

# Building Blocks



A Publication of the Federal Housing Finance Board

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## Eliminates Arbitrage, Creates Risk-Based Capital

### Regulatory Changes To Be Proposed by Finance Board In Financial Management & Mission Achievement.

The Federal Housing Finance Board has unveiled a "framework" document for a proposed regulation later this year that will ensure the FHLBanks System's investments are related to its housing finance and community development mission. The Financial Management and Mission Achievement (FMMA), if adopted, would replace the Finance Board's present Financial Management Policy (FMP).

The FMMA establishes a requirement that 100 percent of the consolidated obligations (CO), or debt, raised by the FHLBank System in the capital markets must be used for mission-related activities. Congress and Treasury have criticized the FHLBank System for arbitraging its investments.

The new policy also would modernize safety and soundness standards by creating risk-based capital requirements for the FHLBanks.

"This is a challenge for the FHLBanks to create new mission assets with their members and at the same time enhance profitability."

Finance Board Chairman Bruce A. Morrison said.

The framework addresses five issues: the responsibilities of FHLBank boards of directors and senior management for risk management, mission achievement, and internal controls; FHLBank authorized investments and use of hedging instruments; risk management and capital standards for the FHLBanks; mission achievement requirements for the FHLBanks; and transition schedules and waiver requests.

Text of the framework document is available on the Finance Board web site at [www.fhfb.gov](http://www.fhfb.gov) under "What's New." A proposed regulation is expected to be considered on July 14.

Under the existing FMP, risk management is accomplished largely through a detailed list of arbitrary restrictions and limits placed on the Banks' investment authority. This approach, while successful in ensuring safety and soundness, has limited the Banks' ability to be creative in developing mission-related investment opportunities and is inconsistent with the risk-based capital approach to risk management adopted and

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used by almost all other financial regulators.

The risk-based capital approach described in the framework represents the Finance Board's attempt to bring the FHLBank System in line, not only with where the other financial regulators have already gone, but also with where they intend to go, in terms of better aligning capital requirements with risk.

Specifically, the credit-risk capital requirement described in the framework improves on the risk-based capital requirement established by the Basle Accord in 1988 and used by bank regulators throughout the world, by basing capital requirements on the actual rated credit risk of each investment, rather than simply on the specific types of assets held. The market-risk capital requirement described in the framework also improves upon existing best practice by requiring that market values at risk be regularly assessed through

stringent stress testing of each FHLBank's entire portfolio, including both on and off-balance sheet items, rather than just for those assets held in a trading account, as is currently required for large commercial banks. The framework also requires that the FHLBank System continue to maintain its triple-A credit rating and includes a minimum total capital leverage requirement.

With regard to mission achievement, the current FMP imposes no explicit requirements in terms of the public purpose use of FHLBank System funds. As discussed in a staff paper that was presented to the Finance Board last spring, FHLBank investments in assets bearing little if any relation to the FHLBanks' public purpose grew dramatically after the Savings and Loan crisis of the late 1980s.

While this increase in non-mission-related investment was a rational response to the sharp fall-off in FHLBank System

advances and net income that occurred during this period. This fall-off was temporary and FHLBank System earnings and advances are now at record levels. Given this recovery, the framework includes a plan to gradually eliminate these post-FIRREA arbitrage investments and return to the pre-FIRREA era when 100 percent of the FHLBank System's debt was used to finance core mission activities.

The framework includes a definition of core mission activities centered on those activities that promote the FHLBank System's housing finance and targeted community development mission and that involve the cooperative nature of the relationship between the FHLBanks and their members. The framework also prescribes a graduated phase-in of the 100 percent core mission activity requirement to allow the FHLBanks time to transition their balance sheets to include more profitable core mission activities and to accomplish the transition in such a manner as to ensure the continued safety and soundness of the FHLBanks.

Finally, the framework explicitly describes the responsibilities of FHLBank boards of directors and senior management -- and thus establishes their accountability -- for both the safety and soundness and mission achievement of the FHLBanks. Included are their responsibilities for establishing and maintaining effective internal control systems, for establishing effective independent audit committees, for performing annual risk assessments, and for adopting and reviewing annually the FHLBanks' risk management, and mission achievement policies.

