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STATEMENT OF

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**BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS**

**OF THE
UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS**

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Good afternoon Chairman Bennett, Senator Johnson, and members of the Subcommittee. Thank you for the opportunity to appear before you today to discuss something that is very important to my business and to my community – the Federal Home Loan Bank System. I am Michael Middleton, Chairman and CEO of Community Bank of Tri-County, in Waldorf, Maryland. I serve as Maryland’s elected director on the Federal Home Loan Bank of Atlanta’s board of directors and am honored to serve as the vice-chairman of that board. I am also a member of the board of the Council of Federal Home Loan Banks.

I am pleased to testify today on behalf of the Atlanta Bank. I am Chairman and CEO of a bank that is a member and long-time user of Federal Home Loan Bank advances, as well as other products, particularly in the community investment area. I believe this experience, together with my five years of service on the board of the Federal Home Loan Bank of Atlanta, gives me a broad perspective on the Federal Home Loan Bank System that I hope can provide helpful insight to the Subcommittee.

Community Bank of Tri-County has over \$300 million in assets and is a true community bank serving southern Maryland. Our customer base draws from a broad economic range and includes rural, agricultural, small business owners and the families employed by high tech companies that support three Naval facilities. We try to tailor our services and products to meet the needs of our communities while competing with large regional and national financial institutions.

At my bank, we take our Community Reinvestment Act responsibilities very seriously. Moderate to smaller sized community banks are increasingly challenged in meeting their CRA requirements. The FHLBank’s programs, explained in greater detail below, provide us with the tools and skills to fulfill this statutory and community responsibility. The FHLBank System helps level the competitive playing field in many ways, enabling Community Bank to continue to be part of the economic foundation of southern Maryland.

BACKGROUND

As you may be aware, the 12 Federal Home Loan Banks are government-sponsored enterprises that were created and organized under the authority of the Federal Home Loan Bank Act of 1932. Congress created the Federal Home Loan Banks to stabilize and improve the availability of funds to support home ownership. Although initially capitalized with government funds, member banks, like mine, have contributed all the Federal Home Loan Banks’ capital for over 50 years. The Federal Home Loan Banks have provided over 70 years of innovation and service to the U.S. housing market, and currently have over 8,000 member institutions.

The Federal Home Loan Banks and their members (federally insured savings associations, commercial banks, credit unions, and some insurance companies) are the

largest source of residential mortgage and community development credit in the United States. Federal Home Loan Banks increase the lending power of local financial institutions. Thanks in large part to the work of Senators Hagel, Johnson, and Bayh to include Federal Home Loan Bank modernization in the Gramm-Leach-Bliley Act, the Federal Home Loan Banks help community financial institutions provide critical small business, community development, rural and agricultural loans, as well as residential mortgages. I believe it is important to note, Senators, that the Federal Home Loan Bank System is the only institution in the United States that fulfills this mission.

The Federal Home Loan Banks are very different from the other housing GSEs. They are unique in that they are cooperatives that are jointly and severally liable for the consolidated debt issued through the Office of Finance as their agent. As cooperatives, only member institutions own the capital of each Federal Home Loan Bank. There is no publicly traded stock and no established marketplace for the Federal Home Loan Banks' capital. Further, there is no market pressure on the price of the capital stock; it is always bought and sold at par. While the Federal Home Loan Banks are not the only cooperatives, nor are they the only institutions that operate with joint-and-several liability, no other housing GSE or private sector financial institution plays the same economic role or operates under the same overall structure as the Federal Home Loan Banks.

It is the task of the Federal Home Loan Banks to maintain a balance between their public policy mission and their obligation to provide adequate returns on the capital supplied by their members. They do this by providing a stable, low-cost, and reliable source of short and long-term funding. For many Federal Home Loan Bank members that are small or medium-sized community banks, direct borrowing in the capital markets is not a viable option. With the disintermediation of our deposits to Wall Street during the 1990's, a gap in funding during the last economic expansion proved the value of the FHLBanks in assisting us in meeting the credit needs of our local market. By providing a necessary source of wholesale funding to help members manage liquidity, loan demand and interest rate risk, the Federal Home Loan Banks enable us to remain independent and continue as an economic engine in our community. Between 1994 and 1999, approximately 30 percent of all wholesale funding used by banks came from the Federal Home Loan Bank System.

As regional institutions, each Federal Home Loan Bank develops its programs in response to the needs of its membership. For example, in response to member demand, the Federal Home Loan Bank of Atlanta provides its members a competitive alternative to the traditional residential secondary mortgage market through two acquired member asset (AMA) programs, Mortgage Partnership Finance® and Mortgage Purchase Program. These AMA programs provide medium and smaller sized institutions with another financial tool in delivering competitive credit products. Like the advance programs, the AMA programs help level the competitive playing field.

