loan fund shall return to the Bank any AHP subsidy that will not be used according to the requirements in this paragraph (c)(13).

(14) *Use of AHP subsidy in loan pools.* Pursuant to written policies established by a Bank's board of directors after consultation with its Advisory Council, a Bank, in its discretion, may provide AHP subsidy under its competitive application program for the origination of first mortgage or rehabilitation loans with subsidized interest rates to AHP-eligible households through a purchase commitment by an entity that will purchase and pool the loans, provided the following requirements are met:

(i) *Eligibility requirements.* The loan pool sponsor's use of the AHP subsidies shall meet the requirements under this paragraph (c)(14), and shall not be used for the purpose of providing liquidity to the originator or holder of the loans, or paying the loan pool's operating or secondary market transaction costs.

(ii) *Forward commitment.* (A) The loan pool sponsor shall purchase the loans pursuant to a forward commitment that identifies the loans to be originated with interest-rate reductions as specified in the approved application for AHP subsidy to households with incomes at or below 80 percent of the median income for the area. Both initial purchases of loans for the AHP loan pool and subsequent purchases of loans to substitute for repaid loans in the pool shall be made pursuant to the terms of such forward commitment and subject to time limits on the use of the AHP subsidy as specified by the Bank in its AHP Implementation Plan and the Bank's

agreement with the loan pool sponsor, which shall not exceed 1 year from the date of approval of the AHP application.

(B) As an alternative to using a forward commitment, the loan pool sponsor may purchase an initial round of loans that were not originated pursuant to an AHP-specific forward commitment, provided that the entities from which the loans were purchased are required to use the proceeds from the initial loan purchases within time limits on the use of the AHP subsidy as specified by the Bank in its AHP Implementation Plan and the Bank's agreement with the loan pool sponsor, which shall not exceed 1 year from the date of approval of the AHP application. The proceeds shall be used by such entities to assist households that are income-eligible under the approved AHP application during subsequent rounds of lending, and such assistance shall be provided in the form of a below-market AHP-subsidized interest rate as specified in the approved AHP application.

(iii) Each AHP-assisted owner-occupied unit and rental project receiving AHP direct subsidy or a subsidized advance shall be subject to the requirements of § 951.7(a), 951.8, and 951.9, respectively, of this part.

(iv) Where AHP direct subsidy is being used to buy down the interest rate of a loan or loans from a member or other party, the loan pool sponsor shall use the full amount of the AHP direct subsidy to buy down the interest rate on a permanent basis at the time of closing on such loan or loans.

(15) *Optional District eligibility requirements.* A Bank may require a project receiving AHP subsidies to meet one or more of the following additional eligibility requirements adopted by the Bank's board of directors and included in its AHP Implementation Plan after consultation with its Advisory Council:

(i) *AHP subsidy limits.* A requirement that the amount of AHP subsidy requested for the project does not exceed limits established by the Bank as to the maximum amount of AHP subsidy available per member each year, or per member, per project, or per project unit in a single funding period; or

(ii) *Homebuyer or homeowner counseling.* A requirement that a household must complete a homebuyer or homeowner counseling program provided by, or based on one provided by, an organization recognized as experienced in homebuyer or homeowner counseling, respectively.

(16) *Prohibited uses of AHP subsidies.* The project shall not use AHP subsidies to pay for:

(i) *Certain prepayment fees.*

Prepayment fees imposed by a Bank on a member for a subsidized advance that is prepaid, unless:

(A) The project is in financial distress that cannot be remedied through a project modification pursuant to § 951.5(f) of this part;

(B) The prepayment of the subsidized advance is necessary to retain the project's affordability and income targeting commitments;

(C) Subsequent to such prepayment, the project will continue to comply with the terms of the approved AHP application and the requirements of this part for the duration of the original retention period;

(D) Any unused AHP subsidy is returned to the Bank and made available for other AHP projects; and

(E) The amount of AHP subsidy used for the prepayment fee may not exceed the amount of the member's prepayment fee to the Bank.

(ii) *Cancellation fees.* Cancellation fees and penalties imposed by a Bank on a member for a subsidized advance commitment that is canceled.

(iii) *Processing fees.* Processing fees charged by members for providing AHP direct subsidies to a project.

(d) *Scoring of applications.* (1) *In general.* A Bank shall establish written scoring guidelines setting forth the Bank's AHP competitive application program scoring criteria and related definitions and point allocations, and implementing other applicable requirements pursuant to this paragraph (d). A Bank shall not adopt additional scoring criteria or point allocations, except as specifically authorized under this paragraph (d).

(2) *Point allocations.* (i) A Bank shall allocate 100 points among the 9 scoring criteria identified in paragraph (d)(5) of this section.

(ii) The scoring criterion for targeting identified in paragraph (d)(5)(iii) of this section shall be allocated at least 20 points.

(iii) The remaining scoring criteria shall be allocated at least 5 points each.

(3) *Fixed point and variable point scoring criteria.* A Bank shall designate each scoring criterion as either a fixed-point or a variable-point criterion, defined as follows:

(i) Fixed-point scoring criteria are those which cannot be satisfied in varying degrees and are either satisfied or not, with the total number of points allocated to the criterion awarded by the Bank to an application meeting the criterion; and

(ii) Variable-point criteria are those where there are varying degrees to which an application can satisfy the

criteria, with the number of points that may be awarded to an application for meeting the criterion varying, depending on the extent to which the application satisfies the criterion, based on a fixed scale or on a scale relative to the other applications being scored. A Bank shall designate the targeting and subsidy-per-unit scoring criteria identified in paragraphs (d)(5)(iii) and (d)(5)(viii), respectively, of this section, as variable-point criteria.

