Mortgage REITs Joining FHLBs Again Even as Regulator Weighs Ban

by Jody Shenn, and Heather Perlberg,

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(Bloomberg) -- The Federal Home Loan Bank of Indianapolis is again admitting mortgage-investment firms as members, even as the overseer of the government-chartered system of 12 regional lenders considers barring such companies.

The FHLB in Indiana recently accepted another insurer owned by a real-estate investment trust, spokeswoman Carrie O'Connor said, after holding off on such approvals while its regulator, the Federal Housing Finance Agency, gathered comments through January on its proposed ban. She wouldn't name the REIT that joined Ladder Capital Corp. and Invesco Mortgage Capital Inc., which have units as members of the cooperative.

"We felt we had an obligation to address good-faith applications," O'Connor wrote in an e-mail.

The move may mark the return of a trend that began in 2012 when investment firms that buy mortgage debt started joining the system to tap cheap and dependable financing. That halted last year as the FHFA proposed banning captive insurers -- which mainly offer coverage to their owners or customers of those parent companies -- after a growing number of REITs used the type of guarantors to gain memberships.

The regulator said REITs could add risks to the system, which encompasses $830 billion of outstanding debt, and might not be permitted as members under the law that says FHLBs can admit banks and insurers. To lend to those owners, the FHLBs jointly raise money with sales of bonds perceived by investors and credit graders as government-backed.

Peter Garuccio, an FHFA spokesman, declined to comment on the Indianapolis FHLB's move and the timeline for the regulator's decision on its September proposal. The FHLBs had voluntarily paused admissions of captive insurers in June.

'Getting Tired'

"Maybe this is somebody's way of saying, 'I'm getting tired of waiting, maybe I can force a decision,'" Michael Widner, an analyst who covers mortgage REITs at Keefe, Bruyette & Woods, said in a telephone interview.

Mortgage REITs responded to the proposal by saying their businesses match the FHLBs' mission of supporting real estate and that they don't present unusual risks, partly because their borrowing is backed by collateral.

"They're looking at this and saying this rule doesn't make a lot of sense," Scott D. Geromette, a partner at Honigman Miller Schwartz and Cohn LLP, who represents some REIT-owned insurers that are FHLB members and some that want to be, said in a telephone interview.

Current REIT members, which also include Annaly Capital Management Inc., Two Harbors Investment Corp. and Redwood Trust Inc., have been boosting their use of the system. Five of their units that joined the Indianapolis, Des Moines or Chicago FHLBs since 2012 were borrowing about $6 billion on Dec. 31, up from $3 billion on June 30, according to data compiled by Bloomberg from their disclosures.

Kicked Out

The Des Moines FHLB in Iowa hasn't admitted any new members of this type in the past year, spokeswoman Angie Richard said in an e-mail. Melissa Warden, a spokeswoman for the Chicago FHLB, declined to comment.

While captive insurers could retain membership for five years if the FHFA's proposal is enacted, those admitted since it was released would be kicked out immediately if the rule is "adopted as proposed," according to the FHFA's plan. "Any new member is fully aware of the potential impact" of the rule, said O'Connor of the Indianapolis FHLB.

Most of the more than 1,300 comments the FHFA's proposal drew addressed issues unrelated to the captive insurer ban.

FHFA Director Melvin L. Watt said this month at the Goldman Sachs Housing Finance Conference that while his agency had no "bias against REITs," there are questions about whether they should be allowed to be members under the law.

"We get called on quite often to do things that we simply don't have the power to do that ought to be done in the legislative branch," he said.

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