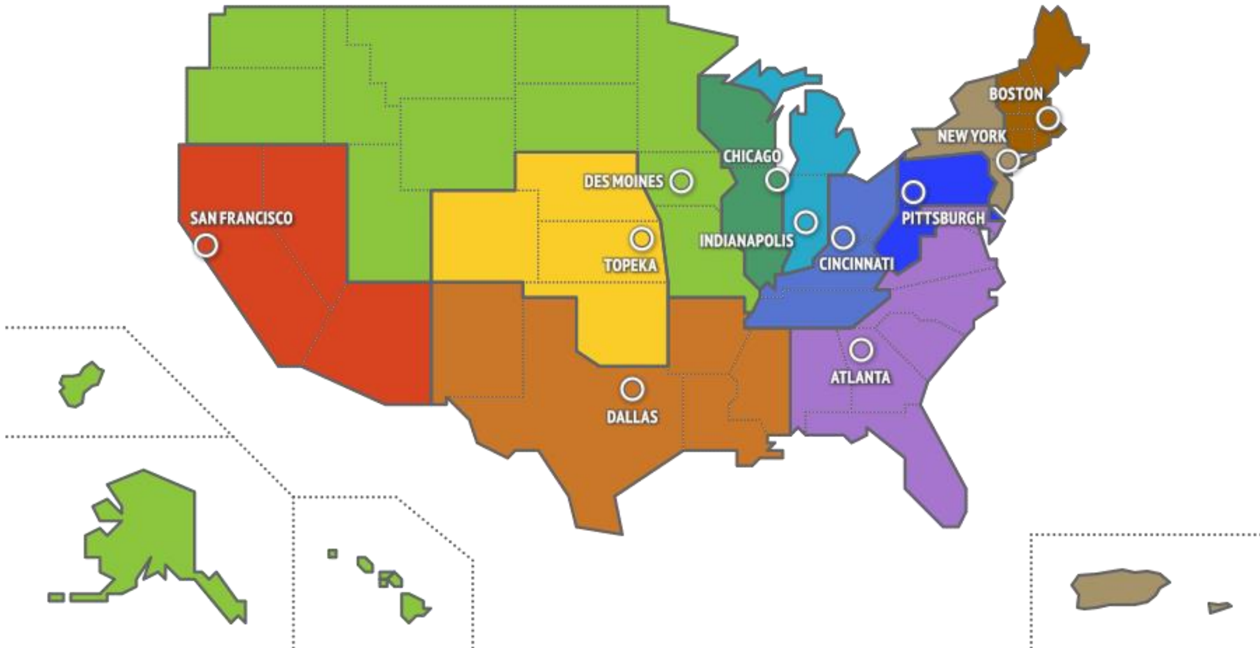
FHLBanks: *The Basics*



For more information, visit www.fhlbanks.com.

The Federal Home Loan Banks (FHLBanks) are 11 private, wholesale banks regionally based throughout the U.S. They are cooperatively owned by approximately 7,000 financial institutions of all sizes and many types. Their mission is to provide reliable liquidity to member institutions in support of housing finance and community investment. Created by Congress, the FHLBanks have been one of the largest, private sources of funding for housing, jobs and economic growth in the U.S. for more than eight decades.

Every day across the country, financial institutions must make decisions about how to fund home mortgages for families and loans to small businesses. By harnessing the collective power of their members, the FHLBanks bring the global credit markets to Main Street America. Their member-owners know they can rely on the FHLBanks as stable sources of funds through all market cycles. The 2008 credit crisis was the most recent illustration of their importance. The FHLBanks increased their advances outstanding to more than $1 trillion while all other sources of funding dried up. As a cooperative, the FHLBanks along with their members have the unique ability to play a critical role in continuously building, sustaining and nurturing communities even when the credit environment tightens.

