

# FHLBank Issue Brief

## The Municipal Investment and Neighborhood Transformation Act (H.R. 7769 / S. 3941)

### **ALLOWING FEDERAL HOME LOAN BANK LETTERS OF CREDIT SUPPORTING COMMUNITY DEVELOPMENT TAX-EXEMPT BONDS**

#### **Overview**

Proposed legislation would make permanent the tax-exempt treatment of community development bonds that are credit-enhanced by Federal Home Loan Bank (FHLBank) Letters of credit (LOCs). This legislation removes an outdated tax barrier and creates more opportunity for FHLBanks to provide dependable credit support through local institutions, helping communities build, maintain, and grow. This public-private partnership is a cost-effective way for local communities to finance critical infrastructure needs.

#### **Background**

The mission of the Federal Home Loan Banks (FHLBanks) is to provide liquidity to members and support housing and community development. FHLBank LOCs support the FHLBanks' mission by enabling members to provide credit enhancement for municipal and revenue-bond financing for housing, infrastructure, and community development activities. The Housing and Economic Recovery Act of 2008 (HERA) amended Section 149(b) of the Internal Revenue Code to provide temporary tax-exemption to community development bonds that are credit-enhanced by FHLBank LOCs. This provision sunset on December 31, 2010. Making this authority permanent would expand access to stable, competitively priced liquidity for tax-exempt community infrastructure financing.

#### **Proposal**

The proposed legislation provides permanent tax-exemption for community development bonds that are credit-enhanced by FHLBank LOCs. The bill:

- Helps local communities that are not served by current credit-support providers to raise funds for infrastructure, water treatment facilities, transportation centers, industrial development, healthcare facilities, educational institutions and other important initiatives at a lower cost.
- Supports FHLBank member financial institutions – banks, credit unions, insurance companies, housing authorities, and CDFIs – in serving traditionally underserved credit enhancement markets for small issuers of tax-exempt bonds traditionally ignored by larger credit enhancement providers.
- Increases the marketability and lowers the financing costs of tax-exempt municipal and private activity bonds.

## Impact of Temporary Tax Exemption under HERA:

During the period when tax-exempt treatment was available under HERA for community development bonds that were credit-enhanced by FHLBank LOCs, LOCs supported 129 tax-exempt bond transactions, financing nearly \$4 billion in projects across the country. Most of these transactions involved small bond issuances that traditionally have difficulty finding other sources of credit enhancement. Roughly half of these deals were under \$10 million, and two-thirds were less than \$30 million.

## These LOCs supported:

- 40 educational institutions (nursery schools through universities and law schools).
- 43 economic development projects (shopping centers, office buildings, warehouses, hotels, equipment and manufacturing, docks, and wharf facilities).
- 25 health care facilities and hospitals (elder housing, nursing homes, wellness centers, rehab facilities, hospitals).
- 5 infrastructure efforts (airport, water, and sewer).
- 16 other nonprofits (YMCA's, Easter Seals, performing arts, schools).

## Hypothetical Use Case

A growing municipality plans to issue tax-exempt bonds to finance a new fire station, including staffing and response-time improvements for an expanded service area. The municipality issues tax-exempt fire district revenue bonds to finance the project.

- Issuing bonds – rather than borrowing directly from a local lender – allows the municipality to access capital from investors at lower interest rates, because the bonds' tax-exempt interest permits investors to accept reduced yields compared with taxable debt.
- The new fire station is a prerequisite for additional residential development, as local codes generally require adequate emergency-response capacity before higher-density housing can be approved or occupied.
- An FHLBank LOC, provided through a member financial institution, serves as a reliable liquidity backstop for the bonds, enhancing investor confidence and supporting efficient market access.
- By lowering required yields and improving marketability, the LOC reduces borrowing costs, without requiring the municipality to incur additional out-of-pocket expenses for separate third-party credit enhancement.

## Other Important Considerations

- FHLBank LOCs do not constitute a federal guarantee of tax-exempt debt. FHLBank LOCs are not directly or indirectly guaranteed by the United States – as stipulated in 12 USC Section 1435.
- FHLBank debt obligations are the joint and several liability of the 11 FHLBanks. The FHLBanks are privately capitalized and rated by credit rating agencies.