**Mark your calendars . . .**

**September 12-15  
Washington, DC**

**The American Bankers Association's  
annual community and economic development  
lending conference  
co-sponsored with the  
Federal Housing Finance Board**

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# FHLBank System Presents Annual Awards; Celebrates 10th Anniversary of AHP, CIP

On May 26, the 12 FHLBanks marked the 10th anniversary of the Affordable Housing Program (AHP) and Community Investment Program (CIP) at their annual Community Partnership Awards. The awards celebrate 24 financial institutions and community-based organizations for their work promoting affordable housing and community economic development across the nation.

The Federal Home Loan Banks set aside **10** percent of their annual earnings for the Affordable Housing Program, which translate into grants of more than \$170 million to affordable housing projects in 1998.

The FHLBanks have provided nearly three-quarters of a billion dollars to the AHP since it began 10 years ago. This money has resulted in the creation of nearly 200,000 housing units.

More than 68 percent of households served by the AHP are very low-income. Others are low- and moderate-income households.

The CIP has provided \$20.4 billion in low-cost funding for housing and economic development since 1990. The money has helped finance 4 10,000 housing units and \$1 billion in targeted economic development projects.

As part of the AHP, the FHLBanks are the largest cash contributor to Habitat for Humanity affiliates. In 1999, the FHLBanks have pledged to build at least one Habitat home in each of the 12 FHLBank districts.

Presidents and other officials of the FHLBanks, along with awardees and guests, began the day with two panel discussions on both the past and future of AHP and CIP.

Author Robert Fulghum, who has supported affordable housing by donating proceeds from his book sales and speaking fees to Habitat for Humanity, was the keynote speaker for the event.

The 1999 Community Partnership Award winners are:

## **FHLBank of Atlanta**

**Farmers and Mechanics National Bank, FCNB National Bank and Interfaith Housing of Western Maryland**, all in Frederick, Maryland, for providing new housing opportunities for low-income families – including four AHP self-help homeownership developments and one AHP-assisted rental project,

**Capital City Bank and the Bethel Community Life Center, Inc.**, both in Tallahassee, Florida, for spearheading a major neighborhood revitalization effort, evidenced by the construction of the Bethel Community Life Center, a 40,000 square foot facility that will provide educational and recreational programs for residents of a low-income neighborhood.

## **FHLBank of Boston**

**Mechanics Savings Bank and West Hartford Interfaith Coalition**, in Hartford and West

Hartford, Connecticut, respectively, for the construction of Flagg Road, a IO-unit, limited-equity-housing cooperative comprised of three new townhouse buildings.

Wainwright Bank & Trust and the International Institute of Boston, Inc., both in Boston, Massachusetts, for the acquisition of a new headquarters to help the International Institute of Boston, Inc. continue to provide comprehensive services to immigrants and refugees.

## **FHLBank of Chicago**

**Continental Community Bank & Trust Co.**, and **The Children's Place Association** in Maywood and Chicago, Illinois, respectively, for renovating a vacant building to create the Family Center, an integrated housing and support services center for families living with HIV/AIDS.

**North Milwaukee State Bank and HR Housing, Inc.**, both in Milwaukee, Wisconsin, for building a 22-unit elderly housing project on a vacant lot adjacent to the church.

## **FHLBank of Cincinnati**

**First Merit Bank, N.A.**, and **Habitat for Humanity of Greater Canton**, both in Canton, Ohio, for the creation of 66 units of owner-occupied housing.

**Winchester Federal Savings Bank**, Winchester, Kentucky, for

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financing the construction of and/or purchasing 126 apartments, 11 single-family homes, four commercial businesses, three churches, and two farms.

FHLBank of Dallas

Mercantile Bank and Community Development Corporation of Brownsville, both in Brownsville, Texas, for enabling the Colonia Redevelopment Project to rehabilitate 31 single-family homes within the Cameron Park Colonia, the largest unincorporated colonia in Cameron County and one of the largest and oldest in Texas.

Centinel Bank of Taos, Taos, New Mexico, for financing and constructing Cid's Food Market. Inc., a project which created 16 new jobs and retained 32 jobs.