(4) *Satisfaction of scoring criteria.* A Bank shall award scoring points to applications for proposed projects based on satisfaction of the scoring criteria adopted by the Bank pursuant to paragraph (d)(5) of this section.

(5) *Scoring criteria.* An application for a proposed project may receive scoring points based on satisfaction of the following 9 scoring criteria:

(i) *Use of donated or conveyed government-owned or other properties.* The financing of housing using a significant proportion, as defined by the Bank in its AHP Implementation Plan, of:

(A) Land or units donated or conveyed by the federal government or any agency or instrumentality thereof; or

(B) Land or units donated or conveyed by any other party for an amount significantly below the fair market value of the property, as defined by the Bank in its AHP Implementation Plan.

(ii) *Sponsorship by a not-for-profit organization or government entity.* Project sponsorship by a not-for-profit organization, a state or political subdivision of a state, a state housing agency, a local housing authority, a Native American Tribe, an Alaskan Native Village, or the government entity for Native Hawaiian Home Lands.

(iii) *Targeting.* The extent to which a project provides housing for very low- and low- or moderate-income households, as follows:

(A) *Rental projects.* An application for a rental project shall be awarded the maximum number of points available under this scoring criterion if 60 percent or more of the units in the project are reserved for occupancy by households with incomes at or below 50 percent of the median income for the area. Applications for projects with less than 60 percent of the units reserved for occupancy by households with incomes at or below 50 percent of the median income for the area shall be awarded points on a declining scale based on the percentage of units in a project that are reserved for households with incomes at or below 50 percent of the median income for the area, and on the percentage of the remaining units

reserved for households with incomes at or below 80 percent of the median income for the area.

(B) *Owner-occupied projects.* Applications for owner-occupied projects shall be awarded points based on a declining scale to be determined by the Bank in its AHP Implementation Plan, taking into consideration percentages of units and targeted income levels.

(C) *Separate scoring.* For purposes of this scoring criterion, applications for owner-occupied projects and rental projects may be scored separately.

(iv) *Housing for homeless households.* The financing of rental housing, excluding overnight shelters, reserving at least 20 percent of the units for homeless households, the creation of transitional housing for homeless households permitting a minimum of 6 months occupancy, or the creation of permanent owner-occupied housing reserving at least 20 percent of the units for homeless households, with the term "homeless households" as defined by the Bank in its AHP Implementation Plan.

(v) *Promotion of empowerment.* The provision of housing in combination with a program offering: employment; education; training; homebuyer, homeownership, or tenant counseling; daycare services; resident involvement in decision making affecting the creation or operation of the project; or other services that assist residents to move toward better economic opportunities, such as welfare to work initiatives.

(vi) *First District priority.* The satisfaction of one of the following criteria, or one of a number of the following criteria, adopted by the Bank and set forth in the Bank's AHP Implementation Plan, as long as the total points available for meeting the criterion or criteria adopted under this category do not exceed the total points allocated to this category:

(A) *Special needs.* The financing of housing in which at least 20 percent of the units are reserved for occupancy by households with special needs, such as the elderly, mentally or physically disabled persons, persons recovering from physical abuse or alcohol or drug abuse, or persons with AIDS; or the financing of housing that is visitable by persons with physical disabilities who are not occupants of such housing;

(B) *Community development.* The financing of housing meeting housing needs documented as part of a community revitalization or economic development strategy approved by a unit of a state or local government;

(C) *First-time homebuyers.* The financing of housing for first-time homebuyers;

(D) *Member financial participation.* Member financial participation (excluding the pass-through of AHP subsidy) in the project, such as providing market rate or concessionary financing, fee waivers, or donations;

(E) *Disaster areas and displaced households.* The financing of housing located in federally declared disaster areas, or for households displaced from federally declared disaster areas due to a disaster;

(F) *Rural.* The financing of housing located in rural areas;

(G) *Urban.* The financing of urban infill or urban rehabilitation housing;

(H) *Economic diversity.* The financing of housing that is part of a strategy to end isolation of very low-income households by providing economic diversity through mixed-income housing in low- or moderate-income neighborhoods, or providing very low- or low- or moderate-income households with housing opportunities in neighborhoods or cities where the median income equals or exceeds the median income for the larger surrounding area, such as the city, county, or Primary Metropolitan Statistical Area, in which the neighborhood or city is located;

(I) *Fair housing remedy.* The financing of housing as part of a remedy undertaken by a jurisdiction adjudicated by a Federal, State, or local court to be in violation of title VI of the Civil Rights Act of 1964 (42 U.S.C. 2000d *et seq.*), the Fair Housing Act (42 U.S.C. 3601 *et seq.*), or any other Federal, State, or local fair housing law, or as part of a settlement of such claims;

(J) *Community involvement.* Demonstrated support for the project by local government, other than as a project sponsor, in the form of property tax deferment or abatement, zoning changes or variances, infrastructure improvements, fee waivers, or other similar forms of non-cash assistance, or demonstrated support for the project by community organizations or individuals, other than as project sponsors, through the commitment by such entities or individuals of donated goods and services, or volunteer labor;

(K) *Lender consortia.* The involvement of financing by a consortium of at least 2 financial institutions; or

(L) *In-District projects.* The financing of housing located in the Bank's District.

(vii) *Second District priority: defined housing need in the District.* The satisfaction of a housing need in the Bank's District, as defined by the Bank

in its AHP Implementation Plan. The Bank may, but is not required to, use one of the criteria listed in paragraph (d)(5)(vi) of this section, provided it is different from the criterion or criteria adopted by the Bank under such paragraph.

(viii) *AHP subsidy per unit.* (A) *Amount of subsidy.* The extent to which a project proposes to use the least amount of AHP subsidy per AHP-targeted unit. In the case of an application for a project financed by a subsidized advance, the total amount of AHP subsidy used by the project shall be estimated based on the Bank's cost of funds as of the date on which all applications are due for the funding period in which the application is submitted.