FHLBanks are regionally focused and controlled. This structure allows each FHLBank to be responsive to the specific community credit needs in its geography. At the same time, the FHLBanks collectively use their combined size and strength to obtain funding at the lowest possible cost for their members. This means that the member banks can advance credit to their local communities at competitive rates.

Membership and Structure

Banks, thrifts, credit unions, community development financial institutions and insurance companies are all eligible for FHLBank membership. Members — ranging in size from some of the largest financial institutions in the world to banks with just a single branch — do business throughout the 50 states and the U.S. territories.

To become a member of an FHLBank, a financial institution must purchase stock in their region's FHLBank, which is held at par value and not traded. As cooperatives, the FHLBanks do not have the pressures of generating high rates of return, as do publicly traded companies. Instead they are able to pass on the benefits of low-cost borrowing to their members — who subsequently pass these savings on to individuals, families, businesses and communities.

Funding Their Members

The FHLBanks provide their members with short- and long-term funding through their secured lending programs. This addresses a key risk of bank management: the unexpected need to fund new assets and deposit withdrawals. Financial institutions are limited in how they can meet funding needs. They can raise new deposits, cut expenses, sell assets, limit new lending or access credit markets. However, it takes time to attract new deposits and it can be prohibitively expensive — especially for smaller institutions, which rely almost entirely on their local customers for new deposits. The capital markets are typically the most efficient way to raise funds in a timely manner, but most smaller financial institutions are not able to access the credit market on their own. For the majority of members banks, the FHLBanks are the most cost-effective way for them to access the credit market.

FHLBank loans to members — called "advances" — are a nearly instantaneous way for members to secure funding. The FHLBanks access the capital markets several times a day to provide their members with funding.

Their size and ability to issue a variety of debt products enables the FHLBanks to tailor the structure of advances to a member's particular funding strategy.

In order to qualify for advances, a member must pledge high-quality collateral in the form of mortgages, government securities or loans on small business, agriculture or community development. The member must also purchase additional stock in proportion to their borrowing. Once the member's FHLBank approves the loan request, it advances those funds to the member institution. As of June 30, 2018, the FHLBanks had nearly $734.5 billion in outstanding advances.

Office of Finance

The global market for FHLBank debt is deep and liquid. The FHLBanks, through the Office of Finance, access the international capital markets daily to provide their members with funding. The Office of Finance manages several flexible funding programs that are designed to meet the needs of a broad group of investors. Bonds and discount notes issued by the FHLBanks are called consolidated obligations. The FHLBanks issue discount notes in maturities ranging from one day to one year, and bonds with maturities of six months to 30 years. The majority of issues are between one and five years. Issue size can range from 10 million to several billion dollars. FHLBank debt is sold through a broad, international network of underwriters.

Buyers of debt securities issued by the FHLBanks represent the entire spectrum of domestic and international fixed-income investors, including commercial banks, central banks, money market funds, investment managers, major corporations, pension funds, government agencies and individuals.

Capital Position

No taxpayer funds are involved in the operation of the cooperatively owned FHLBanks. Each of the 11 regional FHLBanks is uniquely self-capitalizing. During times of high advance activity, capital automatically increases. As advances roll off the books, the FHLBanks typically reduce capital accordingly through member stock repurchases.

In 2011, the FHLBanks launched a joint plan to enhance capital and strengthen safety and soundness even further. The initiative called for each FHLBank to reserve 20 percent of its earnings in a restricted retained earnings account. The plan demonstrates that the FHLBanks are a mechanism for economic stability — staying strong and serving community lenders as a dependable source of funds for housing, jobs and growth.

Safety and Soundness

From their very beginning more than eight decades ago, the FHLBanks have never incurred a credit loss on an advance. This record can be attributed to the full collateralization of all advances, conservative underwriting standards and strong credit monitoring policies. If a loan in a pool of collateral is under-performing, it must be replaced. Additionally, the credit profiles of members are actively monitored.