FHLBank of Des Moines

Home Federal Savings Bank and Habitat Upper Midwest, both in Sioux Falls, South Dakota, for supporting numerous Habitat for Humanity chapters in the creation of 85 homes.

Farmers State Bank of Schell City and Bolivar Educational Advancement Foundation, in Schell City and Bolivar, Missouri, respectively, for constructing a 4,988-square-foot building to house a new school for the severely handicapped.

FHLBank of Indianapolis

Michigan National Bank and Blue Water Habitat for Humanity, in Farmington Hills and Port Huron, Michigan, respectively, for building six single-family homes.

National City Bank of

Evansville and Memorial Community Development Corporation, both in Evansville, Indiana, for purchasing a Subway franchise to use as a training program for welfare-to-work recipients and individuals with little or no employment history.

FHLBank of New York

First Federal Savings of Middletown and Orange County Rural Development Advisory Corporation in Middletown and Campbell Hall, New York, respectively, for the Hearthstone Senior Housing Complex, a project that involves the redevelopment of five historical structures into 84 one-bedroom senior citizen rental housing units.

New York National Bank, Bronx, New York, for continued success in meeting the banking needs of inner-city residents, businesses, and community-based organizations for the past 15 years.

FHLBank of Pittsburgh

Huntington Federal Savings Bank and Huntington City Mission, both in Huntington, West Virginia, for the M&M project. This project involved the purchase and conversion of a brick warehouse-style building into 32 units of affordable housing for homeless women and families, as well as an array of health educational assistance services.

Kishacoquillas Valley National Bank of Bellville and Valley View Haven, Inc., both in Bellville, Pennsylvania, for the renovation and expansion of a continuing care retirement community resulting in the construction of 29 assisted-living

units and the creation of 20 new jobs for low-income individuals.

FHLBank of San Francisco

Bank of America Community Development Bank and Rural California Housing Corporation in Walnut Creek and Sacramento, California, respectively, for supporting Grizzly Hollow, which created 59 self-help homeownership opportunities in a rural area.

Broadway Federal Bank and Inglewood Neighborhood Housing Services, in Los Angeles and Inglewood, California, respectively, for supporting and developing a synergy with the NeighborWorks HomeOwnership Center project, and other small community-based institutions and non-profits.

FHLBank of Seattle

Bank of America, FSB and Silver Lake Properties, L.P., in Portland, Oregon, and Hayden, Idaho, respectively, for providing 45 units of family housing for households at mixed-income levels.

Bank of the Northwest and Thompson/Elske, both in Portland, Oregon, for financing the renovation of two commercial buildings as part of the reconstruction of flood-damaged Nehalem, Oregon.

FHLBank of Topeka

Bank of Oklahoma and Vintage Housing, Inc., both in Tulsa, Oklahoma, for financing Pioneer Village, a 40-unit housing center for the elderly that also provides a congregate meal site and other elder-services.

Tecumseh Building and Loan and MBA Poultry, LLC, both in Tecumseh, Nebraska, for purchasing and re-fitting an unused manufacturing plant to create 200 new jobs.

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# FHLBanks Commit to National Homebuilding Initiative with Habitat for Humanity

In celebration of the 10th anniversary of the Affordable Housing Program (AHP), the 12 FHLBanks have formed a national initiative with Habitat for Humanity International to fund and build a minimum of one house this year in each FHLBank district for very low- to moderate-income individuals and families. The FHLBanks are the largest corporate contributors to Habitat affiliates, helping to build 7,000 Habitat houses with \$39 million in AHP subsidies since 1990. In the United States, one of four Habitat houses is partially funded with dollars from an FHLBank.

Each FHLBank will fund and build a house with a local Habitat affiliate. Labor for each project is donated by staff of FHLBank members, FHLBank employees, community volunteers, and partner-families, who are selected by the Habitat affiliate. As with all Habitat projects, local building contractors are encouraged to donate material and labor. Partner-families contribute up to 500 hours of sweat equity to build the home, and purchase the homes with no-profit, no-interest, 20-year loans from the Habitat affiliate.

"We are delighted to have been selected as the FHLBanks' partner for the 1999 build that celebrates 10 years of the AHP and recognizes our long-standing, out-standing partnership," said Millard Fuller, president and founder of Habitat.