Reflecting the Federal Home Loan Banks' cooperative nature, the financial strategies of the Federal Home Loan Banks are designed to enable them to expand and contract in response to their members' credit needs.

FEDERAL HOME LOAN BANK PROGRAMS – HOW THEY MEET THEIR MISSION LOCALLY

My bank relies on the Federal Home Loan Bank of Atlanta and its programs to deliver financial services to our communities. Like much of the country, our area needs more affordable housing. The price of housing continues to rise and demands for land limit the availability of workforce housing throughout our local market. Our major population centers are growing, resulting in greater need for improved medical, school and volunteer fire/rescue support facilities. The Federal Home Loan Banks are often an invisible, but vital, partner in fulfilling these needs. We use the FHLBank to provide the critical first layer of support upon which many layers of private and public support are built to bring about new affordable housing and/or community growth.

Community Bank has partnered with a number of non-profit Community Development Corporations to support affordable housing and infrastructure development projects through programs offered by the Federal Home Loan Bank of Atlanta. These include the Affordable Housing Program (AHP) and the Economic Development and Growth Enhancement (EDGE) Program. By using AHP, EDGE, and other similar programs, community banks like mine can make affordable housing and community development projects economically feasible.

A good example of this is the Yardley Hills project in Calvert County, Maryland. That project utilized over \$2.7 million in complex layered funding made available by participation in the Federal Home Loan Bank of Atlanta's Affordable Housing Program. In another project we used the EDGE loan program to provide the Jarboe Family Head Start Center in St. Mary's County, Maryland with permanent funding when other traditional banking sources of large regional banks became unavailable.

Federal Home Loan Bank Community Investment Programs have allowed us to partner with the USDA to provide single-family home ownership to very low-income families with structured funding and first time homebuyer funds.

Finally, for one of our community's volunteer fire/rescue needs, we obtained a \$2,000,000 Economic Development Program advance to provide permanent financing for a new firehouse located in a low-income community in La Plata, Maryland.

Senators, these projects and hundreds of others like them would not have been economically feasible without the programs of the Federal Home Loan Bank. They enable community banks to meet those credit needs that often would go unmet by larger non-local banks. It is also important to point out that the Federal Home Loan Banks provide the training and technical assistance that teach smaller institutions to use these

programs – training that would otherwise be too expensive for or unavailable to community banks.

The examples I have given with respect to my bank describe in part the distinctive role played by the Federal Home Loan Banks in housing finance. They make loans, called advances, to their members on the security of mortgages and other eligible collateral. Federal Home Loan Bank advances directly support our housing markets, including those focused on low- and moderate-income households, as well as all aspects of community development critical to the creation of jobs.

Federal Home Loan Banks also help their members provide other needed forms of community development credit. Since the passage of the Gramm-Leach-Bliley Act, Federal Home Loan Banks may now allow “community financial institutions” to pledge as collateral for advances small business, small farm, and small agri-business loans. Expanding the types of eligible collateral that smaller financial institutions may pledge serves a number of purposes. Many smaller institutions, particularly in rural areas, have faced funding needs but have not had sufficient residential mortgage collateral to secure FHLBank advances. Expanding the eligible forms of collateral for these institutions will help them meet these funding needs. With the help of the Federal Home Loan Banks, small local financial institutions may now better serve the community development credit needs of their areas.

As I indicated earlier in my testimony, the Federal Home Loan Banks also help members meet their Community Reinvestment Act (CRA) responsibilities. They do this through programs such as the Affordable Housing Program (AHP), the Community Investment Program (CIP), EDGE, and others. These programs give members access to subsidized and other low-cost funding for affordable housing and community development projects that benefit low and moderate-income neighborhoods.

By supporting their member institutions, the Federal Home Loan Banks also strengthen their communities. Each Federal Home Loan Bank is required, by law, to allocate 10 percent of its net income to affordable housing programs. The funds provided under this program are grants and loans. Last year, the Federal Home Loan Banks contributed \$199 million to the AHP. Since the program’s beginning in 1990, the Federal Home Loan Banks have set aside approximately \$1.7 billion in AHP subsidies, helping to create 360,000 units for low-income families. The Federal Home Loan Banks collectively are the largest source in the nation of private funding for affordable housing.

The Federal Home Loan Banks also have established a number of other housing and economic development initiatives for their members. These programs are funded voluntarily by the Federal Home Loan Banks separate from AHP. The Federal Home Loan Bank of Atlanta has established a predevelopment fund that offers recoverable grants to help finance predevelopment expenses associated with affordable housing and economic development projects. The Atlanta Bank also offers a training and technical assistance initiative for community development corporations serving the neighborhoods

surrounding Historically Black Colleges and Universities, as well as a subsidized loan program called EDGE, mentioned earlier in this testimony, to finance targeted community economic development projects. In addition, FHLBank Atlanta also offers both an at-cost advance program to help members finance loans for economic development activity, and a fund to provide matching equity investments for members investing in New Market Tax Credits.