FHLBanks are jointly and severally liable for their consolidated obligations. That means that in the unlikely event that an individual FHLBank was unable to pay a creditor; the other FHLBanks would be required to step in and cover that debt. This provides an additional level of safety and ensures prudent borrowing. The Government Accountability Office has noted, "Joint and several liability for the payment of consolidated obligations gives investors confidence that [FHLBank] debt will be paid."

Other Services to Members

In addition to being a reliable and ready source of liquidity, the FHLBanks also assist their members with interest rate risk management, asset/liability management, education and reducing earnings volatility.

The FHLBanks provide letters of credit for bond issuances guaranteed by members and mortgage programs. Through letters of credit, individual FHLBanks pass through their credit ratings to member institutions, while pledging to be a credit backstop. In addition, the FHLBanks offer mortgage purchase programs that provide competitive alternatives to the secondary market by taking the interest rate risk of mortgage loans, while members retain a portion of the credit risk and customer relationships.

Affordable Housing and Community Investment Programs

FHLBanks contribute 10 percent of their net income to affordable housing through the Affordable Housing Program (AHP). This program is the largest source of private sector grants for housing and community development in the country. FHLBank members can access these subsidies through the AHP Competitive Application Program and the AHP Homeownership set-aside Program. FHLBank members work with developers and community organizations seeking to build and renovate housing for low- to moderate-income households. Through these partnerships, the FHLBanks have awarded more than $5.8 billion* in AHP funds between 1990 and 2017. To ensure that AHP-funded projects reflect local housing needs, each FHLBank is advised by a 15-member Affordable Housing Advisory Council for guidance on regional housing and community development issues.

The AHP is a flexible program that uses funds in combination with other programs and funding sources, like Low-Income Housing Tax Credits (LIHTC) and Community Development Block Grants (CDBG). These projects serve a wide range of needs. Many are designed for seniors, persons with disabilities, homeless families and individuals, first-time homebuyers and others with limited resources. More than 865,000* housing units have been built using AHP funds, including 492,159 units for very low-income residents. The FHLBanks are the largest, single provider of funds to Habitat for Humanity.

The Community Investment Program (CIP) and Community Investment Cash Advance (CICA) Program also support the FHLBanks core mission, by providing advances to members to assist in the financing of housing or other economic development initiatives to benefit low-and moderate-income households and neighborhoods. Each FHLBank operates a CIP, designed to be a catalyst for economic development because it supports projects that create and preserve jobs and help build infrastructure to support further growth. Unlike the AHP, the CIP does not provide grants. Lenders have used the CIP to fund owner-occupied and rental housing; construct roads, bridges, retail stores and sewage treatment plants; and provide small business loans.

In 2017, the FHLBanks issued approximately $4.6 billion in CIP advances for housing projects and almost $97 million for economic development projects. Through the CICA program, approximately $3.8 billion was advanced for community development projects such as commercial, industrial and manufacturing projects, social services and public facilities.

Additionally, several of the FHLBanks operate other voluntary programs focused on addressing special needs, such as financial literacy, foreclosure prevention, home rehabilitation and small business lending.

Governance and Regulation

Every FHLBank has its own board of directors, comprised of members of that FHLBank and independent (non-member) directors. By statute, two-fifths of the directors must be independent and at least two of those directors must be public interest directors with at least four years of experience in representing community or consumer interests. The boards of directors represent many areas of expertise, including banking, accounting, housing and community development. Directors serve four-year terms and may not serve more than three consecutive terms.

The regulator charged with overseeing the FHLBanks is the Federal Housing Finance Agency (FHFA), created by Congress in the Housing and Economic Recovery Act of 2008. FHFA is led by the FHFA Director and advised by a Federal Housing Finance Oversight Board, composed of the Secretaries of Treasury and HUD, the Chair of the SEC, and the FHFA Director. There is a Deputy Director for FHLBank regulation, while the FHLBank mission oversight is charged to the Deputy Director of Housing Mission and Goals.

*Based on the latest available data from the FHFA.

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