"The FHLBanks' funds, coupled with their coordination of the thousands of hands that will build these houses, will help to add

to our housing stock providing families with safe, decent, and affordable housing," he said.

Established in 1989, the AHP provides subsidies to financial institution members of the FHLBank System to assist in supporting the creation and preservation of housing for lower income families and individuals. Each FHLBank funds its own AHP with 10 percent of its annual profits and manages the program within regulatory requirements established by the Federal Housing Finance Board, the federal regulator of the FHLBank System. Subsidies are awarded through regional funding competitions held semiannually by the FHLBanks.

Since the AHP began 10 years ago, the FHLBanks have awarded over \$780 million in subsidies for housing throughout the nation, creating and rehabilitating more than 202,500 units of housing for very low- to moderate-income individuals and families.

## PROJECTS

**Atlanta:** Will build one new house in Americus, Georgia, with Citizens Bank of Americus and Americus-Sumter County Habitat for Humanity. Contact: Robert Warwick at 404-888-8435.

**Boston:** Scheduled to build one new house in Boston, Massachusetts, with one or more area member financial institutions and Habitat for Humanity of Boston. Contact: David Parish at 617-330-9872.

**Cincinnati:** Committed to build one new house in Dayton, Kentucky, with Fort Thomas Savings Bank, Fort Thomas, Kentucky, and Northern Kentucky Habitat for Humanity. Contact: Carol Peterson at 513-852-7615.

**Chicago:** Will build one new house in Waukegan, Illinois, with FHLBank members Argo Federal Savings Bank, FSB, Bank of Waukegan, First Midwest Bank, NA and Firststar Bank Illinois, and Habitat for Humanity of Lake County, Illinois. Contact: Charles Hill at 312-565-5705.

**Dallas:** Scheduled to build one new house in Arlington, Texas, with the Texas Rangers Baseball Club and the North Central Texas Council of Habitat for Humanity which includes 14 Habitat affiliates. Contact: Chriss Murdoch at 214-944-8636.

**Des Moines:** Committed to build one new house in St. Paul, Minnesota, with a member institution and Twin Cities Habitat for Humanity. Contact: Curt Heidt at 515-281-1175.

**Indianapolis:** To build one new house in Indianapolis, Indiana, with Habitat for Humanity of Greater Indianapolis and Carmel Lutheran Church. Contact: Frederick Hash at 317-465-0428.

**New York:** Scheduled to build one new house in Bay Shore, New York, with Astoria Federal Savings and Loan Association and Habitat for Humanity of Suffolk. Contact: Donald Wolff at 212-441-6821.

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## Board Hosts Forum on Lending in Indian Country

On May 27, the Finance Board cosponsored with the National American Indian Housing Council (NAIHC) a forum on "Successful Mortgage Lending Practices in Indian Country." Participants included tribal representatives, lenders, and homeowners, who offered case histories on how to overcome obstacles to lending in Indian Country.

Representatives of tribes in Alaska, Idaho, and Wisconsin told the gathering what their tribes are doing to increase homeownership opportunities in their respective areas.

The Oneida Tribe in Wisconsin formed partnerships with three local banks and three local credit unions. and since 1995, 135 loans have been closed under its "TLC" program. For this effort, the tribe contributes a 25 percent downpayment and the lender finances the remaining portion of the loan. The tribe uses proceeds from its gaming operations to fund the program.

The Oneida also are reclaiming lost tribal land by purchasing fee-simple land parcels on which existing houses sit and reselling them to tribal members for the purchase price, minus the cost of the land, which the tribe leases to the homeowner for a dollar a year.

The Coeur d'Alene Tribe in Idaho builds houses on tribal lands and later sells the homes to individual borrowers. These transactions are structured to provide lenders with reassurance in the event of foreclosure, a common stumbling block to financing homes on tribal lands.

Since 1993, the Cook Inlet Housing Authority in Alaska has used \$2 million in government funds to leverage \$8.5 million in financing to provide 244 homes for first-time homebuyers. The housing authority provides a 20-percent buy-down and absorbs 2 percent of the 5-percent downpayment required by the Alaska Housing Finance Corporation. A similar program targeted to very low-income families in rural areas uses multiple subsidies, including the FHLBank of Seattle's Affordable Housing Program.