(B) *Separate scoring.* For purposes of this scoring criterion, applications for owner-occupied projects and rental projects may be scored separately.

(ix) *Community stability.* The promotion of community stability, such as by rehabilitating vacant or abandoned properties, being an integral part of a neighborhood stabilization plan approved by a unit of state or local government, and not displacing low- or moderate-income households, or if such displacement will occur, assuring that such households will be assisted to minimize the impact of such displacement.

(e) *Approval of AHP applications.* (1) A Bank shall approve applications for AHP subsidy in descending order starting with the highest scoring application until the total funding amount for the particular funding period, except for any amount insufficient to fund the next highest scoring application, has been allocated.

(2) The Bank also shall approve at least the next 4 highest scoring applications as alternates and, within 1 year of approval, may fund such alternates if any previously committed AHP subsidies become available.

(f) *Modifications of approved AHP applications.* (1) *Modification procedure.* If, prior to or after final disbursement of funds to a project from all funding sources, there is or will be a change in the project that would change the score that the project application received in the funding period in which it was originally scored and approved, had the changed facts been operative at that time, a Bank, in its discretion, may approve in writing a modification to the terms of the approved application, provided that:

(i) The project, incorporating any such changes, would meet the eligibility requirements of paragraph (c) of this section;

(ii) The application, as reflective of such changes, continues to score high enough to have been approved in the funding period in which it was originally scored and approved by the Bank; and

(iii) There is good cause for the modification, and the analysis and justification for the modification are documented by the Bank in writing.

(2) *AHP subsidy increases; no delegation.* Modifications involving an increase in AHP subsidy shall be approved or disapproved by a Bank's board of directors. The authority to approve or disapprove such requests shall not be delegated to Bank officers or other Bank employees.

(g) *Procedure for funding.* (1) *Disbursement of AHP subsidies to members.* (i) A Bank may disburse AHP subsidies only to institutions that are members of the Bank at the time they request a draw-down of the subsidies.

(ii) If an institution with an approved application for AHP subsidy loses its membership in a Bank, the Bank may disburse AHP subsidies to a member of such Bank to which the institution has transferred its obligations under the approved AHP application, or the Bank may disburse AHP subsidies through another Bank to a member of that Bank that has assumed the institution's obligations under the approved AHP application.

(2) *Progress towards use of AHP subsidy.* A Bank shall establish and implement policies, including time limits, for determining whether progress is being made towards draw-down and use of AHP subsidies by approved projects, and whether to cancel AHP application approvals for lack of such progress. If a Bank cancels any AHP application approvals due to lack of such progress, the Bank shall make the AHP subsidies available for other AHP-eligible projects.

(3) *Compliance upon disbursement of AHP subsidies.* A Bank shall establish and implement policies for determining, prior to its initial disbursement of AHP subsidies for an approved project, and prior to each subsequent disbursement if the need for AHP subsidy has changed, that the project meets the eligibility requirements of paragraph (c) of this section and all obligations committed to in the approved AHP application. If a Bank cancels any AHP application approvals due to noncompliance with eligibility requirements of paragraph (c) of this section, the Bank shall make the AHP subsidies available for other AHP-eligible projects.

(4) *Changes in approved AHP subsidy amount where a direct subsidy is used*

to write down prior to closing the principal amount or interest rate on a loan. If a member is approved to receive AHP direct subsidy to write down prior to closing the principal amount or the interest rate on a loan to a project, and the amount of AHP subsidy required to maintain the debt service cost for the loan decreases from the amount of AHP subsidy initially approved by the Bank due to a decrease in market interest rates between the time of approval and the time the lender commits to the interest rate to finance the project, the Bank shall reduce the AHP subsidy amount accordingly. If market interest rates rise between the time of approval and the time the lender commits to the interest rate to finance the project, the Bank, in its discretion, may increase the AHP subsidy amount accordingly.

(5) *AHP outlay adjustment.* If a Bank reduces the amount of AHP subsidy approved for a project, the amount of such reduction shall be returned to the Bank's AHP fund. If a Bank increases the amount of AHP subsidy approved for a project, the amount of such increase shall be drawn first from any currently uncommitted or repaid AHP subsidies and then from the Bank's required AHP contribution for the next year.

(6) *Project sponsor notification of reuse of repaid AHP direct subsidy.* Prior to disbursement by a project sponsor of AHP direct subsidy repaid to and retained by such project sponsor pursuant to a subsidy re-use program authorized by the Bank under § 951.8(f)(2) of this part, the project sponsor shall provide written notice to the member and the Bank of its intent to disburse the repaid AHP subsidy to a household satisfying the requirements of this part and the commitments made in the approved AHP application.

(h) *Bank board duties and delegation.* (1) *Duties.* A Bank's board of directors, after consultation with its Advisory Council, shall be responsible for:

(i) Adoption of the AHP Implementation Plan required pursuant to § 951.3 of this part; and

(ii) Approving or disapproving the applications for AHP subsidy pursuant to § 951.5(e) of this part.

(2) *No delegation.* The Bank's board of directors shall not delegate to Bank officers or other Bank employees the responsibilities set forth in paragraph (h)(1) of this section.

#### **§ 951.6 Homeownership set-aside programs.**

(a) *Establishment of program.* A Bank may establish one or more homeownership set-aside programs

pursuant to the requirements of this part.

(b) *Eligible applicants.* A Bank shall accept applications for AHP direct subsidy under its homeownership set-aside programs only from institutions that are members of the Bank at the time the application is submitted to the Bank.