In addition to examples cited earlier involving my bank, EDGE loans have helped finance a childcare center serving low-income families in Tuscaloosa, Alabama. Training and technical assistance supported by the Federal Home Loan Bank of Atlanta in North Carolina enabled Elizabeth City State University, a Historically Black University, to obtain financing through the Bank's Affordable Housing Program for the rehabilitation of owner-occupied units damaged by Hurricane Floyd. Other Federal Home Loan Banks have customized programs as well – programs like assistance to potential minority-homebuyers; first-time low-income homebuyer programs; various predevelopment and affordable housing capacity initiatives; flood relief assistance programs; and rural technical assistance programs to help communities address unmet affordable housing needs by establishing rural housing partnerships.

I strongly believe that the Federal Home Loan Bank System is able to provide the important benefits it does because of its dynamic membership of large and small institutions and its regional, decentralized, cooperative structure. And, I can say unequivocally that without the Federal Home Loan Banks and the programs they provide, it would be far more difficult for my bank, and the thousands of other community banks to remain independent, competitive and capable of extending important housing and community development credit.

FHLBANK AND DIRECTOR RESPONSIBILITY

I have discussed the role of the Federal Home Loan Banks in meeting their mission of providing competitive funding to their member financial institutions to increase the availability of funds for residential and community development lending. I have given you examples of why the Federal Home Loan Bank System is so vital for community banks like mine. As I stated earlier, I am also an elected member of the board of directors of the Federal Home Loan Bank of Atlanta, and that role imposes additional important responsibilities.

As a director I know that the Federal Home Loan Banks have obligations in addition to the mission of being a creative funding source for the extension of residential and community development credit. The Federal Home Loan Banks, although being exempt from Federal, State, and local taxation, are required to make payments to the Resolution Funding Corporation (REFCORP) and the Affordable Housing program (AHP). Those mandatory contributions are equivalent to a 26.5 percent effective income tax rate.

The Federal Home Loan Bank of Atlanta and its board of directors support the Administration's position that the housing GSEs should provide complete and transparent financial disclosures that constitute "best of class." That is why we, along with the other FHLBanks, have been working on these issues with all relevant parties to resolve the specific issues presented by the FHLBanks' statutory mission, cooperative structure, and joint and several liability.

As a director I want the Atlanta Bank to meet the highest standards of disclosure. At the same time, as a director, I have an obligation to all the other member/owners to be certain that such disclosures are not administered in a manner that could impair the mission, operations, or increase the cost of funds of the Bank. If, as a director, I agree to voluntarily register the Bank's equity with the SEC, not only do I assume additional personal civil and criminal liabilities under the relevant statutes, but I also assume liability for my decision to voluntarily register. In conducting my fiduciary duty as a corporate director consistent with the Business Judgment Rule, I must believe that all critical issues have been satisfactorily resolved and sustainable agreements reached before I, as a director representing the shareholders of the Bank, am permitted to agree to such action.

Just one example of the outstanding issues is how joint and several liability will be handled. The Federal Home Loan Banks have always been jointly and severally liable for each other's debt. Under SEC registration, it is possible that each Federal Home Loan Bank could have to create an additional on balance sheet liability reflecting the "fair value" of such liability for the combined debt of all the FHLBanks. Critical accounting issues like this and others must be effectively resolved in a manner that all the Federal Home Loan Banks can rely on going forward without the threat of quarter-to-quarter or year-to-year reconsideration upon each SEC filing.

Contrary to popular misconceptions, the Federal Home Loan Banks are privately capitalized by their members and do not receive any taxpayer assistance to operate. The Federal Home Loan Bank System debt is not guaranteed by the Federal government, and does not constitute an obligation of the United States. The Federal Home Loan Banks have operated since 1932 to help bring needed credit to the members and communities they serve. And they have done so in a safe and sound manner. The Federal Home Loan Banks are required by statute to obtain sufficient collateral on advances to protect against losses, and to accept only certain collateral on their advances. Consequently, no Federal Home Loan Bank has ever experienced a credit loss on an advance. At the end of 2002, for example, the Federal Home Loan Banks had rights to collateral, either loans or securities, on a member-by-member basis, with an estimated fair market value in excess of outstanding advances.

The resources and services provided by the Federal Home Loan Banks to their member institutions play a key role in the continued success of our nation's housing market. They play a key role in serving the financial needs of our local communities.

Without the Federal Home Loan Banks, it would be far more difficult for our nation to achieve these objectives.

Thank you for the opportunity to appear before you this afternoon. I would be pleased to answer any questions that you may have.