Washington Mutual Bank, a member of the FHLBank of Seattle, has been making loans in Indian Country for some time because "it makes good financial sense," according to Washington Mutual Bank vice president, Beth Castro.

Income levels among many segments of the Native American community are increasing and homeownership is becoming financially possible, she said. The bank's staff has spent considerable time learning about the complexities of tribal infrastructure, and requires employees working with the Native American community to participate in culture-sensitivity training.

The bank provide homebuyer education assistance through "trainer-to-trainer" courses conducted by the National Partnership for Housing. The bank makes conventional loans that it holds in portfolio, as well as FHA 248 insured loans, and will soon offer HUD 184 guaranteed loans.

Thomas Wright, a former banker and a current lending

consultant to Indian tribes, said that home buyer readiness is a key issue in Indian Country, and lending in these areas is not complicated -- that it is a function of cooperation. He pointed out that 200,000 homes are needed on tribal lands, offering lenders a tremendous business opportunity.

PMI Mortgage Insurance Company reported it has committed to insuring \$60 million of mortgages for Native Americans through partnerships with Washington Mutual Bank and other financial institutions. Under one PMI program, the tribe pledges assets to offset losses due to property foreclosure. In exchange, a tribal member receives a loan with a small downpayment requirement and expanded credit features.

Two women whose families undertook the long journey to homeownership in Indian Country spoke of the initial delays and eventual successful outcomes.

Angela Waters from the Tulalip Tribe in Washington obtained a mortgage from Washington Mutual Bank, told the forum "I did nothing but sign my name and write my social security number, and write the date and it great."

Wanetta Thompson received her loan from the Mille Lacs Band of the Ojibwa through the Minnesota Chippewa Housing Corporation. the only tribal nonmember mortgagee in the FHLBank System. Her first daughter was born the month they moved into the home, which she says " . . . is a dream come true."

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# FHLBank System Continues Y2K Preparation

As a precautionary measure, the Finance Board and the FHLBanks are attempting to gauge the level of Y2K-related demand for cash that may occur in December 1999 as a result of potential consumer demand for cash. The FHLBanks are building up liquidity reserves and structuring advances to be prepared to meet the possible demand for advances that could result from an increase in demand for cash.

Each FHLBank is developing its own programs to deal with a possible liquidity problem. Generally, these programs revolve around special advances, lines of credit, and extended or renewed maturities of advances. For specific details, FHLBank System members are encouraged to check with the regional FHLBank.

These programs are necessary, FHLBank System officials believe, due to consumer uncertainty about

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The Finance Board is participating with other federal agencies in a White House initiative to streamline the mortgage lending process in Indian Country by creating one-stop mortgage centers.

The NAIHC provides research, training and technical assistance to tribes and encourages the development of greater housing and homeownership opportunities for Native Americans. Through its Mortgage Partnership Program it also assists financial institutions in providing greater lending on reservations through educational forums and direct means.

computer problems associated with Y2K issues. Polls show that consumers are concerned that banks' computer systems and automated teller machines may shut down, making it difficult to withdraw cash. Y2K issues center on public concern that the nation's computers will fail when their internal clocks tick over from December 31, 1999, to January 1, 2000.

The Finance Board, the FHLBanks, and the FHLBank System's Office of Finance have taken significant steps in the past 18 months to ensure the FHLBank System's computers make a smooth transition from 1999 to 2000.

The FHLBanks applied examination standards and procedures published by the Federal Financial Institutions Examination Council, supplemented by guidance published by the General Accounting Office.

In addition, the Finance Board, which regulates the FHLBanks, engaged an information technology consultant to assist its examiners in technical reviews of the testing and implementation phases of Y2K project management. The Finance Board also sends the FHLBanks Advisory Bulletins, which contain formal Y2K guidance, provide an informal newsletter dedicated to Y2K matters, and periodically meets with FHLBank personnel involved in Y2K project management.