(c) *Minimum eligibility requirements.* A Bank's homeownership set-aside programs shall meet the following eligibility requirements:

(1) *Member allocation criteria.* AHP direct subsidies shall be provided to members pursuant to allocation criteria established by the Bank in its AHP Implementation Plan.

(2) *Eligible households.* Members shall provide AHP direct subsidies only to households that:

(i) Have incomes at or below 80 percent of the median income for the area at the time the household is accepted for enrollment by the member in the Bank's homeownership set-aside program, with such time of enrollment by the member defined by the Bank in its AHP Implementation Plan;

(ii) Complete a homebuyer or homeowner counseling program provided by, or based on one provided by, an organization experienced in homebuyer or homeowner counseling, in the case of households that are first-time homebuyers; and

(iii) Are first-time homebuyers, in the case of households receiving funds pursuant to the first-time homebuyer requirement in § 951.2(b)(2) of this part, and meet such other eligibility criteria that may be established by the Bank in its AHP Implementation Plan, such as a matching funds requirement, homebuyer or homeowner counseling requirement for households that are not first-time homebuyers, or criteria that give priority for the purchase or rehabilitation of housing in particular areas or as part of a disaster relief effort.

(3) *Maximum grant amount.* Members shall provide AHP direct subsidies to households as a grant, in an amount up to a maximum of \$15,000 per household, as established by the Bank in its AHP Implementation Plan, which limit shall apply to all households.

(4) *Eligible uses of AHP direct subsidy.* Households shall use the AHP direct subsidies to pay for down payment, closing cost, counseling, or rehabilitation assistance in connection with the household's purchase or rehabilitation of an owner-occupied unit, including a condominium or cooperative housing unit or manufactured housing, to be used as the household's primary residence.

(5) *Retention agreement.* An owner-occupied unit purchased or

rehabilitated using AHP direct subsidy shall be subject to a 5-year retention agreement described in § 951.9(a)(7) of this part.

(6) *Financial or other concessions.* The Bank may, in its discretion, require members and other lenders to provide financial or other concessions, as defined by the Bank in its AHP Implementation Plan, to households in connection with providing the AHP direct subsidy or financing to the household.

(7) *Financing costs.* The rate of interest, points, fees, and any other charges for all loans made in conjunction with the AHP direct subsidy shall not exceed a reasonable market rate of interest, points, fees, and other charges for loans of similar maturity, terms, and risk.

(8) *Counseling costs.* The AHP direct subsidies may be used to pay for counseling costs only where:

(i) Such costs are incurred in connection with counseling of homebuyers who actually purchase an AHP-assisted unit; and

(ii) The cost of the counseling has not been covered by another funding source, including the member.

(9) *Cash back to household.* A member may provide cash back to a household at closing on the mortgage loan in an amount not exceeding \$250, as determined by the Bank in its AHP Implementation Plan, and a member shall use any AHP direct subsidy exceeding such amount that is beyond what is needed at closing for closing costs and the approved mortgage amount as a credit to reduce the principal of the mortgage loan or as a credit toward the household's monthly payments on the mortgage loan.

(d) *Approval of AHP applications.* A Bank shall approve applications for AHP direct subsidy in accordance with the Bank's criteria governing the allocation of funds.

(e) *Procedure for funding.* (1) *Disbursement of AHP direct subsidies to members.* (i) A Bank may disburse AHP direct subsidies only to institutions that are members of the Bank at the time they request a draw-down of the subsidies.

(ii) If an institution with an approved application for AHP direct subsidy loses its membership in a Bank, the Bank may disburse AHP direct subsidies to a member of such Bank to which the institution has transferred its obligations under the approved AHP application, or the Bank may disburse AHP direct subsidies through another Bank to a member of that Bank that has assumed the institution's obligations under the approved AHP application.

(2) *Reservation of homeownership set-aside subsidies.* A Bank shall establish and implement policies for reservation of homeownership set-aside subsidies for households enrolled in the Bank's homeownership set-aside program. The policies shall provide that set-aside subsidies be reserved no more than 2 years in advance of the Bank's time limit in its AHP Implementation Plan for draw-down and use of the subsidies by the household and the reservation of subsidies be made from the set-aside allocation of the year in which the Bank makes the reservation.

(3) *Progress towards use of AHP direct subsidy.* A Bank shall establish and implement policies, including time limits, for determining whether progress is being made towards draw-down and use of the AHP direct subsidies by eligible households, and whether to cancel AHP application approvals for lack of such progress. If a Bank cancels any AHP application approvals due to lack of such progress, it shall make the AHP direct subsidies available for other applicants for AHP direct subsidies under the homeownership set-aside program or for other AHP-eligible projects.

#### **§ 951.7 Monitoring.**

(a) *Competitive application program.* (1) *Initial monitoring policies for owner-occupied and rental projects.* (i) *Adoption and implementation.*

Pursuant to written policies established by a Bank, the Bank shall monitor each AHP owner-occupied and rental project under its competitive application program prior to, and within a reasonable period of time after, project completion to determine, at a minimum, whether:

(A) The project is making satisfactory progress towards completion, in compliance with the commitments made in the approved AHP application, Bank policies, and the requirements of this part;

(B) Following completion of the project, satisfactory progress is being made towards occupancy of the project by eligible households; and

(C) Within a reasonable period of time after project completion, the project meets the following requirements, at a minimum:

(1) The AHP subsidies were used for eligible purposes according to the commitments made in the approved AHP application;

(2) The household incomes and rents comply with the income targeting and rent commitments made in the approved AHP application;

(3) The project's actual costs were reasonable in accordance with the

Bank's project cost guidelines, and the AHP subsidies were necessary for the completion of the project as currently structured;

(4) Each AHP-assisted unit of an owner-occupied project and rental project is subject to AHP retention agreements that meet the requirements of § 951.9(a)(7) or (a)(8), respectively, of this part; and

(5) The services and activities committed to in the approved AHP application have been provided in connection with the project.

