Restore Mortgage REIT Access to Federal Home Loan Bank Advances

Real estate investment trusts (REITs) are financial institutions that are required to invest primarily in real estate-related assets. Some REITs have used advances from the Federal Home Loan Banks (FHLBs) as one of many sources of funding for these real estate-related assets. Recently, however, the Federal Housing Finance Agency (FHFA)—as regulator of the FHLB system—rescinded the FHLB membership eligibility of captive insurance companies, many of which were affiliated with REITs. Through either legislative or administrative means, REITs’ captive insurers should have their FHLB eligibility reinstated in order to allow them to continue to access stable funding to support investments in housing finance.

OVERVIEW

- REITs are companies that allow investors to pool resources for the purpose of investing in real estate-related assets. In order to qualify for REIT status, these companies return the vast majority of their income to their shareholders, and federal taxes are then paid on those dividends (rather than at the corporate level). REITs hold assets that are almost exclusively real estate-related, and most of their income must be derived from real estate-related sources.
- Mortgage REITs (mREITs) are a subgroup of REITs that invest primarily in residential and/or commercial mortgages or interests in mortgages. By law, housing-related assets such as mortgage-backed securities (MBS) constitute the vast majority of their investments.
- mREITs use a combination of equity and debt to fund their investments. For many companies, repurchase (repo) agreements serve as an important, but occasionally volatile, source of funding.
- Over the past decade, some captive insurance companies affiliated with mREITs established membership in the FHLB system, utilizing the stable, longer-term funding provided by the FHLBs to better match certain assets in the mREIT portfolios.
• In 2014, FHFA proposed a number of revisions to the eligibility requirements for FHLB members. In early 2016, FHFA issued a final rule on FHLB membership, which among other provisions rescinded the eligibility of captive insurers, such as those affiliated with mREITs. This regulatory change in turn made mREITs ineligible to access FHLB advances on a bifurcated timeline: some mREIT-affiliated captive insurers have already been forced to terminate their FHLB memberships, while others must do so by early 2021.

IMPACT

• For those mREITs with captive insurer affiliates in the FHLB system, advances from their FHLB serve as an alternative to other sources of funding—including repo agreements—helping to diversify funding in both term and lender for these important sources of private capital in the secondary market.
• mREITs have generally been able to borrow at longer maturities via FHLB advances than they can via repo agreements. This longer-dated funding reduces market risk by extending the length of time the firm has to repay borrowed funds. By increasing the maturity of their funding, mREITs can also use their balance sheets to respond to short-term market fluctuations. For example, if demand for a particular type of securitized product dries up for a short period of time, mREITs can utilize the space on their balance sheets to retain that product until market conditions improve.
• mREITs routinely use their access to FHLB advances to develop or increase lending to a broader cohort of creditworthy borrowers than those served by the mortgage market today. This is because the private wholesale funding market is currently less suited to supporting loans made to borrowers who fall just outside of the credit box that is defined by the Qualified Mortgage standard.

MBA’S POSITION / NEXT STEPS

• Captive insurers have been valuable FHLB members for more than two decades, functioning as a stabilizing force in the housing finance market and creating a reliable source of capital for lenders and investors.
• As mREITs become an ever more important source of private capital in our mortgage market, access to the FHLB system will ensure a more reliable supply of longer-term liquidity—making the overall housing finance system more stable.
• MBA believes that mREITs, at the very core of their business model, maintain a commitment to supporting housing finance. They therefore further the mission of the FHLB system and warrant eligibility for FHLB membership.
• MBA strongly supports efforts, such as legislation introduced in the Senate in 2018 during the prior Congress (S. 2361, the Housing Opportunity Mortgage Expansion (HOME) Act, led by Sens. Tammy Duckworth (D-IL), Tim Scott (R-SC), Ron Johnson (R-WI) and Tammy Baldwin (D-WI)), to reinstate the eligibility of captive insurers for FHLB membership.
• MBA supports reintroduction of this type of legislation and continues to believe it would represent an important step forward in recognizing the need for diverse forms of private capital as Congress considers the future of housing finance.
• MBA will continue to work with legislators, the administration, and FHFA to find safe, sustainable ways for mREITs to participate in the FHLB system.