The Finance Board began including a Y2K review as part of its examinations during 1997. During 1998, the Finance Board intensified its Y2K examinations using a multi-phase approach. The

first phase reviewed each FHLBank and the OF to assess the extent to which their Y2K project management conformed to current guidelines. During the second phase, the Finance Board used an information technology consultant to assist examiners in reviewing the institutions' testing and implementation of remediated systems.

Following completion of the second phase, which is expected by

(See Y2K, page 8)

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**(PROJECTS. from page 5)**

**Pittsburgh:** Will build one new house, landscape an adjacent property, and clean a vacant lot for future home development with Pittsburgh Habitat for Humanity in Braddock, Pennsylvania. Contact: John Bendel at 412-288-2820.

**Topeka:** Committed to build one new house in Topeka, Kansas, with Commerce Bank Topeka and Topeka Habitat for Humanity. Contact: Christopher Imming at 785-233-0507.

**San Francisco:** Will help complete the building of a 25-home subdivision in South Central Los Angeles with City National Bank, Los Angeles, Washington Mutual, Irvine, and Habitat for Humanity of Los Angeles. Contact: James Yacenda at 714-633-1271.

**Seattle:** Scheduled to build one new house in Redmond, Washington, with First Mutual Savings Bank and Habitat for Humanity of East King County. Contact: Judith Dailey at 206-340-8708.

# Resources

"Hands-on Housing" reprints two **Shelterforce** articles about the construction of affordable housing -- for anyone building it or considering it. "Factory-Built Housing" looks at the manufactured-housing industry and provides tips for community developers. "The Affordable In-Fill House" analyzes a project designed by NHI and built by **HANDS, Inc.**, a community development corporation. The reprints are available from the **National Housing Institute**, 439 Main Street, Orange, NJ 07050.

The Rural 2000 Community Development Initiative, a grant initiative funded by the **BankAmerica Foundation and the Bank of America**, aims to increase the level of community development resources in low- and moderate-income rural markets served by the Bank of America. For grant guidelines and more information contact the BankAmerica Foundation, Corporate Community Development, #3246, P.O. Box 37000, San Francisco, CA 94137, or call (415)953-3175.

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June 30, the Finance Board will review the results of integration testing performed by the FHLBanks, as well as their business resumption contingency planning and testing.

The Finance Board requires each FHLBank to adhere to the U.S. Securities and Exchange Commission guidance for disclosure regarding Y2K matters.

"In Search of Shelter: The Growing Shortage of Affordable Rental Housing for Low-income Families" reports the number of available low-income units has gone from a surplus of 300,000 in 1970 to a shortage of 4.4 million in 1995. The report is available from the **Center on Budget and Policy Priorities**, Suite 510, 20 First Street, Washington DC 20002, or by calling (202) 408-1080.

"The State of the Nation's Housing: 1998" is an examination of economic and social trends affecting housing in America. The study is available from **The Joint Center for Housing Studies**, Harvard University, 79 John F. Kennedy Street, Cambridge, MA 020138 or by calling (617) 495-7908.

**Affordable Housing Finance** will be publishing periodic reports on the latest developments in financing and government assistance for first-time and low-income homebuyers. For information call 1-800-989-7255.

"Federal Funding Sources for Rural Areas: Fiscal Year 1999" is an annual report from the **Rural Information Center Publications Series**. That provides extensive listings of federal assistance programs, national, regional, and local office contacts and grants application procedures. For a catalog call 800-669-8331, or visit [www.gsa.gov/fdac](http://www.gsa.gov/fdac).

**The Coalition of Community Development Financial Institutions (CDFIs)** has published its first directory with detailed organization and contact information for CDFIs across the country. The directory is \$35 for nonprofits and \$75 for for-profit organizations. To order, call 215-923-5363.

"Sustainable Rural Community Development: Moving Toward Sustainable Futures" is a report of the Salzburg, Austria, housing seminar. For more information, contact the **Kellogg Foundation** at their website, [www.wkkf.org](http://www.wkkf.org)

## Brochure Available

Free copies of the CPA brochure featuring a photo and detailed description of each winning entry are available by writing to: CPA Brochure, %Dennis McGee, FHFBB-Public Affairs, 1777 F Street NW, Washington, DC 20006.

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