(ii) *Back-up and other project documentation.* The Bank's written monitoring policies shall include requirements for:

(A) Bank review of back-up project documentation regarding household incomes and rents maintained by the project sponsor or owner; and

(B) Maintenance and Bank review of other project documentation in the Bank's discretion.

(iii) *Sampling plan.* The Bank shall not use a sampling plan to select the projects to be monitored under this paragraph (a)(1), but may use a reasonable risk-based sampling plan to review the back-up project documentation.

(2) *Reliance on long-term tax credit monitoring for rental projects.* For completed AHP rental projects that have been allocated federal Low-Income Housing Tax Credits (tax credits), a Bank may, in its discretion, for purposes of long-term AHP monitoring under its competitive application program, rely on the monitoring by the state-designated housing credit agency administering the tax credits of the income targeting and rent requirements applicable under the Low-Income Housing Tax Credit Program, and the Bank need not obtain and review reports from such agency or otherwise monitor the projects' long-term AHP compliance.

(3) *Reliance on other long-term governmental monitoring for rental projects.* For completed AHP rental projects that received funds other than tax credits from federal, state, or local government entities, a Bank may, in its discretion, for purposes of long-term AHP monitoring under its competitive application program, rely on the monitoring by such entities of the income targeting and rent requirements applicable under their programs, provided that the Bank can show that:

(i) The compliance profiles regarding income targeting, rent, and retention period requirements of the AHP and the other programs are substantively equivalent;

(ii) The entity has demonstrated and continues to demonstrate its ability to monitor the project;

(iii) The entity agrees to provide reports to the Bank on the project's incomes and rents for the full 15-year AHP retention period; and

(iv) The Bank reviews the reports from the monitoring entity to confirm that they comply with the Bank's monitoring policies.

(4) *Long-term monitoring policies for rental projects.* (i) *Adoption and implementation.* In cases where a Bank does not rely on monitoring by a federal, state, or local government entity pursuant to paragraphs (a)(2) or (a)(3) of this section, pursuant to written policies established by the Bank, the Bank shall monitor completed AHP rental projects under its competitive application program, commencing in the second year after project completion to determine, at a minimum, whether during the full 15-year retention period, the household incomes and rents comply with the income targeting and rent commitments, respectively, made in the approved AHP applications.

(ii) *Annual project owner certifications; backup and other project documentation.* A Bank's written monitoring policies shall include requirements for:

(A) Bank review of annual certifications by project owners to the Bank that household incomes and rents are in compliance with the commitments made in the approved AHP application;

(B) Bank review of back-up project documentation regarding household incomes and rents maintained by the project owner; and

(C) Maintenance and Bank review of other project documentation in the Banks' discretion.

(iii) *Risk factors and other monitoring.* (A) *Risk factors; other monitoring.* A Bank's written monitoring policies shall take into account risk factors such as the amount of AHP subsidy in the project, type of project, size of project, location of project, sponsor experience, and any monitoring of the project provided by a federal, state, or local government entity.

(B) *Risk-based sampling plan.* A Bank may use a reasonable, risk-based sampling plan to select the rental projects to be monitored under this paragraph (a)(4), and to review the annual project owner certifications, back-up, and any other project documentation. The risk-based sampling plan and its basis shall be in writing.

(5) *Annual adjustment of targeting commitments.* For purposes of

determining compliance with the targeting commitments in an approved AHP application for both initial and long-term AHP monitoring purposes under a Bank's competitive application program, such commitments shall be considered to adjust annually according to the current applicable median income data. A rental unit may continue to count toward meeting the targeting commitment of an approved AHP application as long as the rent charged to a household remains affordable, as defined in § 951.1 of this part, for the household occupying the unit.

(b) *Homeownership set-aside programs: Monitoring policies.* (1) *Adoption and implementation.* Pursuant to written policies adopted by a Bank, the Bank shall monitor compliance with the requirements of its homeownership set-aside programs, including monitoring to determine, at a minimum, whether:

(i) The AHP subsidy was provided to households meeting all applicable eligibility requirements in § 951.6(c)(2) of this part and the Bank's homeownership set-aside program policies; and

(ii) All other applicable eligibility requirements in § 951.6(c) of this part and the Bank's homeownership set-aside program policies are met, including that the AHP-assisted units are subject to retention agreements required under § 951.6(c)(5) of this part.

(2) *Member certifications; back-up and other documentation.* The Bank's written monitoring policies shall include requirements for:

(i) Bank review of certifications by members to the Bank, prior to disbursement of the AHP subsidy, that the subsidy will be provided in compliance with all applicable eligibility requirements in § 951.6(c) of this part;

(ii) Bank review of back-up documentation regarding household incomes maintained by the member; and

(iii) Maintenance and Bank review of other documentation in the Bank's discretion.

(3) *Sampling plan.* The Bank may use a reasonable sampling plan to select the households to be monitored, and to review the back-up and any other documentation received by the Bank, but not the member certifications required in paragraph (b)(2) of this section. The sampling plan and its basis shall be in writing.

#### **§ 951.8 Remedial actions for noncompliance.**

(a) *Recovery of AHP subsidies.* A Bank shall recover the amount of any AHP

subsidies (plus interest, if appropriate) that are not used in compliance with the commitments made in the approved application for AHP subsidy and the requirements of this part, if the misuse is the result of the actions or omissions of the member, the project sponsor, or the project owner.

(b) *Responsible party for repayment of AHP subsidies.* Except as provided in paragraph (c) of this section:

(1) If the member causes the AHP subsidies to be misused through its actions or omissions, the member shall repay the AHP subsidies to the Bank.

