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Critics have misread the CBO's report on the Federal Home Loan banks

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The Home Loan Bank System has delivered for banks and consumers for nearly 100 years. The FHFA should be careful about interfering unnecessarily in a system that benefits so many, writes Ryan Donovan.

Reading the recent BankThink piece entitled, "CBO called out the Federal Home Loan banks. It's now up to Congress," left me wondering whether I had read the same CBO report that was referred to in the piece.

While the report centers on the role of the Home Loan banks, several key points contained in the report are worth reiterating.

First, CBO rightly asserts that the Home Loan banks "are cooperatives owned by their member institutions" and that they are "privately owned and operated corporations." This is important because it means that the Home Loan banks are not government agencies, and their employees are not government employees. Assertions to the contrary are not only flagrantly false, but deceptive.

Second, while the CBO report estimates that the Home Loan banks will be subsidized to the tune of $7.3 billion in 2024, the report also very clearly states that "Congress does not appropriate funds for [the Home Loan banks]." So, the logical question then is if the Home Loan banks are indeed subsidized, how does this subsidy work and how is it paid?

There are those who would argue that it is taxpayers that foot this bill. However, a careful read of the CBO report leads to the accurate conclusion that it is investors in Federal Home Loan Bank System debt that pay it in the form of a lower return on their capital. Otherwise stated, private investors using private funds willingly accept lower returns on Home Loan bank debt relative to potentially higher yields from other securities due to the inherent safety of Home Loan bank debt.

As the CBO report makes clear, the safety of Home Loan bank debt stems from the fact that the loans the Home Loan banks make to members are over-collateralized, the Home Loan banks retain a perfected security interest in all collateral pledged and that the Home Loan banks are jointly and severally liable for the debt of the entire system. The CBO report also notes that the status of the Home Loan banks as a government-sponsored enterprise "creates the perception among investors" of an implied guarantee. The important takeaway here is that it is investors in Home Loan bank securities that assume the guarantee — the government is not implying a guarantee. In fact, the disclosures on Home Loan bank-issued securities clearly state the following: "THE SECURITIES ARE NOT OBLIGATIONS OF THE UNITED STATES AND ARE NOT GUARANTEED BY THE UNITED STATES." [Emphasis in original].

In other words, the willingness of investors to accept a lower rate of return on Home Loan bank debt reflects a market-driven choice predicated on the confidence they place in the Home Loan Bank System's robustness. Aside from the federal government's initial infusion of capital to establish the system in 1932, Congress has never appropriated any direct government financial assistance to the Home Loan banks. Private investors pay to subsidize the Home Loan Bank System, not the government or taxpayers.

The Home Loan banks are indeed exempt from state and local taxes, as the CBO report notes, amounting to roughly $1 billion in foregone tax payments according to CBO. But Home Loan banks, like credit unions and S-Corp banks, are pass-through entities and what the CBO report does not contemplate is that the dividends the Home Loan banks distribute to their members as a return on their capital investment in these cooperatives are taxed as income.

Regarding the benefits that accrue from this arrangement, here again a careful read of the CBO report provides an answer. Most significantly, the report concludes that the discount on the cost of Home Loan Bank System debt passes through to members and then on to those members' customers. This passage from the CBO report is instructive:

"Lower financing costs on FHLBs' debt are passed along through lower rates on advances than members would receive when borrowing in private debt markets. In turn, competition leads members to offer lower rates to borrowers."

One recent study that quantifies this benefit and cited in the CBO report concludes that the Home Loan Bank System saves borrowers $13 billion in mortgage interest payments every year and leads to a more than 16% increase in mortgage originations. And anecdotally, Home Loan bank members have frequently shared the importance of access to Home Loan bank funding to support their lending activities in the communities they serve. At a time when millions of Americans are struggling to make ends meet, the kind of savings passed on from Home Loan banks through their members to consumers are important and are a direct result of the value the Home Loan bank System delivers.

The fact is, the capital investment that members make in the Home Loan bank grants them access to funding that allows many local community lenders to provide mortgages and small-business loans in thousands of communities across the country, and at lower market rates thanks to the Home Loan banks. The beneficiaries of that lending activity are taxpayers like you and me.

Ultimately, the Home Loan Bank System works — and has worked — for the benefit of taxpayers and the broader financial system for over 90 years.

Suggestions that the system is characterized by "waste, fraud and abuse" are without merit. These terms do not appear anywhere in the CBO report, nor do they appear in the Federal Housing Finance Agency's (FHFA) recently released report on the system — a report that was produced after a yearslong review process that relied on input from roughly 1,000 stakeholders, including Home Loan Bank System members, affordable housing advocates, academics and financial trade associations. In fact, if one were to summarize in a single phrase what FHFA heard during its review, it is that stakeholders want more, not less, from the Home Loan Bank System. And that is precisely what the Home Loan banks are focused on.

Not only have the Home Loan banks already voluntarily agreed to contribute a total of 15% of their net income to affordable housing and community development initiatives on a go-forward basis, a 50% increase above the statutorily required minimum, they are also currently working on voluntary and pilot programs to support affordable housing and community development, and are actively engaging with Community Development Financial Institutions (CDFIs) to make it easier for them to rely on Home Loan bank liquidity.

These are just a few examples of what the Home Loan banks are doing to address the many recommendations in FHFA's report.

What both the FHFA report and the CBO report inherently recognize is that the Home Loan Bank System is an integral piece of the U.S. economy and financial system and stands behind thousands of community banks, credit unions, CDFIs and other lenders. The conversation going forward should focus on positive steps that can be taken to "bolster and improve the Home Loan Bank System," as FHFA clearly stated was its aim in producing its report, and seriously consider the ramifications of unnecessarily interfering with a system that has worked to the benefit of communities across the country for nearly 100 years.

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