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Banknotes

LIQUIDITY, STABILITY, COMMUNITY:

The Federal Home Loan Banks at 90

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Sometimes the most important institutions are those we take for granted. The American public may not be aware of the Federal Home Loan Banks (FHLBanks), but for nearly a century, the U.S. financial system has relied on these little-known entities as critical sources of liquidity, stability and community support. To celebrate the 90th anniversary of the Federal Home Loan Bank System, we're highlighting the FHLBanks, our impact on community banks here in Illinois and across the nation and how we are evolving to meet your communities' needs now and in the future.



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Liquidity and the American Dream

The FHLBank System was born from the Great Depression when roughly 1,700 savings institutions failed, 40% of all home mortgages went into default and a House committee observed that America was “drifting into a nation of tenants.” In 1932, Herbert Hoover responded to the crisis by recommending “the establishment of a system of home-loan discount banks as the necessary companion in our financial structure of the Federal Reserve Banks and our Federal Land Banks,” aiming to “relieve present distressing pressures against home and farm property owners.”

And so, Congress created the FHLBank System to promote homeownership by providing liquidity to thrift institutions — savings banks, savings and loan associations and building and loan associations — which originated most home mortgages at the time and were not eligible for membership in the Federal Reserve System. The Federal Home Loan Bank Act of 1932 represented one of the first pieces of U.S. public policy to support homeownership as a national goal.

Since then, as the financial system has changed and evolved, Congress has expanded the FHLBanks’ mission by broadening it to include economic and community development in addition to housing finance. This shift began in 1989, when Congress expanded membership to include commercial banks and later expanded the collateral community financial institutions allowed to pledge to back their FHLBank borrowings.

Throughout these changes, though, two defining characteristics of the FHLBanks have remained constant:

Cooperative ownership. By creating the FHLBanks as cooperatives, Congress ensured the interests of our shareholders are aligned with our customers, because the two groups are one and the same. Also, our not-for-profit structure ensures an appropriate risk appetite for the cooperative. We exist to serve our members and their communities.



Regional management. Rather than one centralized FHLBank with local branches, the FHLBank System is a confederation of independently run regional Banks, each with its own board of directors, president and management. This separation ensures that we're focused on the unique needs of our local member institutions and their communities — which can differ dramatically across the country. The needs of the FHLBank of Chicago's district of Illinois and Wisconsin can be quite different than other states across the nation. Individual FHLBanks also have the freedom to innovate in ways that can benefit the entire system. A great example of this is the Mortgage Partnership Finance® (MPF®) Program, a secondary mortgage market option that hundreds of community banks across the country have used to compete with larger mortgage originators, retain the servicing of their customers and improve their profitability. Originally begun by Chicago, the MPF Program is offered by five other FHLBanks, and several others have adopted variations of the program.

Stability in Uncertain Times

Most importantly, the FHLBanks continue to fulfill their mission as a reliable and stable source of short-term liquidity and long-term funding for community financial institutions, nearly always on the same day.

This reliability is a nice feature in normal times but essential during times of economic uncertainty, especially when other sources of wholesale funding dry up. The FHLBanks are designed to be available when members need us the most. With sufficient collateral, members know they can always turn to the FHLBanks for same-day funding at the best price possible given the current market conditions. We are their “break glass in case of emergency” option, as Congress intended.



How can we lend when others can't? As a creation of Congress, we have the implicit backing of the United States government. Our unique structure also permits accordion-like flexibility: we can expand the balance sheet and our borrowings when needed, and then contract when demand lessens, all done safely and soundly. For example, during the financial crisis of 2008–09, the FHLBank System accommodated a massive surge in borrowing, expanding from approximately \$600 billion system-wide to nearly \$1 trillion. Conversely, in recent years as community banks have been flush with deposits, advance levels at many FHLBanks have declined significantly — some by as much as 50%. For most institutions, this contraction would be catastrophic. But because of our cooperative structure, the FHLBanks have scaled back safely, ready to lend when our members need us.

Investing in Our Communities

Supporting affordable housing and the economic health of communities throughout our districts is a core element of the FHLBanks' mission today. It's also a critical way we back our member financial institutions, as these investments expand opportunities for those who live, work and do business in the neighborhoods our members serve.

In many cases, FHLBank community investment programs directly facilitate business opportunities for members as they support local individuals and initiatives. This is one benefit of our service delivery model, which leverages our partnership with members and, in turn, their partnerships with local beneficiaries. Our members are the experts on their communities, so we support them as they take the lead in applying for affordable housing and economic development resources on behalf of local organizations or individuals, and we rely on their guidance in adapting our offerings over time.



Our program offerings — including the Affordable Housing Program (AHP) General Fund and the Downpayment Plus® (DPP®) programs — are shaped and reshaped each year in response to identified local needs. For example, given strong member demand for year-round access to our DPP grant program, FHLBank Chicago has supplemented its required contribution to this program with additional voluntary funding. In recent years, FHLBank Chicago has also initiated innovative programs to meet local needs for equitable access to homeownership, small business development and equity in the affordable housing development industry, among others. In 2020, FHLBank Chicago responded to the pandemic by introducing the COVID-19 Relief Program, which offered zero-rate advances as well as grants for members to distribute to local small businesses and nonprofits.

In 2021 alone, FHLBank Chicago provided:

- \$29 million in AHP General Fund grants creating 2,315 units of affordable housing
- \$19 million in DPP grants supporting 3,400 homebuyers
- \$157 million in Community Advances funding 518 affordable housing units and 1,062 jobs
- \$300,000 in Community First® Capacity-Building Grants to benefit six nonprofit community lenders
- \$1.7 billion in COVID-19 Relief Program zero-rate advances, drawn by 52% of members



Each of these programs, along with others added this year, has made a tremendous impact throughout Illinois and Wisconsin. The numbers alone don't tell the full story. Families achieved their dream of owning a home. Small businesses were able to survive and thrive. Safe and affordable rental housing was created or renovated. Seen in this light, the data hints at how the FHLBanks, through partnerships with our members, transform lives and communities.

Evolving with Our Members

Today, with accelerating demand for online banking, increased competition from fintech companies, cyber security threats and changing social norms, community banks face tremendous pressure to change — and the FHLBanks will continue to evolve alongside them. We are constantly gathering feedback from members through our elected board members, group meetings and individual consultations with FHLBank sales directors. Our close partnership trade associations like CBAI also are an important resource for understanding the unique needs of Illinois community banks.

The general public may not be aware of the Federal Home Loan Banks, but over the past 90 years, they've benefited from our activities supporting homeownership and affordable housing, more vibrant local economies and a financial system that is the envy of the world. As we approach a century of FHLBanks, we will continue to work behind the scenes, to serve our members and improve their communities. ■