(2) If the project sponsor or owner causes the AHP subsidies to be misused through its actions or omissions, the following shall apply, as determined by the Bank in its discretion:

(i) The member shall recover the AHP subsidies from the project sponsor or owner and repay them to the Bank; or

(ii) The project sponsor or owner shall repay the AHP subsidies directly to the Bank.

(c) *Recovery not required.* Recovery of the AHP subsidies is not required if:

(1) The member, project sponsor, or project owner cures the noncompliance within a reasonable period of time;

(2) The circumstances of noncompliance are eliminated through a modification of the terms of the approved application for AHP subsidy pursuant to § 951.5(f) of this part; or

(3) The member is unable to collect the AHP subsidy after making reasonable efforts to collect it.

(d) *Settlements.* A Bank may settle a claim for AHP subsidies that it has against a member, project sponsor, or project owner for less than the full amount due. If a Bank enters into such a settlement, the Finance Board may require the Bank to reimburse its AHP fund in the amount of any shortfall under paragraph (e)(2) of this section, unless:

(1) The Bank has sufficient documentation showing that the sum agreed to be repaid under the settlement is reasonably justified, based on the facts and circumstances of the noncompliance (including the degree of culpability of the non-complying parties and the extent of the Bank's recovery efforts); or

(2) The Bank obtains a determination from the Finance Board that the sum agreed to be repaid under the settlement is reasonably justified, based on the facts and circumstances of the noncompliance (including the degree of culpability of the non-complying parties and the extent of the Bank's recovery efforts).

(e) *Reimbursement of AHP fund.* (1) *By the Bank.* A Bank shall reimburse its

AHP fund in the amount of any AHP subsidies (plus interest, if appropriate) misused as a result of the actions or omissions of the Bank.

(2) *By Finance Board order.* The Finance Board may order a Bank to reimburse its AHP fund in an appropriate amount upon determining that:

(i) The Bank has failed to reimburse its AHP fund as required under paragraph (e)(1) of this section; or

(ii) The Bank has failed to recover AHP subsidy from a member, project sponsor, or project owner pursuant to the requirements of paragraph (a) of this section, and has not shown that such failure is reasonably justified, considering factors such as the extent of the Bank's recovery efforts.

(f) *Use of repaid AHP subsidies.* (1) *Use of repaid AHP subsidies in other AHP-eligible projects.* Except as provided in paragraph (f)(2) of this section, amounts of AHP subsidy, including any interest, repaid to a Bank pursuant to this part shall be made available by the Bank for other AHP-eligible projects.

(2) *Re-use of repaid AHP direct subsidies in same project.* (i) *Requirements.* AHP direct subsidy, including any interest, repaid to a member or project sponsor under a homeownership set-aside program or the competitive application program, respectively, may be repaid by such parties to the Bank for subsequent disbursement to and re-use by such parties, or retained by such parties for subsequent re-use, as authorized by the Bank, in its discretion, after consultation with its Advisory Council, in its AHP Implementation Plan, provided all of the following requirements are satisfied:

(A) The member or the project sponsor originally provided the AHP direct subsidy as down payment, closing cost, rehabilitation, or interest rate buy down assistance to an eligible household to purchase or rehabilitate an owner-occupied unit pursuant to an approved AHP application;

(B) The AHP direct subsidy, including any interest, was repaid to the member or project sponsor as a result of a sale by the household of the unit prior to the end of the retention period to a purchaser that is not a low-or moderate-income household; and

(C) The repaid AHP direct subsidy is made available by the member or project sponsor, within the period of time specified by the Bank in its AHP Implementation Plan, to another AHP-eligible household to purchase or rehabilitate an owner-occupied unit in

the same project in accordance with the terms of the approved AHP application.

(ii) *No delegation.* A Bank's board of directors shall not delegate to Bank officers or other Bank employees the responsibility to adopt any Bank policies on re-use of repaid AHP direct subsidies in the same project pursuant to paragraph (f)(2)(i) of this section.

(g) *Suspension and debarment.* (1) *At a Bank's initiative.* A Bank may suspend or debar a member, project sponsor, or project owner from participation in the Program if such party shows a pattern of noncompliance, or engages in a single instance of flagrant noncompliance, with the terms of an approved application for AHP subsidy or the requirements of this part.

(2) *At the Finance Board's initiative.* The Finance Board may order a Bank to suspend or debar a member, project sponsor, or project owner from participation in the Program if such party shows a pattern of noncompliance, or engages in a single instance of flagrant noncompliance, with the terms of an approved application for AHP subsidy or the requirements of this part.

(h) *Transfer of Program administration.* Without limitation on other remedies, the Finance Board, upon determining that a Bank has engaged in mismanagement of its Program, may designate another Bank to administer all or a portion of the first Bank's annual AHP contribution, for the benefit of the first Bank's members, under such terms and conditions as the Finance Board may prescribe.

(i) *Finance Board actions under this section.* Except as provided in paragraph (d)(2) of this section, actions taken by the Finance Board under this section are reviewable under § 907.9 of this chapter.

#### § 951.9 Agreements.

(a) *Agreements between Banks and members.* A Bank shall have in place with each member receiving an AHP subsidized advance or AHP direct subsidy an agreement or agreements containing, at a minimum, the following provisions, where applicable:

(1) *Notification of member.* The member has been notified of the requirements of this part as they may be amended from time to time, and all Bank policies relevant to the member's approved application for AHP subsidy.

(2) *AHP subsidy pass-through.* The member shall pass on the full amount of the AHP subsidy to the project or household, as applicable, for which the subsidy was approved.

(3) *Use of AHP subsidy.* (i) *Use of AHP subsidy by the member.* The

member shall use the AHP subsidy in accordance with the terms of the member's approved application for the subsidy and the requirements of this part.

(ii) *Use of AHP subsidy by the project sponsor or owner.* The member shall have in place an agreement with each project sponsor or project owner in which the project sponsor or project owner agrees to use the AHP subsidy in accordance with the terms of the member's approved application for the subsidy and the requirements of this part.

(4) *Repayment of AHP subsidies in case of noncompliance.* (i)

*Noncompliance by the member.* The member shall repay AHP subsidies to the Bank in accordance with the requirements of § 951.8(b)(1) of this part.

(ii) *Noncompliance by a project sponsor or owner.* (A) *Agreement.* The member shall have in place an agreement with each project sponsor or project owner in which the project sponsor or project owner agrees to repay AHP subsidies to the member or the Bank in accordance with the requirements of § 951.8(b)(2)(i) or (b)(2)(ii) of this part, respectively (as applicable).

(B) *Recovery of AHP subsidies.* The member shall recover from the project sponsor or project owner and repay to the Bank any AHP subsidy in accordance with the requirements of § 951.8(b)(2)(i) of this part (if applicable).

(5) *Project monitoring.* (i) *Monitoring by the member.* The member shall comply with the monitoring requirements applicable to it, as established by the Bank in its monitoring policies pursuant to § 951.7 of this part.

(ii) *Agreement.* The member shall have in place an agreement with each project sponsor and project owner, in which the project sponsor and project owner agree to comply with the monitoring requirements applicable to such parties, as established by the Bank in its monitoring policies pursuant to § 951.7 of this part.

(6) *Transfer of AHP obligations.* (i) *To another member.* The member shall make best efforts to transfer its obligations under the approved application for AHP subsidy to another member in the event of its loss of membership in the Bank prior to the Bank's final disbursement of AHP subsidies.

(ii) *To a nonmember.* If, after final disbursement of AHP subsidies to the member, the member undergoes an acquisition or a consolidation resulting

in a successor organization that is not a member of the Bank, the nonmember successor organization assumes the member's obligations under its approved application for AHP subsidy, and where the member received an AHP subsidized advance, the nonmember assumes such obligations until prepayment or orderly liquidation by the nonmember of the subsidized advance.

(7) *Retention agreements for owner-occupied units.* The member shall ensure that an AHP-assisted owner-occupied unit is subject to a deed restriction or other legally enforceable retention agreement or mechanism requiring that:

(i) The Bank or its designee is to be given notice of any sale or refinancing of the unit occurring prior to the end of the retention period;

(ii) In the case of a sale or refinancing of the unit prior to the end of the retention period, an amount equal to a pro rata share of the AHP subsidy that financed the purchase, construction, or rehabilitation of the unit, reduced for every year the seller owned the unit, shall be repaid to the Bank from any net gain realized upon the sale or refinancing, unless:

(A) The unit was assisted with a permanent mortgage loan funded by an AHP subsidized advance;

(B) The unit is sold to a very low-, or low- or moderate-income household; or

(C) Following a refinancing, the unit continues to be subject to a deed restriction or other legally enforceable retention agreement or mechanism described in this paragraph (a)(7); and

(iii) In the case of a direct subsidy, such repayment of AHP subsidy shall be made:

(A) *To the Bank.* If the Bank has not authorized re-use of the repaid AHP subsidy or has authorized re-use of the repaid subsidy but not retention of such repaid subsidy by the member or project sponsor pursuant to § 951.8(f)(2) of this part, or has authorized retention and re-use of such repaid subsidy by the member or project sponsor pursuant to such section and the repaid subsidy is not re-used in accordance with the requirements of the Bank and such section; or

(B) *To the member or project sponsor.* To the member or project sponsor for reuse by such member or project sponsor, if the Bank has authorized retention and re-use of such subsidy by the member or project sponsor pursuant to § 951.8(f)(2); and

(iv) The obligation to repay AHP subsidy to the Bank shall terminate after any foreclosure.



(8) *Retention agreements for rental projects.* The member shall ensure that an AHP-assisted rental project is subject to a deed restriction or other legally enforceable retention agreement or mechanism requiring that:

(i) The project's rental units, or applicable portion thereof, must remain occupied by and affordable for households with incomes at or below the levels committed to be served in the approved AHP application for the duration of the retention period;

(ii) The Bank or its designee is to be given notice of any sale or refinancing of the project occurring prior to the end of the retention period;

(iii) In the case of a sale or refinancing of the project prior to the end of the retention period, the full amount of the AHP subsidy received by the owner shall be repaid to the Bank, unless:

(A) The project continues to be subject to a deed restriction or other legally enforceable retention agreement or mechanism incorporating the income-eligibility and affordability restrictions committed to in the approved AHP application for the duration of the retention period; or

(B) If authorized by the Bank, in its discretion, the households are relocated, due to the exercise of eminent domain, or for expansion of housing or services, to another property that is made subject to a deed restriction or other legally enforceable retention agreement or mechanism incorporating the income-eligibility and affordability restrictions committed to in the approved AHP application for the remainder of the retention period; and

(iv) The income-eligibility and affordability restrictions applicable to the project shall terminate after any foreclosure.

(9) *Lending of AHP direct subsidies.* If a member or a project sponsor lends AHP direct subsidy to a project, any repayments of principal and payments of interest received by the member or the project sponsor must be paid forthwith to the Bank, unless the direct subsidy is being both lent and re-lent by a revolving loan fund pursuant to § 951.5(c)(13) of this part.

(10) *Special provisions where members obtain AHP subsidized advances.* (i) *Repayment schedule.* The term of an AHP subsidized advance shall be no longer than the term of the member's loan to the project funded by the advance, and at least once in every 12-month period, the member shall be scheduled to make a principal repayment to the Bank equal to the amount scheduled to be repaid to the member on its loan to the project in that period.

(ii) *Prepayment fees.* Upon a prepayment of an AHP subsidized advance, the Bank shall charge a prepayment fee only to the extent the Bank suffers an economic loss from the prepayment.

(iii) *Treatment of loan prepayment by project.* If all or a portion of the loan or loans financed by an AHP subsidized advance are prepaid by the project to the member, the member may, at its option, either:

(A) Repay to the Bank that portion of the advance used to make the loan or loans to the project, and be subject to a fee imposed by the Bank sufficient to compensate the Bank for any economic loss the Bank experiences in reinvesting the repaid amount at a rate of return below the cost of funds originally used by the Bank to calculate the interest rate subsidy incorporated in the advance; or

(B) Continue to maintain the advance outstanding, subject to the Bank resetting the interest rate on that portion of the advance used to make the loan or loans to the project to a rate equal to the cost of funds originally used by the Bank to calculate the interest rate subsidy incorporated in the advance.

(b) *Agreements between Banks and project sponsors or owners.* A Bank shall have in place an agreement with each project sponsor or project owner, in which the project sponsor or project owner agrees to repay AHP subsidies directly to the Bank in accordance with the requirements of § 951.8(b)(2)(ii) of this part (if applicable).

(c) *Application to existing AHP projects and units.* The requirements of section 10(j) of the Act (12 U.S.C. 1430(j)) and the provisions of this part, as amended, are incorporated into all agreements between Banks, members, project sponsors, and project owners receiving AHP subsidies under the competitive application program, and between Banks, members and unit owners under the homeownership set-aside program. To the extent the requirements of this part are amended from time to time, such agreements are deemed to incorporate the amendments to conform to any new requirements of this part. No amendment to this part shall affect the legality of actions taken prior to the effective date of such amendment.

#### § 951.10 Conflicts of interest.

(a) *Bank directors and employees.* (1) Each Bank's board of directors shall adopt a written policy providing that if a Bank director or employee, or such person's family member, has a financial interest in, or is a director, officer, or employee of an organization involved in, a project that is the subject of a

pending or approved AHP application, the Bank director or employee shall not participate in or attempt to influence decisions by the Bank regarding the evaluation, approval, funding, monitoring, or any remedial process for such project.

(2) If a Bank director or employee, or such person's family member, has a financial interest in, or is a director, officer, or employee of an organization involved in, an AHP project such that he or she is subject to the requirements in paragraph (a)(1) of this section, such person shall not participate in or attempt to influence decisions by the Bank regarding the evaluation, approval, funding, monitoring, or any remedial process for such project.

(b) *Advisory Council members.* (1) Each Bank's board of directors shall adopt a written policy providing that if an Advisory Council member, or such person's family member, has a financial interest in, or is a director, officer, or employee of an organization involved in, a project that is the subject of a pending or approved AHP application, the Advisory Council member shall not participate in or attempt to influence decisions by the Bank regarding the approval for such project.

(2) If an Advisory Council member, or such person's family member, has a financial interest in, or is a director, officer, or employee of an organization involved in, an AHP project such that he or she is subject to the requirements in paragraph (b)(1) of this section, such person shall not participate in or attempt to influence decisions by the Bank regarding the approval for such project.

(c) *No delegation.* A Bank's board of directors shall not delegate to Bank officers or other Bank employees the responsibility to adopt the conflict of interest policies required by this section.

#### § 951.11 Temporary suspension of AHP contributions.

(a) *Request to Finance Board.* If a Bank finds that the contributions required pursuant to § 951.2(a) of this part are contributing to the financial instability of the Bank, the Bank may apply in writing to the Finance Board for a temporary suspension of such contributions.

(b) *Board of Directors review.* (1) In determining the financial instability of a Bank, the Board of Directors shall consider such factors as:

- (i) Severely depressed Bank earnings;
- (ii) A substantial decline in Bank membership capital; and
- (iii) A substantial reduction in Bank advances outstanding.

(2) *Limitations on grounds for suspension.* The Board of Directors shall not suspend a Bank's annual AHP contributions if it determines that the Bank's reduction in earnings is due to:

(i) A change in the terms of advances to members that is not justified by market conditions;

(ii) Inordinate operating and administrative expenses; or

(iii) Mismanagement.

**§ 951.12 Affordable Housing Reserve Fund.**

(a) *Deposits.* If a Bank fails to use or commit the full amount it is required to contribute to the Program in any year pursuant to § 951.2(a) of this part, 90 percent of the unused or uncommitted amount shall be deposited by the Bank in an Affordable Housing Reserve Fund established and administered by the Finance Board. The remaining 10

percent of the unused and uncommitted amount retained by the Bank should be fully used or committed by the Bank during the following year, and any remaining portion shall be deposited in the Affordable Housing Reserve Fund.

(b) *Use or commitment of funds.*

Approval of applications for AHP subsidies from members sufficient to exhaust the amount a Bank is required to contribute pursuant to § 951.2(a) of this part shall constitute use or commitment of funds. Amounts remaining unused or uncommitted at year-end are deemed to be used or committed if, in combination with AHP subsidies that have been returned to the Bank or de-committed from canceled projects, they are insufficient to fund:

(1) The next highest scoring AHP application in the Bank's final funding period of the year for its competitive application program;

(2) Pending applications for funds under the Bank's homeownership set-aside programs; and

(3) Project modifications approved by the Bank pursuant to the requirements of this part.

(c) *Carryover of insufficient amounts.* Such insufficient amounts as described in paragraph (b) of this section shall be carried over for use or commitment in the following year in the Bank's competitive application program or homeownership set-aside programs.

Dated: September 13, 2006.

By the Board of Directors of the Federal Housing Finance Board.

**Ronald A. Rosenfeld,**

*Chairman.*

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